May 05, 2021

The Honorable Ron Wyden
Chairman
U.S. Senate Committee on Finance
Washington, DC

The Honorable Richard Neal
Chairman
U.S. House Committee on Ways and Means
Washington, DC

The Honorable Mike Crapo
Ranking Member
U.S. Senate Committee on Finance
Washington, DC

The Honorable Kevin Brady
Ranking Member
U.S. House Committee on Ways and Means
Washington, DC

Re: AICPA International Tax Legislative Proposals – Simplification and Technical Proposals

Dear Chairmen Wyden and Neal, and Ranking Members Crapo and Brady:

The American Institute of CPAs (AICPA) submits for your consideration the enclosed international tax legislative simplification and technical proposals. Our focus in this set of proposals is on changes to provisions in the Internal Revenue Code that need attention, recommendations that are technical in nature, and recommendations that perhaps can be readily addressed.

Specifically, we recommend that Congress:

1. Clarify the limited nature of section 958(b)(4)[1] repeal.
2. Permit taxpayers with outstanding section 965(h) installments to obtain a refund for overpayments of tax, notwithstanding any future installment amounts of section 965 transition tax liability.
3. Consolidate the reporting of foreign assets under Title 31 and Title 26 into a single report.
4. For purposes of assessing penalties related to international information reporting, grant an automatic 6 month extension time to file international informational returns without requiring the filing of Form 7004, *Application for Automatic Extension of Time To File Certain Business Income Tax, Information, and Other Returns* or Form 4868, *Application for Automatic Extension of Time To File U.S. Individual Income Tax Return*.
5. Clarify that the section 78 gross up is not necessary when foreign taxes are properly attributable to previously taxed earnings and profits (PTEP) distributions.

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

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The AICPA is the world's largest member association representing the CPA profession, with more than 431,000 members in the U.S. 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 intend to continue our efforts in this area and submit further comments and proposals on major tax issues and reform efforts. The AICPA urges you to consider the enclosed proposals for inclusion in future tax legislation. If you have any questions, please contact David Sites, Chair, AICPA International Tax Technical Resource Panel, at (202) 861-4104 or David.Sites@us.gt.com; Amy Miller, AICPA Senior Manager – Tax Policy & Advocacy, at (202) 434-9264 or Amy.Miller@aicpa-cima.com; or Lauren Pfingstag, AICPA Director – Congressional and Political Affairs, at (202) 434-9208 or Lauren.Pfingstag@aicpa-cima.com; or me at (612) 397-3071 or Chris.Hesse@CLAconnect.com.

Sincerely,

Christopher W. Hesse, CPA
Chair, AICPA Tax Executive Committee

cc:

Mr. Thomas A. Barthold, Chief of Staff, Joint Committee on Taxation
Jose E. Murillo, Deputy Assistant Secretary, Office Of Tax Policy, Department of the Treasury

AMERICAN INSTITUTE OF CPAs

AICPA International Tax Legislative

Simplification and Technical Proposals

Approved by
Tax Executive Committee

May 05, 2021

FOREWORD

The American Institute of CPAs (AICPA) actively pursues and publishes positions on a number of legislative proposals. These international tax positions address legislative proposals as well as statutory provisions we have identified as needing modification. The enclosed international tax legislative proposals correct technical problems in the Internal Revenue Code (IRC or "Code") or simplify existing provisions. These proposals generally promote simplicity and fairness.

This submission includes items focused on improving international tax administration and effectively promoting important policy objectives. This submission is not a comprehensive list of all provisions that we believe Congress should modify from the reformed Code. We intend to continue our efforts in this area and make further recommendations in the future.

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Proposal: Clarify the limited nature of section 958(b)(4) repeal.

Present Law

Public Law No. 115-97 (the "TCJA") completely repealed section 958(b)(4), which prevented "downward attribution" under section 318(a)(3) from a foreign person to a U.S. person. Due to downward attribution and the repeal of section 958(b)(4), certain foreign corporations are now treated as Controlled Foreign Corporations (CFCs). In effect, lower-tier U.S. entities may now be deemed to own and control other foreign entities in the structure, causing several problems. These problems include additional compliance burdens, an expansion of entities subject to the CFC rules (and, by extension, an expansion of entities subject to the Specified Foreign Corporation (SFC) rules under section 965) and income inclusions by certain ultimate U.S. investors.

