AICPA

February 8, 2024

The Honorable Lily Batchelder
Assistant Secretary for Tax Policy
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Mr. William Paul
Principal Deputy Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

RE: Comments on Notice 2023-80 – Guidance Regarding the Foreign Tax Credit and Dual Consolidated Losses in Relation to the GloBE Rules, and the Extension and Modification of Temporary Relief in Notice 2023-55

Dear Ms. Batchelder and Mr. Paul:

The American Institute of CPAs (AICPA) appreciates the efforts of the Department of the Treasury ("Treasury") and the Internal Revenue Service (IRS) to publish Notice 2023-80 (the "Notice"), which provides guidance in addressing the foreign tax credit rules and the dual consolidated loss rules, to certain types of taxes described in the Organisation for Economic Co-operation and Development (OECD) "Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two)" (GloBE Model Rules).[1]

These comments are in addition to our prior comments on OECD tax issues.[2] These comments are in response to the Notice, and we recommend that Treasury and the IRS provide guidance addressing the following issues and recommendations relating to Pillar Two:

1. The collateral impact of Pillar Two taxes on controlled foreign corporation (CFC) inclusions and the application of section[3] 952(c) limitation.
   - We recommend that Treasury and the IRS:
     - Confirm that a CFC is allowed to deduct income inclusion rule (IIR) taxes for all purposes other than the high-tax exceptions provided in section 954(b)(4) and Treas. Reg. § 1.951A-2(c)(7).

[1] Organisation for Economic Co-operation and Development (OECD), Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two) (Dec. 14, 2021).
[2] See prior AICPA comments, "Comments on Draft Organisation for Economic Co-operation and Development OECD/G20 Inclusive Framework Pillar One Multilateral Convention Text," December 11, 2023; "Public Consultation Document – Global Anti-Base Erosion Proposal ("GloBE") – Pillar Two," December 2, 2019; "Public Consultation Document – Secretariat Proposal for a "Unified Approach" under Pillar One," November 11, 2019; "Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy – Comments on Income Allocation between Jurisdictions (Pillar One)," October 4, 2019; and "Comments on the OECD Public Consultation Addressing the Tax Challenges of the Digitalisation of the Economy," May 28, 2019.
[3] Unless otherwise indicated, all references to a "section" are to a section of the Internal Revenue Code of 1986, as amended (IRC or the "Code"), and references to a "Treas. Reg. §" are to the Treasury regulations promulgated under the Code.

1455 Pennsylvania Ave. NW, Washington, DC 20004-1081
T: +1 202.737.6600 F: +1 202.638.4512
aicpaglobal.com | cimaglobal.com | aicpa.org | cgma.org

- Clarify whether IIR taxes are earnings and profits (E&P) adjustments at the CFC level.
- Assuming IIR taxes are permissible as an E&P deduction, evaluate and clarify whether a taxpayer's section 952(c) limitation is meant to be determined before any potential E&P deduction for IIR taxes.

2. The interaction between the Dual Consolidated Loss (DCL) rules and the jurisdictional blending rules under Pillar Two.
   - We recommend that:
     - The DCL rules not be impacted by any application of Pillar Two.
     - Should Treasury and the IRS determine that the DCL rules are applicable to the Pillar Two regime, losses in jurisdictions that do not yield a tax benefit under Pillar Two should not be considered as a foreign use of such losses.
     - Specifically, to the extent the loss does not affect the IIR tax, or a country-by-county transitional safe harbor is applied, then:
       - Jurisdictional blending under Pillar Two should not constitute a foreign use.
       - It also should not be treated as an offset or reduction of the income of a foreign affiliate.
       - Neither current nor future Model Rule guidance, including the guidance recently released addressing the treatment of hybrid arbitrage arrangements under the Transitional Country-by-Country Reporting (CbCR) Safe Harbor,[4] should be classified as "mirror legislation" under the DCL rules.
     - The same exemption to foreign use should apply to a loss in any jurisdiction where the Multinational Enterprise Group ("MNE Group") applies one of the Pillar Two transitional safe harbors.

3. Request for further guidance providing more certainty as to the creditability of certain Pillar Two taxes.
   - We recommend that:
     - Treasury and the IRS confirm that qualified domestic minimum top-up taxes (QDMTTs) (and also IIRs) that are consistent with the GloBE Model Rules generally meet the requirements for a creditable foreign income tax under section 901.
     - Foreign taxes meeting the QDMTT safe harbor requirements under OECD administrative guidance receive per se creditability treatment to simplify the compliance process for U.S. taxpayers and align with global standards.

4. Treatment of specific Pillar Two taxes within the context of a foreign law inclusion regime under Treas. Reg. § 1.861-20(b)(11).
   - We recommend that Treasury and the IRS amend Treas. Reg. § 1.861-20(b)(11) to clarify that an IIR is a foreign law inclusion regime for purposes of allocating and apportioning foreign income taxes under Treas. Reg. § 1.861-20.

---

[4] See *Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)*, December 2023.

5. Request clarification on the application of the rules in Notice 2023-80 providing an extension of the temporary relief previously provided in Notice 2023-55.
   - We recommend that Treasury and the IRS:
     - Clarify their intent on the issuance of any forthcoming guidance related to relief provided under Notice 2023-55 and the Notice with respect to future applicability dates and / or retroactive impact to taxpayers.
     - Specifically, issue guidance indicating that the relief period will apply to all tax years beginning on or after December 28, 2021, and beginning on or before the date that Notice or other guidance withdrawing or modifying the temporary relief is issued (or any later date specified in such Notice or other guidance).

