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November 15, 2010

Hon. Douglas Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Comments on the Effective Date of Section 909

Dear Commissioner Shulman:

Enclosed are comments on the effective date of Section 909. These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association, and should not be construed as representing the policy of the American Bar Association.

Sincerely,

A handwritten signature in black ink, appearing to read "Charles H. Egerton".

Charles H. Egerton
Chair, Section of Taxation

cc: Michael F. Mundaca, Assistant Secretary (Tax Policy), Department of the Treasury
William J. Wilkins, Chief Counsel, Internal Revenue Service
Michael Danilack, Deputy Commissioner (International), Department of the Treasury
Jeffrey Van Hove, Acting Tax Legislative Counsel, Department of the Treasury
Stephen E. Shay, Deputy Assistant Secretary (International Tax Affairs), Department of the Treasury
Manal Corwin, International Tax Counsel, Department of the Treasury

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**ABA SECTION OF TAXATION
COMMENTS ON THE EFFECTIVE DATE OF
INTERNAL REVENUE CODE SECTION 909**

These comments (the “Comments”) are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Dirk Suringa, of the Foreign Activities of U.S. Taxpayers Committee of the Section of Taxation. The Comments were reviewed by Mark Harris, Committee Chair. The Comments were further reviewed by Philip West of the Section’s Committee on Government Submissions, and by Joan C. Arnold, Council Director for the Foreign Activities of U.S. Taxpayers Committee.

Although the members of the Section of Taxation who participated in preparing these Comments have clients who might be affected by the federal income tax principles addressed by these Comments, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

Contact: Dirk Suringa
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Date: November 15, 2010

EXECUTIVE SUMMARY

In response to a request for comments made by officials of the Department of Treasury (“Treasury”) at the 2010 Joint Fall CLE Meeting of the American Bar Association Section of Taxation in Toronto, Canada on September 24, 2010, these Comments address potential guidance regarding the effective date of section 909.¹

Section 909 was added to the Code by section 211 of the recently enacted legislation commonly referred to as the Education Jobs and Medicaid Assistance Act of 2010.² Section 909 modifies the timing for claiming a foreign tax credit pursuant to section 901 for foreign taxes paid or accrued. It provides that if there is a “foreign tax credit splitting event” for a foreign income tax paid or accrued by a taxpayer, the tax is not taken into account for purposes of computing a foreign tax credit pursuant to section 901 before the tax year in which the related income is taken into account for U.S. tax purposes by the taxpayer.³ If there is a foreign tax credit splitting event for a foreign income tax paid or accrued by a section 902 corporation (defined below), the tax is not taken into account for purposes of the taxes deemed paid under section 902 or section 960 or the determination of earnings and profits (“E&P”) under section 964(a) before the tax year in which the related income is taken into account for U.S. federal income tax purposes by the section 902 corporation or its domestic corporate shareholder. A foreign tax credit splitting event generally occurs when one entity pays a foreign tax and a related entity takes into account the income on which the foreign tax was imposed.

Section 909 generally applies to foreign income taxes paid or accrued in taxable years beginning after December 31, 2010.⁴ However, section 909 applies retroactively to foreign income taxes paid or accrued by a foreign corporation with respect to which one or more domestic corporations meets the ownership requirements of subsection (a) or (b) of section 902 (a “section 902 corporation”) in taxable years beginning before December 31, 2010, for purposes of computing the amounts of foreign taxes deemed paid by the domestic corporation under section 902 or section 960 for tax periods after December 31, 2010. For example, if a U.S. corporation receives a dividend or has a subpart F inclusion from a section 902 corporation after 2010, section 909 may prevent foreign taxes paid or accrued in years before 2011 from being included in the post-1986 tax pool of the section 902 corporation, for purposes of computing the U.S. corporation’s deemed paid credit.⁵ Section 909(e)(1) grants authority for the Internal Revenue Service (the “Service”) and Treasury to issue regulations or other guidance necessary or appropriate to carry out the purposes of section 909, including appropriate exceptions.⁶

¹ References to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”), unless otherwise indicated.

² Pub. L. No. 111-226, § 211, 124 Stat. 2389 (2010).

³ Section 909(a).

⁴ See Pub. L. No. 111-226, § 211(c), 124 Stat. at 2395.

⁵ See 124 Stat. at 2395.