The repeal of section 958(b)(4) applies retroactively to a foreign corporation's last taxable year beginning before January 1, 2018 and each subsequent taxable year. It also applies to taxable years of U.S. shareholders in which or with which the taxable years of those foreign corporations end.

Description of Proposal

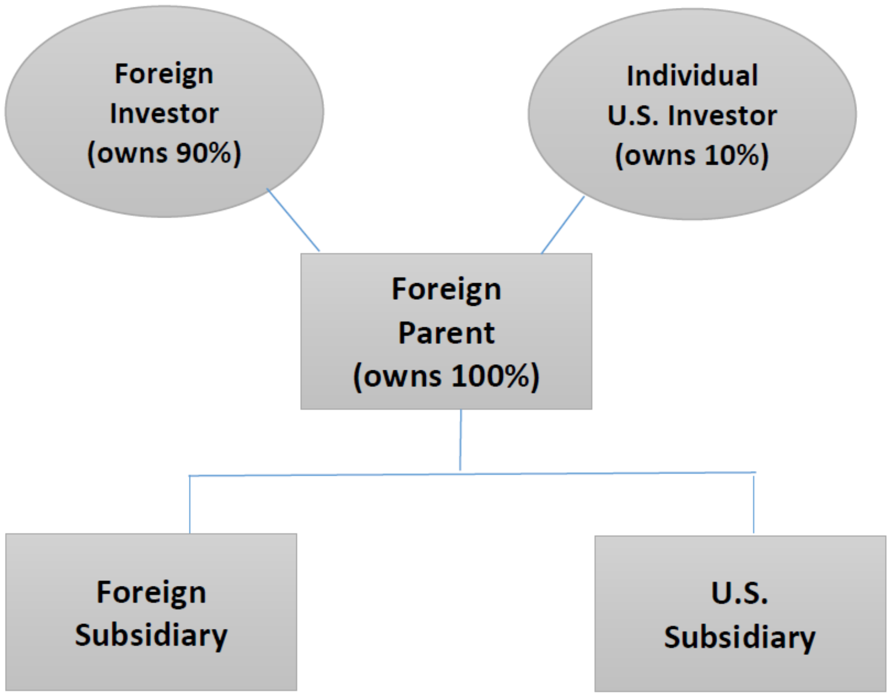
Provide legislation to clarify the exclusion of a foreign corporation, which is considered a CFC solely as a result of the "downward attribution" rules of section 318(a)(3), from the definition of a CFC for any U.S. shareholder not considered a related party (within the meaning of section 954(d)(3)) with respect to the domestic corporation to which ownership was attributed.

Analysis

The treatment of these entities as CFCs is inconsistent with the intent of Congress when it repealed section 958(b)(4). According to page 633 of the Joint Explanatory Statement of the Committee of the Conference (Conference Report) for the TCJA relating to the repeal of section 958(b)(4), "the Senate Finance Committee explanation states that the provision is not intended to cause a foreign corporation to be treated as a controlled foreign corporation with respect to a U.S. shareholder as a result of attribution of ownership under section 318(a)(3) to a U.S. person that is not a related person (within the meaning of section 954(d)(3)) to such U.S. shareholder as a result of the repeal of section 958(b)(4)." The Report further states that the "conference agreement follows the Senate amendment."

The Conference Report also provides that "in adopting this provision, the conferees intend to render ineffective certain transactions that are used to [sic] as a means of avoiding the subpart F provisions. One such transaction involves effectuating 'de-control' of a foreign subsidiary, by taking advantage of the section 958(b)(4) rule that effectively turns off the constructive stock ownership rules of 318(a)(3) when to do otherwise would result in a U.S. person being treated as owning stock owned by a foreign person. Such a transaction converts former CFCs to non-CFCs, despite continuous ownership by U.S. shareholders."

The application of our recommendation is illustrated by the following example and diagram:



As a result of the changes enacted as part of the TCJA, U.S. Subsidiary is treated as owning 100% of the stock in Foreign Subsidiary, converting Foreign Subsidiary from a non-CFC, under prior TCJA-law, into a CFC. Unless the related party exclusion described by the Conference Report is applied, Foreign Subsidiary would, as a new "constructive" CFC, become subject to additional information reporting. The Individual U.S. investor may now be required to include Foreign Subsidiary's gross income under sections 951, 965, 951A, among others. Absent the repeal of section 958(b)(4), the Individual U.S. Investor would not have been subject to the various rules applicable under the CFC regime.