* * * * *

The AICPA is the world's largest member association representing the accounting profession, with more than 421,000 members in the United States and worldwide, and a history of serving the public interest since 1887. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

We appreciate your consideration of our recommendations and welcome the opportunity to further discuss our comments. If you have any questions, please contact Cory Perry, chair of the OECD Task Force at 202 521-1509, or cory.perry@us.gt.com, or Reema Patel, Senior Manager of Tax Policy and Advocacy at 202 434-9217, or Reema.Patel@aicpa-cima.com, or me at (830) 372-9692 or bvickers@alamo-group.com.

Sincerely,

Blake Vickers, CPA, CGMA
Chair, AICPA Tax Executive Committee

cc: The Honorable Daniel I. Werfel, Commissioner, Internal Revenue Service
Mr. Peter Blessing, Associate Chief Counsel (International), Internal Revenue Service
Ms. Lindsay Kitzinger, Office of the International Tax Counsel, Department of the Treasury
Mr. Jim Wang, Deputy International Tax Counsel (Acting), Office of the International Tax Counsel, Department of the Treasury
Ms. Elena Virgadamo, Office of the International Tax Counsel (Treaty Affairs), Department of the Treasury

AMERICAN INSTITUTE OF CPAs

Comments on Notice 2023-80 – Guidance Regarding the Foreign Tax Credit and Dual Consolidated Losses in Relation to the GloBE Rules, and the Extension and Modification of Temporary Relief in Notice 2023-55

February 8, 2024

The American Institute of CPAs (AICPA) appreciates the efforts of the Department of the Treasury ("Treasury") and the Internal Revenue Service (IRS) to publish Notice 2023-80 (the "Notice"), which provides guidance in addressing the foreign tax credit rules and the dual consolidated loss rules, to certain types of taxes described in the Organisation for Economic Co-operation and Development (OECD) "Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two)" (GloBE Model Rules).[1]

These comments are in addition to our prior comments on OECD tax issues.[2] These comments are in response to Notice 2023-80 ("the Notice"), and we recommend that the Department of the Treasury ("Treasury) and the Internal Revenue Service (IRS) provide guidance addressing the following issues relating to Pillar Two:

1. The collateral impact of Pillar Two taxes on controlled foreign corporation (CFC) inclusions and the application of section[3] 952(c) limitation.

2. The interaction between the Dual Consolidated Loss (DCL) rules and the jurisdictional blending rules under Pillar Two.

3. Request for further guidance providing more certainty as to the creditability of certain Pillar Two taxes.

4. Treatment of specific Pillar Two taxes within the context of a foreign law inclusion regime under Treas. Reg. § 1.861-20(b)(11).

5. Request clarification on the application of the rules in Notice 2023-80 providing an extension of the temporary relief previously provided in Notice 2023-55.

---

[1] Organisation for Economic Co-operation and Development (OECD), Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two) (Dec. 14, 2021).

[2] See prior AICPA comments, "Comments on Draft Organisation for Economic Co-operation and Development OECD/G20 Inclusive Framework Pillar One Multilateral Convention Text," December 11, 2023; "Public Consultation Document – Global Anti-Base Erosion Proposal ("GloBE") – Pillar Two," December 2, 2019; "Public Consultation Document – Secretariat Proposal for a "Unified Approach" under Pillar One," November 11, 2019; "Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy – Comments on Income Allocation between Jurisdictions (Pillar One)," October 4, 2019; and "Comments on the OECD Public Consultation Addressing the Tax Challenges of the Digitalisation of the Economy," May 28, 2019.

[3] Unless otherwise indicated, all references to a "section" are to a section of the Internal Revenue Code of 1986, as amended (IRC or the "Code"), and references to a "Treas. Reg. §" are to the Treasury regulations promulgated under the Code.

BACKGROUND

Pillar Two

The Pillar Two rules create a coordinated system of minimum taxation intended to ensure that Multinational Enterprise Groups ("MNE Groups") with annual revenue of 750 million euros or more pay a minimum level of tax on the income arising in each jurisdiction in which they operate. An in-scope MNE Group must calculate its effective tax rate in each jurisdiction in which it operates using the Pillar Two rules. The effective tax rate under Pillar Two is Adjusted Covered Taxes divided by GloBE income or loss. If the effective tax rate for a jurisdiction is below the 15% minimum rate, a top-up tax may be imposed and collected under one of the three following interlocking rules, each of which is aimed at reducing profit shifting and base erosion:

- **Income inclusion rule (IIR)**: The IIR imposes a top-up tax at the parent-entity level that effectively allows countries to "top up" the tax on earnings of foreign subsidiaries with effective rates below 15%.
- **Undertaxed profit rule (UTPR)**: The UTPR will generally deny deductions with respect to members of a group, or otherwise implements measures that result in the imposition of additional tax on income subject to an effective rate below 15%, unless it is otherwise subject to an IIR or QDMTT.
- **Qualified domestic minimum top-up tax (QDMTT)**: The QDMTT is a domestic top-up tax that will take precedence over either an IIR or UTPR and tax domestic entities up to 15% before another country's UTPR or IIR applies.