⁶ See also Staff of the Joint Comm. on Tax’n, Technical Explanation of the Revenue Provisions of the Senate Amendment to the House Amendment to the Senate Amendment to H.R. 1586, Scheduled for Consideration by the House of Representatives on August 10, 2010, at 6 (2010) [the “Joint Committee Explanation”].

Although much additional guidance will be needed for the proper implementation of section 909, below are our recommendations for near-term guidance concerning the retroactive application of section 909, as applied to section 902 corporations. Our recommendations are summarized as follows:

1. If under section 909 a foreign tax credit splitting event would be treated as having occurred with respect to foreign taxes of a section 902 corporation for taxable years beginning before January 1, 2011, we recommend that the foreign tax credit splitting event not be treated as having occurred unless the foreign taxes were paid or accrued by:
 - a) a member of a foreign consolidated group, the members of which under foreign law are not jointly and severally liable for the foreign tax imposed on the group;
 - b) a reverse hybrid entity;⁷ or
 - c) a disregarded entity,⁸ the ownership of which is transferred in a transaction that does not result in a closing of the entity's foreign taxable year, but only if the foreign taxes paid or accrued by the disregarded entity for the year of the change of ownership are less than a specified percentage (e.g., 25 percent) of the foreign acquiring corporation's pool of post-1986 foreign income taxes.

Taxpayers were put on notice by Proposed Regulations issued in 2006 (the "2006 Proposed Regulations")⁹ that the inappropriate separation of income and credit, subsequently targeted by section 909, could arise in these three situations. We recognize that the 2006 Proposed Regulations did not deal exclusively with these three situations and were intended to apply more broadly. Nevertheless, we believe that these situations were the main targets of the 2006 Proposed Regulations and therefore serve as an appropriate basis to target the retroactive application of section 909.

2. We recommend that no foreign tax credit splitting event be treated as having occurred for purposes of section 909 with respect to foreign taxes paid or accrued during taxable years beginning before January 1, 2007. Some cut-off date is necessary to make the retroactive application of section 909 administrable for the Service and taxpayers. The 2006 Proposed Regulations were the first formal guidance broadly targeting the separation of income and credit in the circumstances covered by section 909, and they contained a proposed effective date that put taxpayers on notice of impending changes for taxable years beginning after January 1, 2007.

⁷ A reverse hybrid entity generally is an entity that is treated as a partnership for foreign tax purposes and as a corporation for U.S. tax purposes. See Prop. Reg. § 1.901-2(f)(2)(iii), 71 Fed. Reg. 44,240 (2006).

⁸ A disregarded entity is an entity that is not viewed as a separate entity for U.S. tax purposes.

⁹ Prop. Reg. § 1.901-2(f), 71 Fed. Reg. 44,240 (2006).

COMMENTS

I. Description of Section 909

Under section 909, if there is a foreign tax credit splitting event for a foreign income tax paid or accrued by a taxpayer, the tax is not taken into account for U.S. federal income tax purposes before the tax year in which the related income is taken into account for U.S. federal income tax purposes by the taxpayer.¹⁰ A foreign tax credit splitting event for a foreign income tax occurs if the related income is (or will be) taken into account by a covered person.¹¹ A covered person with respect to any person who pays or accrues a foreign income tax (payor) is:

1. any entity in which the payor holds, directly or indirectly, at least a ten percent ownership interest (determined by vote or value);¹²
2. any person which holds, directly or indirectly, at least a ten percent ownership interest (determined by vote or value) in the payor;¹³
3. any person which bears a relationship to the payor described in section 267(b) or section 707(b);¹⁴ and
4. any other person specified by the Service and Treasury.¹⁵

Under the statute, a foreign income tax means any income, war profits, or excess profits tax paid or accrued to any foreign country or to any U.S. possession.¹⁶ Related income means, for any portion of any foreign income tax, the income or E&P to which the portion of foreign income tax relates.¹⁷

If there is a foreign tax credit splitting event for a foreign income tax paid or accrued by a section 902 corporation, the tax is not taken into account for purposes of the taxes deemed paid under section 902 or section 960,¹⁸ or the determination of E&P under section 964(a),¹⁹ before the tax year in which the related income is taken into account for U.S. federal income tax purposes by the section 902 corporation or its domestic corporate shareholder.²⁰ If a foreign income tax suspended by the foregoing rules is subsequently released because the related foreign

¹⁰ Section 909(a).