Interpreting the plain language of the relevant code sections does not provide the intended result of the TCJA, resulting in an increasing number of taxpayers falling under the definition of a U.S. shareholder of a CFC than anticipated by Congress. As a result, Individual U.S. Investor in our example is subject to all of the provisions applicable to U.S. Shareholders of a CFC (including subpart F inclusions and GILTI, as well as increased disclosure compliance) on an ongoing basis.

Conclusion/Recommendation

Clarify the law to follow Congressional intent.

Proposal: Permit taxpayers with outstanding section 965(h) installments to obtain a refund for overpayments of tax, notwithstanding any future installment amounts of section 965 transition tax liability.[1]

Present Law

Under section 965, Treasury and the IRS reached a conclusion in the question and answer (Q&A) 13 and 14 for the 2017 filing years. These FAQs were posted to the IRS website on April 13, 2019, later explained in an IRS Chief Counsel Memorandum (PMTA 2018-16 or "PMTA"), and most recently re-affirmed in Q&A 4 of a new set of IRS FAQs issued in response to the CARES Act, posted to the IRS website on April 23, 2020. Allowing taxpayers to obtain a refund for losses incurred during this tumultuous economic period, regardless of whether they have outstanding section 965(h) installments, is necessary for fair and sound administration of the tax system

Description of Proposal

Congress should enact legislation similar to that provided for in section 2208 of the original version of the CARES Act legislation introduced in the Senate on March 19, 2020, which provides as follows:

> (a) IN GENERAL.—Section 965(h) of the Internal Revenue Code of 1986 is amended by adding at the end the following new paragraph:
>
> "(7) INSTALLMENTS NOT TO PREVENT CREDIT OR REFUND OF OVERPAYMENTS OR INCREASE ESTIMATED TAXES.—If an election is made under paragraph (1) to pay the net tax liability under this section in installments—
>
> "(A) no installment of such net tax liability shall—
>
> "(i) in the case of a request for credit or refund, be taken into account as a liability for purposes of determining whether an overpayment exists for purposes of section 6402 before the date on which such installment is due, or
>
> "(ii) for purposes of sections 6425, 6654, and 6655, be treated as a tax imposed by section 1, section 11, or subchapter L of chapter 1, and
>
> "(B) the first sentence of section 6403 shall not apply with respect to any such installment."
>
> (b) LIMITATION ON PAYMENT OF INTEREST.—In the case of the portion of any overpayment which exists by reason of the application of section 965(h)(7) of the Internal Revenue Code of 1986 (as added by this section)—

[1] See AICPA Comment Letter, "Overpayments, Section 965(h) Transition Tax Installments, and Net Operating Loss Carryback Relief under the CARES Act," submitted October 20, 2020.

(1) if credit or refund of such portion is made on or before the date which is 45 days after the date of the enactment of this Act, no interest shall be allowed or paid under section 6611 of such Code with respect to such portion; and

(2) if credit or refund of such portion is made after the date which is 45 days after the date of the enactment of this Act, no interest shall be allowed or paid under section 6611 of such Code with respect to such portion for any period before the date of the enactment of this Act.

(c) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect as if included in section 14103 of Public Law 115–97.

Analysis

The AICPA remains concerned about the negative effect of the decision of Treasury and the IRS for certain taxpayers regarding the application of overpayments of tax unrelated to the section 965 transition tax or the installment payments under section 965(h). This concern has been amplified by the recent crisis caused by the COVID-19.

Many businesses are experiencing significant reductions in revenues and cash flow as a result of the COVID-19 crisis. Without cash reserves, the reduction in revenues may force many businesses to either look for additional funding in a difficult market or to reduce their expenses, including through layoffs or reduction of wages. Indeed, we have already seen dramatic layoffs and increases in unemployment claims since the Coronavirus affected the U.S.[2]

United States businesses with foreign subsidiaries may have incurred a section 965 transition tax liability following the enactment of the TCJA. These businesses, which may now experience constrained revenues, may have elected to pay the section 965 transition tax liability in eight annual installments under section 965(h). Some of the central purposes of the CARES Act are to provide relief for businesses and their employees and to help stabilize the U.S. economy.[3]

We understand that the intent and purpose of the CARES Act provision granting relief through a temporary carryback period for NOL deductions extends to U.S. businesses and employers with payments in installments of the transition tax liability under section 965(h). However, we believe such businesses and employers may face severe constraints in obtaining the benefits of that extended NOL carryback period because of Q&A 14. Due to the Treasury and IRS interpretation,

[2] According to the Bureau of Labor Statistics (BLS) Employment Situation Summary for September 2020, "In September, the unemployment rate declined by 0.5 percentage point to 7.9%, and the number of unemployed persons fell by 1.0 million to 12.6 million." The unemployment rate was 3.5% in February and jumped quickly to nearly 15% in April as U.S. employers laid off more than 20 million people due to the coronavirus pandemic.