In general, GloBE income or loss represents a common taxable base on which a top-up tax is imposed. The computation of GloBE income or loss of a Constituent Entity is the financial net income or loss (FANIL) of such entity, calculated in accordance with an "Acceptable Financial Accounting Standard."[4] FANIL is then adjusted as follows:

> [FANIL] is then adjusted under Article 3.2 for common differences between financial accounting and taxable income in order to reflect intended policy outcomes (such as the exclusion of dividend income and adding-back of illegal payments).[5]

[4] An Acceptable Financial Accounting Standard generally includes the accounting standard used in the preparation of the consolidated financial statements of the Ultimate Parent Entity of a Constituent Entity, but may also include various other accounting standards as described in the Model Rules, Article 3.1.

[5] Commentary to Article 3, paragraph 1; *see also* Commentary to Article 3.2, paragraph 17 ("Once the Financial Accounting Net Income or Loss of a Constituent Entity is determined, it is adjusted for certain book to tax differences (that is, differences between financial accounting results and taxable income results) that are common in Inclusive Framework jurisdictions. Differences between financial accounting standards and tax accounting rules generally can be categorized as giving rise either to permanent differences that will not reverse in a future period or temporary differences (i.e., timing differences) that will reverse in a future period."); Commentary to Article 3.2.1, paragraph 20 ("Article 3.2.1 sets out the adjustments to the Financial Accounting Net Income or Loss that are required in the computation of each Constituent Entity's GloBE Income or Loss. These adjustments bring the Constituent Entity's GloBE Income or Loss more into alignment with the computation of taxable income under a typical CIT (for example, exclusion of equity method income or loss from a non-Controlling Interest in a corporation) and prevent double taxation of the MNE Group's income under the GloBE Rules (for example, exclusion of dividends received from Constituent Entities).").

In accordance with the GloBE Model Rules, the interlocking rules follow a specific order of imposing taxes on Net GloBE Income,[6] as follows: local jurisdiction taxes (covered taxes), QDMTTs, CFC Tax Regime taxes, IIR taxes, and lastly, UTPR taxes. Under these ordering rules, the IIR tax liability is indirectly reduced by certain allocable CFC taxes. Therefore, CFC taxes are intended to be calculated independently of taxes paid under the IIR. As per the GloBE Model Rules, the U.S.'s Global Intangible Low-Taxed Income (GILTI) regime is a blended CFC tax regime, which is an allocable CFC taxes for purposes of the order rules discussed above.

Presently, there are no enacted laws incorporating Pillar Two into the U.S. Code. Additionally, proposed legislation aimed at aligning the U.S. with Pillar Two has reached a standstill in Congress.

Dual Consolidated Loss

Congress enacted section 1503(d), and Treasury promulgated the regulations thereunder (the "DCL rules"), to prevent a separate unit[7] (including a foreign branch) from "double dipping." Double dipping occurs when a separate unit uses a single economic loss to offset income in two tax jurisdictions.

A DCL, as defined by section 1503(d)(2)(A), is a net operating loss (NOL) incurred by a U.S. corporation that is subject to income tax in a foreign country or taxed on a residence basis in that foreign jurisdiction. Under these rules, if a U.S. corporation is also taxed in a foreign jurisdiction and has an NOL, the U.S. corporation has a DCL and must comply with the regulations under section 1503(d).

The DCL rules primarily restrict the "domestic use" of a DCL, which is considered to occur when the DCL is made available to offset, directly or indirectly, the income of a domestic affiliate either in the taxable year in which the DCL is recognized, or in any other taxable year.[8]

In general, taxpayers have two options for utilizing a DCL within the U.S. When a separate unit of a U.S. corporation incurs a DCL, that separate unit must decide between either using the loss to offset income of the U.S. corporation's U.S. affiliates (by making a "domestic use election") or using any portion of the loss against the income of one or more foreign persons, including foreign corporations that are owned by the U.S. corporation, referred to in the DCL rules as a "foreign use."

---

[6] The Net GloBE Income of a jurisdiction for a fiscal year is the positive amount, if any, computed in accordance with the following formula: Net GloBE Income = GloBE Income of all Constituent Entities – GloBE Losses of all Constituent Entities. See *Organisation for Economic Co-operation and Development (OECD), Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two) (Dec. 14, 2021)*, Article 5.1.2.

[7] *See* Treas. Reg. § 1.1503-2(c)(3), which defines a "separate unit" of a domestic corporation to mean any partnership interest, any trust interest, or a "foreign branch" of a domestic corporation. For this purpose, the regulations define "foreign branch" by reference to the section 367 regulations.

[8] Treasury Reg. § 1.1503(d)-2.

Once a domestic use election is made, the taxpayer must inform the IRS over a five-year period, certifying that neither a foreign use has occurred nor any other triggering event has taken place.[9] If a foreign use or other triggering event occurs, the taxpayer is generally required to recapture the tax benefit it received from the use of the DCL within the U.S.[10] The recaptured amount is treated as ordinary income and generally retains the same source, character, and separate foreign tax credit category to which the items of deduction or loss making up the DCL were allocated and apportioned.[11]

The DCL rules contain a mirror legislation rule that denies a taxpayer the ability to make a domestic use election where the foreign country has enacted legislation that operates like section 1503(d), and, thus, prohibits the taxpayer from claiming the DCL in the foreign country. The mirror legislation rule was designed to prevent the “revenue gain” resulting from the disallowance of a double dip going solely to the foreign country.[12] The effect of the mirror legislation rule is that a DCL may be disallowed in both the U.S. and in the foreign country. In such cases, Congress intended for the Treasury to pursue a bilateral agreement with the foreign jurisdiction so that the DCL could offset income of an affiliate in only one country.[13]