¹¹ Section 909(d)(1).

¹² Section 909(d)(4)(A).

¹³ Section 909(d)(4)(B).

¹⁴ Section 909(d)(4)(C).

¹⁵ Section 909(d)(4)(D).

¹⁶ Section 909(d)(2). The report authored by the Joint Committee on Taxation states that section 909 is intended to apply to creditable "in-lieu-of" taxes. *See* Joint Committee Explanation, *supra* note 6, at 5.

¹⁷ Section 909(d)(3). The question whether a tax relates to income would benefit from further guidance but is beyond the scope of this letter.

¹⁸ Section 909(b)(1).

¹⁹ Section 909(b)(2).

²⁰ *See* section 909(b).

income is taken into account, the tax is treated as paid or accrued in the tax year in which the income is taken into account (except for purposes of the section 986 foreign currency translation rules).²¹

The above rules apply to foreign income taxes paid or accrued in taxable years beginning after December 31, 2010.²² They also apply to foreign income taxes paid or accrued by section 902 corporations in tax years beginning before January 1, 2011 (and not deemed paid under section 902(a) or section 960 before January 1, 2011), but only for purposes of applying sections 902 and 960 for periods after December 31, 2010.²³ However, the rule that taxes paid or accrued by a section 902 corporation are not taken into account in computing E&P under section 964(a) does not apply retroactively.²⁴

II. Response to Request for Comments

A. General Observations on the Implementation of Section 909

The statutory definition of a foreign tax credit splitting event is very broad, and no formal legislative history exists to clarify the intent of Congress. A report issued by the Joint Committee on Taxation suggests that certain events not widely considered to be abusive “splitter” transactions, such as group relief payments or disregarded payments, nevertheless could fall within the statutory definition of a foreign tax credit splitting event.²⁵

The breadth of the statutory language prompts particular concern given its impending effective date of January 1, 2011, and its retroactivity in respect of the post-1986 tax pools of section 902 corporations. Taxpayers have a very limited period of time in which to react to the new law by identifying all possible foreign tax credit splitting events and deciding on an appropriate course of action, such as repatriating earnings and the related foreign tax credits before the January 1, 2011 effective date.

Treasury and the Service are therefore to be commended for considering the issuance of guidance that would clarify on a near-term basis some of the main issues regarding the scope and breadth of section 909. Such guidance would give the Service, Treasury, and taxpayers more time to study the many complex issues arising out of the enactment of section 909.

These Comments are intended to provide recommendations for the development of near-term guidance and are not intended to cover other issues. The basic approach we suggest is to develop a relatively broad safe harbor with respect to the retroactive application of section 909 to tax years of section 902 corporations beginning before January 1, 2011. The safe harbor we propose would limit the retroactive application of section 909 to the separation transactions identified by the 2006 Proposed Regulations.

²¹ See section 909(c)(2); Joint Committee Explanation, *supra* note 6, at 6.

²² Pub. L. No. 111-226, § 211(c)(1), 124 Stat. at 2395-96 (2010).

²³ *Id.*

²⁴ Pub. L. No. 111-226, § 211(c), 124 Stat. 2395 (2010).

²⁵ See Joint Committee Explanation, *supra* note 6, at 6.

B. The 2006 Proposed Regulations Identify Splitting Events

The 2006 Proposed Regulations, like section 909, would address transactions involving the separation of foreign taxes from related foreign income. They would amend the existing section 901 Regulations regarding the identity of the person considered to pay a foreign tax for U.S. federal income tax purposes. The 2006 Proposed Regulations generally would treat foreign law as imposing legal liability on the person whom foreign law requires to take into account the income subject to the foreign tax. The 2006 Proposed Regulations also deal with specific structures that can give rise to the separation of income and credit. The 2006 Proposed Regulations focus on three specific structures:

1. Foreign Consolidated Groups²⁶

The 2006 Proposed Regulations would construe foreign law to allocate income among a group of persons that compute their income on a combined basis, and then would attribute to the income of each person the related foreign taxes. The 2006 Proposed Regulations would make clear that the foreign tax must be apportioned among all the members based on the relative amounts of net income of each member as computed under foreign law.