[3] *See* Senate Majority Leader Mitch McConnell's remarks on the Senate Floor regarding the CARES Act (March 19, 2020); U.S. Senate Committee on Finance Press Release on Tax Policies for Phase 3 Coronavirus Response (March 19, 2020) (providing that the provision reversing the Q&A 14 guidance of Treasury and the IRS "corrects an error in the TCJA, allows companies to recover the overpayment of taxes paid on the toll charge to help with liquidity during the current crisis."); Chairman of the U.S. House Ways and Means Committee Richard Neal's Floor Remarks on the Coronavirus Response Legislation (March 27, 2020).

many U.S. businesses that generated positive taxable income prior to the COVID-19 pandemic but are now experiencing losses and revenue constraints could not obtain a refund by carrying back the losses to prior year periods as long as they have future section 965 transition tax installments that remain unpaid.

Conclusion/Recommendation

Congress should enact legislation to permit taxpayers with outstanding section 965(h) installments to obtain a refund for overpayments of tax, notwithstanding any future installment amounts of section 965 transition tax liability.

Proposal: Consolidate the reporting of foreign assets under Title 31 and Title 26 into a single report.

Present Law

Under Title 31 of the U.S. Code (the Bank Secrecy Act, or BSA) – Reports of Foreign Bank Accounts 31 C.F.R § 1040.350 and §5314, U.S. citizens, resident aliens and certain entities with aggregated balances in accounts held outside the U.S. that exceed a $10,000 statutory threshold are required to report on FinCEN Form 114, *Report of Foreign Bank and Financial Accounts* ("FBAR") specified details on these accounts. Simultaneously, these same taxpayers are also required under 26 USC § 6038D to report nearly identical information on Form 8938 *Statement of Specified Foreign Financial Assets*, yet subject to different reporting rules and thresholds. This duplicative reporting is cumbersome for taxpayers who struggle to discern nuances in the separate statutes, heightened risk for penalties for unintended noncompliance, and inefficient tax administration, both in processing duplicated information as well as responding to penalty abatement requests that could be reduced with a single consolidated report.

Description of Proposal

Congress should enact legislation to consolidate FBAR and Form 8938 reporting requirements into a single compliance form, with an original (not extended) due date of October 15th, encompassing the data requirements included in both current Forms 8938 and the FBAR.

Analysis

The AICPA appreciates the history of cooperation with the Service and elected officials in matters relating to foreign asset reporting and understands the need for information reporting of offshore assets. Our membership advocates, however, simplification of regulations to streamline this reporting from the inefficient duplicative process into a single consolidated report. Form 8938 clearly represents a modernization of vital information gathering for foreign assets, yet the FBAR still remains with outdated and inconsistent rules. The data needed from taxpayers should be consolidated into a single Form 8938 that may be signed and submitted irrespective of income tax filing requirements, and the FBAR can be eliminated.

One of the most striking disparities in reporting is the differences in reporting thresholds between the two forms. Form 8938 under 26 U.S.C. § 6038D (enacted as a part of the HIRE Act) applies a $50,000 filing requirement (and higher, depending on residency and filing status). In contrast, the FBAR under 31 C.F.R. § 103.27(c) applies a remarkably smaller threshold of only $10,000 for identical information. This threshold was set in 1970 and has never been indexed for inflation. Given the rate of inflation since 1970 on most commonly available inflation calculators, this amount equates to over *$65,000* in today's dollars. The $50,000 threshold of the Form 8938 is more appropriate for modern foreign asset reporting, to align with the intended scope these laws first considered. This $50,000 threshold should be indexed for inflation as further explained below.