The Foreign Tax Credit

Under section 901, U.S. corporations and certain other U.S. persons may elect to claim a credit against their U.S. federal income tax liabilities for the amount of foreign income taxes paid, accrued, or deemed paid to a foreign country during the taxable year. Pursuant to the regulations under section 901, a “foreign income tax” generally includes a “net income tax.” A foreign tax is a net income tax only if it meets the net gain requirement. Under final regulations, issued in 2022 (the “2022 Final Regulations”), the net gain requirement consists of four subsidiary requirements: (i) the realization requirement, (ii) the gross receipts requirement, (iii) the cost recovery requirement, and (iv) the attribution requirement. The Notice provides, in relevant part, temporary relief in determining whether a foreign tax is a net income tax. Under the Notice, which generally permits a taxpayer to apply the final section 901 regulations as in effect prior to the 2022 Final Regulations (the “1983 Final Regulations”), a foreign tax is creditable if: (i) it is a tax, and (ii) it has the predominant character of an income tax in the U.S. sense. In general, this requirement is met if the foreign tax is likely to reach net gain in the normal circumstances in which it is applied, and it is not a “soak-up tax.”

[9] Treasury Reg. § 1.1503(d)-6(c).
[10] Treasury Reg. §1.1503(d)-6(h).
[11] Treasury Reg. § 1.1503(d)-6(h)(5).
[12] 85 Fed. Reg. 20,424, T.D. 9315, Dual Consolidated Loss Regulations; Correction, (April 25, 2007).
[13] Id.

SPECIFIC COMMENTS

1. The collateral impact of Pillar Two taxes on CFC inclusions and the application of the section 952(c) limitation

Overview

The disallowance of both a deduction and a credit for an IIR, as outlined in the Notice, may be necessary to prevent circularity between the U.S.'s CFC regime and the Pillar Two IIR regime. However, if Subpart F of a CFC continues to be limited by earnings and profits (E&P) under section 952(c), and E&P is reduced at the CFC level due to IIR taxes, it would perpetuate circularity in the calculation. Without further adjustment to the section 952(c) limitation, the IIR calculation may indirectly depend on itself when the limitation applies.

Recommendations

Treasury and the IRS should confirm that a CFC is allowed to deduct IIR taxes for all purposes other than the high-tax exceptions provided in section 954(b)(4) and Treas. Reg. § 1.951A-2(c)(7). Additionally, Treasury and the IRS should clarify whether IIR taxes are E&P adjustments at the CFC level. Assuming IIR taxes are permissible as an E&P deduction, Treasury and the IRS should evaluate and clarify whether a taxpayer's section 952(c) limitation is meant to be determined before any potential E&P deduction for IIR taxes.

Analysis

In accordance with the GloBE Model Rules, taxes are imposed on Net GloBE Income, as follows: local jurisdiction taxes (covered taxes), QDMTTs, CFC Tax Regime taxes, IIR taxes, and lastly, UTPR taxes. Therefore, CFC taxes are intended to be calculated independently of taxes paid under the IIR, and subsequently, the IIR tax liability is indirectly reduced by certain allocable CFC taxes.

Section 2.02(4) of the Notice states that a final top-up tax is treated as if it were a creditable tax at the CFC level with the disallowance of the credit pursuant to section 2.02(3) of the Notice applying at the level of the CFC's U.S. shareholder. Section 2.02(5) of the Notice instructs taxpayers to include in gross income under section 78 an amount equal to the amount of a final top-up tax deemed paid by the taxpayer and provides that the deduction disallowance rule of section 75(a)(4) apply to any foreign income tax paid or accrued in such taxable year regardless of whether a foreign tax credit is allowed for the particular tax. As a result, a taxpayer who chooses to credit foreign income taxes would be required to include in gross income under section 78 an amount equal to the final IIR tax deemed paid by the taxpayer under section 960(a), section 960(b), and section 960(d), and would not be able to claim a deduction for a final IIR tax under section 275(a)(4).[14]

[14] See section 2.02(5) of the Notice.

However, the Notice does not appear to disallow the deduction of IIR taxes at the CFC-level when computing GILTI or Subpart F.[15] Absent any prohibition, such taxes would also presumably reduce the E&P of a CFC.[16] Thus, an E&P adjustment for IIR taxes may impact the amount of Subpart F income calculated under section 952(c) for taxpayers whose Subpart F income is limited by their E&P. This, in turn, would affect the amount of IIR taxes calculated when following the GloBE Model Rules ordering system, potentially creating circularity in the calculations.

Additional ordering rules may be necessary to avoid circularity in the Pillar Two system, including by application of section 952(c). As noted above, under the Pillar Two rules, qualifying CFC taxes reduce the effective tax rate of the jurisdiction to which they are allocated and by extension may reduce the top-up tax due under the IIR. As a result, if Subpart F is reduced by a section 952(c) limitation that is increased by a deduction for an IIR tax, circularity would exist in the calculation, and would result in a situation where the IIR calculation depends on itself indirectly. This creates a loop where the value of a variable (the CFC tax) is used to calculate the IIR and results in a dependency that does not have a clear starting point or resolution.