2. Reverse Hybrid Entities²⁷

The 2006 Proposed Regulations would provide special rules for determining the identity of the taxpayer in the case of reverse hybrid entities. The 2006 Proposed Regulations would treat a reverse hybrid as having legal liability under foreign law for foreign taxes imposed on an owner of the reverse hybrid in respect of the owner's share of income of the reverse hybrid. The reverse hybrid's foreign tax liability would be determined based on the portion of the owner's taxable income (as computed under foreign law) that is attributable to the owner's share of the income of the reverse hybrid.

3. Ownership Changes for Disregarded Entities²⁸

The 2006 Proposed Regulations generally would treat a foreign tax imposed on a disregarded entity as imposed on the owner of the disregarded entity. However, if the ownership of the disregarded entity changes during its foreign taxable year and the change does not result in a closing of that taxable year, any foreign tax paid or accrued for that taxable year would be allocated between the old owner and the new owner.

²⁶ Prop. Reg. § 1.901-2(f)(2)(i) and (ii), 71 Fed. Reg. 44,240 (2006).

²⁷ Prop. Reg. § 1.901-2(f)(2)(iii), 71 Fed. Reg. 44,240 (2006).

²⁸ Prop. Reg. § 1.901-2(f)(3)(ii), 71 Fed. Reg. 44,240 (2006).

C. Pre-2011 Splitting Events Should Be Limited to Those Identified in the 2006 Proposed Regulations

For purposes of applying section 909 to the pre-2011 taxes of section 902 corporations, we recommend that the term “foreign tax credit splitting event” be limited to the three structures set forth above that were highlighted by the 2006 Proposed Regulations. The approach of section 909 differs from that of the 2006 Proposed Regulations, but both sets of rules seek to identify situations in which income and credit could become separated. Issuance of the 2006 Proposed Regulations put taxpayers on notice that the transactions set forth above were separation transactions that Treasury and the Service intended to address. Other structures and transactions, such as group relief regimes and hybrid instruments, were specifically excluded from the 2006 Proposed Regulations or left unaddressed. In our view these other structures and transactions should not be treated as foreign tax credit splitting events on a retroactive basis, as taxpayers arguably were not put on notice that they might be treated as such.

We further recommend the adoption of an exception in the case of a change in ownership of a disregarded entity that does not result in the closing of its foreign taxable year. Such a transaction should not be considered a foreign tax credit splitting event if the foreign income taxes paid or accrued by the disregarded entity in the year of the change of ownership are less than a specified percentage (*e.g.*, 25%) of the foreign acquiring entity’s pool of post-1986 taxes. It is not uncommon for disregarded entities to be transferred in a given year without any purpose of separating income from credit (*e.g.*, to consolidate ownership of several entities conducting the same business to prepare them for sale to a third party). If the transfer of a disregarded entity does not increase the recipient’s foreign tax pool by more than a relatively small percentage, in our view it is unlikely that a purpose of the transaction was to separate income from credits. Given the likely inadvertence of any separation achieved in such a case, a retroactive application of section 909 would not appear to be justified.

The 2006 Proposed Regulations originally would have applied to foreign taxes paid or accrued in taxable years beginning on or after January 1, 2007, and we recommend the same effective date for the retroactive application of section 909. In theory, section 909 could be applied retroactively back to 1986 and beyond, but we recommend that this approach not be pursued based on the basic unfairness and administrative burden placed upon both taxpayers and the Service by such an approach. While section 909 is an anti-abuse provision that has a retroactive dimension, Congress gave the Service and Treasury discretion to determine the extent of its retroactivity. In Notice 2007-95,²⁹ the Service and Treasury changed the effective date of the 2006 Proposed Regulations to make them prospective and not retroactive. In light of that guidance, we believe that an appropriate balance in this case would be to limit the retroactive application of section 909 to a date no earlier than the date the 2006 Proposed Regulations originally would have been effective.

For purposes of applying section 909 to section 902 corporations, therefore, we recommend that only the three structures described above be treated as foreign tax credit splitting

²⁹ 2007-2 C.B. 1091.

events for taxes paid or accrued only in taxable years beginning on or after January 1, 2007, and before January 1, 2011. To protect the interests of the government in litigation, we assume that no inference would be offered as to the treatment under general principles of law of foreign taxes paid or accrued in years beginning before that date.