The following example illustrates a potential scenario where this may occur:

> **Example:** In calendar year 2024, Taxpayer X (a U.S. C corporation) owns 100% of CFC Y, who owns 100% of Foreign Disregarded Entity (DRE) Z. CFC Y has a pre-tax loss of ($90,000) and DRE Z has pre-tax earnings of $100,000. DRE Z paid no local-country income taxes or QDMTT, and $100,000 of its earnings is considered passive Subpart F income at the CFC Y level. CFC Y paid no local-country income taxes.
>
> CFC Y adds the $100,000 of earnings from DRE Z to its ($90,000) loss to reach $10,000 of pre-tax earnings, all of which is considered passive Subpart F income. Before the application of the IIR, and assuming no other adjustments to make, CFC Y has E&P of $10,000.
>
> Taxpayer X has elected to credit foreign taxes. Taxpayer X increases its taxable income by the $10,000 of passive Subpart F income. Taxed at a rate of 21%, the tax due is $2,100. Assuming Taxpayer X has no foreign tax credits from other sources in the passive category, its U.S. tax liability as a result of DRE Z's operations is $2,100. Under the allocation rules for covered taxes in the GloBE Model Rules, the CFC Tax Regime tax amount allocated from the Constituent Entity-owner that is subject to the CFC tax (Taxpayer X) to the Constituent Entity (DRE Z) is $1,500.[17]
>
> Applying the GloBE Model Rules, a top-up tax is required to be calculated for DRE Z since it has a 0% effective rate of tax (before the allocation of CFC taxes under Article 4.3.2(c) of the

---

[15] Treasury Reg. § 1.952-2 provides the rules for determining gross income and taxable income of a foreign corporation for purposes of computing Subpart F income of a CFC. The computation of tested income or tested loss of a CFC (a component used in computing the GILTI inclusion) is also determined under the rules of Treas. Reg. § 1.952-2. See Treas. Reg. § 1.951A-2(c)(2). It appears any IIR taxes incurred remain deductible at the CFC level under this authority.
[16] See generally section 964 and section 312.
[17] The allocation of CFC taxes is beyond the scope of this discussion. For purposes of the example, we have generally assumed that the CFC taxes allocable thereunder would be limited to a 15% rate on the passive income includible under the CFC regime, or $1,500. See generally Article 4.3.3(b) of the GloBE Model Rules.

GloBE Model Rules). The IIR top-up tax is equal to $15,000 but is reduced to $13,500 as a result of subtracting the $1,500 of U.S. CFC tax due on the passive Subpart F income.

However, CFC Y must now recompute its E&P by including a reduction for the top-up tax calculated on DRE Z's GloBE income. CFC Y reduces its E&P of $10,000 by the $13,500 of top-up tax paid, resulting in an E&P deficit of ($3,500). Applying the section 952(c) rules, CFC Y is now limited by its E&P deficit and no longer has a passive Subpart F income inclusion. Therefore, there is no longer any amount of U.S. taxes on which to claim a reduced IIR tax. The net result is circularity in the calculation, with CFC Y's IIR tax depending on the Subpart F and vis versa.

2. The interaction between the DCL rules and the jurisdictional blending rules under Pillar Two

Overview

Section 1503(d) and the regulations thereunder (the "DCL rules") prevent "double dipping" of losses, which occurs when the same economic tax loss offsets or reduces both income subject to U.S. federal income tax (but not a foreign jurisdiction's income tax) and income subject to the foreign jurisdiction's income tax (but not U.S. federal income tax). Absent the DCL rules, a dual resident corporation or hybrid entity separate unit could be part of a U.S. consolidated group for U.S. federal income tax purposes and part of a foreign consolidated group for foreign income tax purposes, allowing losses to be consolidated under both taxing regimes. Any net loss incurred by the dual resident corporation or hybrid entity separate unit could, therefore, be used to offset the income of members of the U.S. consolidated group and the income of other foreign affiliates.

In calculating the jurisdictional effective tax rate under the Pillar Two rules, a blending approach is applied under which all income and loss of group-entities within the same jurisdiction is aggregated. Jurisdictional blending allows for all the profits, losses, and taxes of the Constituent Entities of the MNE Group located in the same jurisdiction to be blended for purposes of the effective tax rate calculation. This aggregation could be viewed as giving rise to the "double-dipping" concerns that the DCL rules were intended to address.

Recommendations

We believe that the Pillar Two rules are sufficiently different from traditional foreign jurisdictional income tax regimes such that the same policy issues are not present. Pillar Two is effectively an alternative minimum tax that is applying in addition to the normal corporate income tax. Thus, we recommend that the DCL rules not be impacted by any application of Pillar Two. The AICPA would be happy to discuss this further with Treasury and the IRS or provide further comments in this area upon request.

However, should Treasury and the IRS determine that the DCL rules are applicable to the Pillar Two regime, the AICPA recommends that losses in jurisdictions that do not yield a tax benefit under Pillar Two should not be considered as a foreign use of such losses.

Specifically, the AICPA recommends that, to the extent the loss does not affect the IIR tax, or a country-by-county transitional safe harbor is applied, then jurisdictional blending under Pillar Two should not constitute a foreign use. It also should not be treated as an offset or reduction of the income of a foreign affiliate. Additionally, we request that neither current nor future Model Rule guidance, including the guidance recently released addressing the treatment of hybrid arbitrage arrangements under the Transitional CbCR Safe Harbor,[18] be classified as "mirror legislation" under the DCL rules.

The AICPA further recommends that the same exemption to foreign use apply to a loss in any jurisdiction where the MNE Group applies one of the Pillar Two transitional safe harbors.

Analysis

The DCL rules were established with the intention of preventing multinational enterprises from utilizing tax residency differences to "double dip" losses across jurisdictions and reduce their group's income tax liability. Under the Pillar Two rules, jurisdictional blending should not be considered a foreign use if the utilization of such losses in a foreign jurisdiction does not reduce the overall group's IIR top-up tax.

> **Example:** Assume a Country Y eligible entity (FP) wholly-owns a U.S. corporation (USS). Assume further that USS owns a Country X eligible entity (FHC). FHC has elected to be a disregarded entity for U.S. tax purposes pursuant to Treas. Reg. § 301.7701-3 but is treated as a corporation under Country X law. FHC, in turn, wholly-owns a subsidiary in Country X ("FS") that is a regarded entity for both U.S. and Country X tax purposes. FHC incurs a loss that is a DCL for U.S. purposes, but that is not eligible to be shared with FS under Country X's income tax regime. Further assume that Country Y is a Pillar Two compliant jurisdiction and imposes an IIR.
>
> If FHC's Country X effective tax rate under Pillar Two on its GloBE income exceeds 15%, the fact that FHC and FS operations are aggregated under the Pillar Two calculation will have no impact on the FP group's total top-up tax under the IIR. Since the foreign loss provides no foreign tax benefit and is combined only to determine the Country X net GloBE income, this combination should not be considered a foreign use. Furthermore, it should not be treated as a foreign consolidation under the DCL rules.

When the foreign effective tax rate of Net GloBE Income being offset by a loss under Pillar Two equals or exceeds 15%, we recommend that any consolidation under the Pillar Two rules not be viewed as a foreign use nor should the act of combining the loss be considered a foreign consolidation for purposes of the DCL rules. The AICPA further recommends that the same exemption to foreign use apply to a loss in any jurisdiction where the MNE Group applies one of the Pillar Two transitional safe harbors.

The mirror legislation rule is generally intended to prevent the revenue gain resulting from the disallowance of "double-dipping" going solely to the foreign country. As noted, the AICPA

[18] See *Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)*, December 2023.

believes that the Pillar Two rules are sufficiently different from traditional foreign jurisdictional income tax regimes such that the same policy issues are not present. Pillar Two is effectively an alternative minimum tax that is applying in addition to the normal corporate income tax. Very generally, the OECD guidance, and the anti-abuse rules included to date, do not operate in a manner similar to section1503(d). Rather, the policy behind these rules, such as the hybrid arbitrage arrangements under the Transitional CbCR Safe Harbor, is intended, for example, to prevent tax motivated transactions that "purports to allow one of the Constituent Entities to qualify for the safe harbor and thereby avoid [IIR, QDMTT or UTPR top-up taxes under the GloBE Model Rules]."[19] Therefore, we request that neither current nor future Model Rule guidance, including the guidance recently released addressing the treatment of hybrid arbitrage arrangements under the Transitional CbCR Safe Harbor, be classified as "mirror legislation" under the DCL rules.

3. Request for further guidance providing more certainty as to the creditability of certain Pillar Two taxes

Overview

The evaluation of whether a tax imposed by a foreign jurisdiction is a foreign income tax is an important and necessary component of the U.S. foreign tax credit system. A foreign tax either is or is not a foreign income tax in its entirety for all persons subject to the tax, which meets the U.S. government's objective of "ensur[ing] consistent outcomes for taxpayers and minimiz[ing] the administrative burdens on the IRS that would result if the creditability of a foreign tax instead varied depending on each taxpayer's particular facts."[20]

The Pillar Two rules introduce three core top-up taxes that generally may apply in addition to local jurisdictional taxes (as defined above, QDMTTs, IIRs, and UTPRs). The GloBE Model Rules and related administrative guidance provide numerous guidelines with respect to the design and implementation of QDMTTs and IIRs to ensure consistency across implementing jurisdictions (for purposes of this letter, such QDMTTs and IIRs are referred to as "Pillar Two Top-Up Taxes").[21]

The OECD guidance contains a QDMTT safe harbor that, when applicable, eliminates the need for taxpayers to conduct a second calculation under the GloBE Rules after completing a QDMTT calculation under local foreign laws.[22] A local jurisdiction's QDMTT must qualify for the safe harbor by meeting several standards beyond the existing Pillar Two QDMTT rules. Very generally, the QDMTT must be based on the financial accounting standard of a group's ultimate parent entity (or a local financial accounting standard), must be computed according to the GloBE Model Rules, and must meet the requirements of a continuous monitoring process.[23]

---

[19] See *Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)*, December 2023, page 18.
[20] 85 Fed. Reg. 72,078, REG-101657-20, Guidance related to the Foreign Tax Credit; Clarification of Foreign Derived Tangible Income, 72,087 (Nov. 12, 2020).
[21] No comments contained in this letter relate to the UTPR. The AICPA will provide comments on this area as needed at a later date.
[22] See *Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)*, July 2023, Section 5.1.
[23] Id.

The analysis of whether a foreign tax meets the regulatory requirements under either the 2022 Final Regulations or the 1983 Final Regulations requires a detailed understanding of non-U.S. tax laws. In the case of Pillar Two Top-Up Taxes, this requires an analysis of various accounting standards, as well as the "GloBE adjustments" required by the GloBE Model Rules. The requirement that each taxpayer independently analyze the creditability of a foreign tax creates uncertainty, as well as places a significant burden on taxpayers to analyze all foreign U.S. taxes, including Pillar Two Top-Up Taxes. This burden is in addition to the significant increases in compliance and complexity that taxpayers are already contending with the global adoption of the Pillar Two rules.

Recommendations

The AICPA recommends that Treasury and the IRS confirm that QDMTTs (and also IIRs) that are consistent with the GloBE Model Rules generally meet the requirements for a creditable foreign income tax under section 901. We also recommend that foreign taxes meeting the QDMTT safe harbor requirements under OECD administrative guidance receive per se creditability treatment to simplify the compliance process for U.S. taxpayers and align with global standards.

Analysis

Providing a safe harbor with respect to the creditability of QDMTTs and IIRs that substantially conform to the GloBE Model Rules should considerably alleviate this burden on taxpayers. Limiting the types of top-up taxes that are creditable foreign income taxes without further validation by taxpayers to QDMTTs and IIRs ensures that a credit is only permitted for taxes that comply with the GloBE Model Rules. Top-up taxes with significant deviations would still be subject to analysis under the regulations. This approach promotes consistency, increases certainty, and reduces administrative burdens on both taxpayers and the IRS.

While the AICPA appreciates that it may not be appropriate in all cases for Treasury and the IRS to provide guidance regarding the creditability of foreign taxes, we believe that QDMTTs (and also IIRs) provide a unique circumstance necessitating further guidance for two reasons:

1. Net GloBE Income should generally be expected to reach net gain in the normal circumstances in which it applies. While the GloBE Model Rules acknowledge that each implementing jurisdiction will have "its own unique combination of additions to and exclusions from [FANIL],"[24] the rules are ultimately intended to reflect taxable income. The fact that Net GloBE Income in a particular jurisdiction may not equal the taxable income computed in the same jurisdiction reflects the limitations inherent in using a common tax base, and the tax policy objective of making adjustments for items that are "sufficiently material and widely accepted" in adopting jurisdictions.[25]

[24] OECD (2022), Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two), First Edition: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, Article 3.2.1, paragraph 21.
[25] *Id.*

2. The GloBE Model Rules represent a framework that has been carefully developed by tax professionals around the world. Many years of work by global tax professionals, including representation by U.S. tax professionals, went into the development of the GloBE Model Rules, and significant guidance has been released on the design and qualification of QDMTTs.[26] Further, the QDMTT Safe Harbor as outlined in the OECD guidance acknowledges the need to align global and local computational requirements to establish consistency and simplify the additional tax compliance burden for taxpayers. The QDMTT safe harbor requirements, as established by the OECD, necessitate strict compliance with the model rules and require a thorough peer review process be followed.

   It is expected that this peer review process will provide standardization in how a jurisdiction's domestic minimum top-up tax is evaluated in accordance with the GloBE Model Rules and ensure that QDMTTs will not have significant disparities across jurisdictions. Because of the framework established by the GloBE Model Rules, there will be sufficient harmonization between QDMTTs (and likely IIRs) implemented by each jurisdiction. Consequently, it is reasonable to anticipate that taxes meeting the QDMTT safe harbor criteria would also be recognized as creditable taxes for U.S. tax purposes. This harmonization makes a creditability "safe harbor" appropriate, in particular for QDMTTs.

Providing a creditability safe harbor for that QDMTTs (and also IIRs) based on the GloBE Model Rules will also provide taxpayers certainty in their financial statement and tax computations, thus reducing the burden on taxpayers prospectively as jurisdictions implement compliant QDMTTs and IIRs throughout 2024. Should a taxpayer receive confirmation from a foreign jurisdiction affirming that a paid QDMTT meets the established safe harbor criteria, it would be reasonable to rely on this certification for foreign tax credit purposes, thereby obviating the need for separate and repeated analyses regarding the credibility of such QDMTT.

In addition, unless the foreign tax deviates from the GloBE Model Rules, there is no discernible policy reason for requiring taxpayers to conduct independent analyses of QDMTTs and IIRs. Inconsistency in this regard is incompatible with Treasury and the IRS's stated objective to simplify and clarify the application of the rules. The future regulations described in the Notice appear to include, as a core assumption, that the QDMTT and the IIR, as described in the GloBE Model Rules, meet the definition of a foreign income tax under section 901 and would otherwise be creditable, but for a limitation in the Notice or otherwise in the Code.[27] Therefore, if the GloBE Model Rules are enacted without deviations by a local jurisdiction, it would follow that such taxes

[26] *See* Tax Challenges Arising From The Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two) – February 2023 ("The definition of "Qualified Domestic Minimum Top-up Tax" (QDMTT) is set out in Article 10.1 of the GloBE Rules. This definition distinguishes QDMTT from other minimum taxes in that it requires that the minimum tax is implemented and administered in a way that is consistent with the outcomes provided for under the GloBE Rules and Commentary").

[27] The Notice does not directly address an IIR tax, but rather discusses a "Final Top-up Tax." However, Example 1 in Section 2.02(6)(a) of the Notice includes an analysis concluding that an "IIR is a final top-up tax" when it aligns with the definition of a "Final Top-up Tax" and further concludes that "[n]o credit is allowed under section 901 to USP for the Country X IIR that USP is deemed to pay." Similarly, Example 3 states that the "QDMTT imposed by Country Y is a foreign income tax within the meaning of Treas. Reg. § 1.901-2(a) and Treas. Reg. § 1.901-2(b)." Both examples appear to include the core assumption or underlying fact that the QDMTT or the IIR, as describe in the Model Rules, both meet the definition of a foreign income tax under section 901 and would otherwise be creditable, but for a limitation in the Notice or otherwise in the Code.

should also meet the definition of a creditable foreign income tax under section 901, unless otherwise limited by a specific provision.

Regardless of whether the creditability safe harbor recommendation is adopted, in addition to providing confirmation as described above, the AICPA recommends that Treasury and the IRS add examples in the regulations under Treas. Reg. § 1.901-2(b) illustrating the application of the regulations to the common elements of QDMTTs and IIRs to aid taxpayers in their evaluations of these new top-up taxes.

4. Treatment of specific Pillar Two taxes within the context of a foreign law inclusion regime under Treas. Reg. § 1.861-20(b)(11)

<u>Overview</u>

The Notice states that the IRS intends to publish proposed regulations, which describe the treatment of an IIR tax.[28] The Notice specifically defines "Final Top-up Tax," or an IIR tax, as a foreign income tax, or tested tax, when computing the tax, foreign law takes into account either:

> "… the amount of tax imposed on the direct or indirect owners of the entity subject to the tested tax by other countries (including the United States) with respect to the income subject to the tested tax, or
>
> in the case of an entity subject to the tested tax on income attributable to its branch in the foreign country imposing the tested tax, the amount of tax imposed on the entity by its country of residence with respect to such income."

However, the Notice is silent on whether an IIR tax should be treated as a foreign law inclusion regime for purposes of allocating and apportioning foreign income taxes under Treas. Reg. § 1.861-20.

A foreign income inclusion regime is defined under Treas. Reg. § 1.861-20(b)(11) as:

> "… a foreign law tax regime similar to the subpart F or GILTI regime described in sections 951 through 959, or the PFIC regime described in sections 1293 through 1295 (relating to qualified electing funds), that imposes a tax on a shareholder of an entity based on an inclusion in the shareholder's taxable income of certain of the entity's current earnings, whether or not the foreign law deems the entity's earnings to be distributed."

<u>Recommendation</u>

The AICPA recommends that Treasury and the IRS amend Treas. Reg. § 1.861-20(b)(11) to clarify that an IIR is a foreign law inclusion regime for purposes of allocating and apportioning foreign income taxes under Treas. Reg. § 1.861-20.

---

[28] For simplicity, we have used the term "IIR tax" as described in the GloBE Model Rules and the term "Final Top-up Tax" as described in the Notice interchangeably in this comment letter.

Analysis

Generally, Treas. Reg. §1.861-20 provides guidance on how to allocate and apportion foreign taxes paid or accrued in a given tax year. There are special rules, particularly, in the 2020 final regulations that expressly assign specific gross income items to statutory and residual groupings. For example, the 2020 final regulations specify that "foreign income items …similar to subpart F or GILTI are assigned to the same categories as the gross income of the foreign law CFC that gave rise to the foreign law inclusion item." Without a determination as to whether the final top up tax or IIR is to be treated as a foreign-law inclusion regime, similar to subpart F or GILTI, its classification for purposes of allocating and apportioning related foreign taxes paid or accrued in a given year remains uncertain.

5. Request clarification on the application of the rules in Notice 2023-80 providing an extension of the temporary relief previously provided in Notice 2023-55

Overview

These 2022 Final Regulations raised questions and concerns from the taxpayer community as they significantly restricted the rules governing the creditability of foreign taxes and further restricted creditability of foreign taxes relative to the previous regulations (i.e., the 1983 Final Regulations).

In response to taxpayers' questions and concerns, Treasury and the IRS issued Notice 2023-55, providing relief for taxpayers determining whether foreign taxes are eligible to be taken as foreign tax credits. The temporary relief primarily defers certain aspects of the 2022 Final Regulations. Notice 2023-55 instead allows taxpayers to use a modified version of the rules that existed before the most recent final regulations (i.e., the 1983 Final Regulations). However, the relief is generally not extended to certain digital service taxes (DSTs).

Under Notice 2023-55, taxpayers may apply the temporary relief to foreign taxes paid or accrued in the relief period, provided that the taxpayer satisfies certain requirements.[29] The relief period means taxable years beginning on or after December 28, 2021 (i.e., the effective date of the 2022 Final Regulations), and ending on or before December 31, 2023.

The IRS subsequently extended the FTC temporary relief under Notice 2023-55 with the issuance of the Notice. The Notice modifies the relief period so that the relief provided by Notice 2023-55 is extended to apply to all tax years beginning on or after Dec. 28, 2021, and ending before the date that Notice or other guidance withdrawing or modifying the temporary relief is issued (or any later date specified in such notice or other guidance). Thus, taxpayers may continue to rely on the relief extended under Notice 2023-55 for taxes paid in tax years ending before the temporary relief is withdrawn or modified.

[29] Notice 2023-55, Section 3, describes several eligibility requirements necessary to qualify for relief, however, such requirements are not relevant to this discussion and are omitted for brevity.

Recommendations

The AICPA requests Treasury and the IRS clarify their intent on the issuance of any forthcoming guidance related to relief provided under Notice 2023-55 and the Notice with respect to future applicability dates and / or retroactive impact to taxpayers. Specifically, we request that Treasury and the IRS issue guidance indicating that the relief period will apply to all tax years beginning on or after December 28, 2021, and beginning on or before the date that Notice or other guidance withdrawing or modifying the temporary relief is issued (or any later date specified in such Notice or other guidance).

Analysis

Relief provided under Notice 2023-55 is extended to include taxable years that end before future guidance is issued. Under this open-ended relief period, taxpayers may be excluded from relief, potentially retroactively, in the year in which updated guidance is issued. Thus, taxpayers may not know whether relief will be provided with respect to a taxable year until its close, resulting in significant uncertainty.

The Notice is silent on the future as it relates to the elements of applicable dates and retroactive impact of the temporary relief granted under Notices 2023-55 and extended under the Notice, which could potentially affect quarterly financial statement positions and disclosures as well as estimated tax payments.