Curiously, however, the penalty for noncompliance of an FBAR is indexed for inflation, setting the penalty for non-willful violations now higher than the reporting threshold. 31 C.F.R. 5321(a)(5) authorizes the Secretary to assess penalties for violations of section 5314. In 2015, § 701 of the Inflation Adjustment Act authorized agencies to annually adjust for inflation Civil Monetary Penalties (CMP) assessed beginning in 2017. The current CMP for those assessed after January 28, 2021 is up to $13,640. Bearing in mind that the FBAR reporting threshold is an aggregate of high values in accounts at *any* point in time, and not a report of actual wealth, it is possible that the penalty for non-willful filing violations exceeds the amount ever held abroad by a taxpayer. Consider a common example of holding $6,000 in a foreign time deposit, which expires in a given year and is rolled to a new time deposit that bears a new account number. The aggregate of the high values in each of the two accounts – each having had $6,000 in them – is $12,000 and above the reporting threshold. Yet, should the account holder have misunderstood the aggregation rules and failed to report an FBAR for that year, the penalty assessed would be $13,640 – well in excess of the cash actually held abroad. By contrast, the current penalty for failure to file a Form 8938 is set at $10,000, a fraction of the $50,000 reporting threshold and is not indexed for inflation. We recommend that any indexing for inflation, if necessary to apply to the penalties, also apply to the reporting threshold to maintain a logical parity between the two values.

Further confusion in reporting lies in identifying which entities must file which form, if at all, and which assets are reportable on which form. As the forms are very similar and much of the same information must be reported twice, slight differences remain which, if interpreted incorrectly, lead to costly penalty assessment. Requiring two different forms with different reporting thresholds and different sets of rules adds unnecessary confusion for taxpayers.

a. Individuals and entities who may not have an income tax filing requirement (such as disregarded tax entities or children), and as such do not have a requirement to report assets on a Form 8938, still must file a separate FBAR.

    - For example, consider a U.S. citizen who operates a business through a single-member LLC in both the U.S. and Canada, and holds bank accounts in Canada for its Canadian customers. She must report the FBAR under the tax ID of the LLC and not under her Social Security Number. In contrast, however, she would still include the foreign accounts on her Form 8938 for the year, as an account in which she has an interest. Aside from reporting identical information twice, to two separate agencies of the same Treasury Department, this confusing difference may lead to an unreported FBAR by the LLC (*i.e.* having been reported under the SSN of the taxpayer).
    - Children may not have an income tax filing obligation, though they may still be beneficiaries of financial assets abroad. Often this is the result of an inheritances or gifts to which they and their parents may not even be aware. The Form 8938 would not be required in this instance where the children do not have sufficient income to necessitate an income tax return filing, though the additional step to submit the FBAR may well be missed.

In both of these cases, it is very easy for the taxpayer to confuse the income tax filing requirement with the FBAR requirement and make a potentially costly mistake of missing the FBAR filing altogether.

b. The definition of a "foreign account" varies between the forms, as well. The FBAR form includes accounts of a U.S. bank that are held at a *branch* that is outside the U.S. With the increase in digital banking, there is often not a branch *anywhere*. Therefore, it is confusing to discern where the "branch" in question is located. By contrast, Form 8938 requires the bank itself be a foreign financial institution, which is a much clearer determination for the taxpayer to make.

c. Accounts held indirectly are reportable on the FBAR – these may include accounts through stock ownership in a Controlled Foreign Corporation (CFC) or a foreign partnership. Form 8938, however, recognizes these assets have already been reported on Forms 5471, *Information Return of U.S. Persons With Respect To Certain Foreign Corporations,* or Form 8865, *Return of U.S. Persons With Respect to Certain Foreign Partnerships,* and exempts duplicative filing.

Lastly, consolidating the reporting into a single form simplifies and reduces the quantity of forms subject to civil monetary penalties. Though the Secretary has authority to consider and abate penalty assessment in cases for which reasonable cause can be shown, it is an unnecessarily stressful and costly step for the taxpayer to hire qualified representation to petition for abatement, as the "reasonable cause" bar is set extraordinarily high. The taxpayer must then wait months for a reply from the IRS. The Service, in turn, must address these penalty abatement requests while citing significant understaffing problems, most recently in Commissioner Rettig's testimony before the House Ways and Means Committee on Thursday March 18, 2021. In this hearing, the Committee sought means for which Congress could assist the Service in its significant backlogs and staffing challenges. This proposal to consolidate duplicative work offers some of that desperately needed relief. Any concerns with 26 U.S.C. § 6013 disclosure over transmission of similar information to other Governmental agencies could be drafted into legislation.

Conclusion/Recommendation

We recommend that Congress eliminate the FBAR by consolidating foreign asset reporting into a single Form 8938 that bears an original (not extended) due date of October 15th that may be submitted separate from an income tax return when none is required. This will eliminate costly and duplicative reporting, reduce confusion and taxpayer risk for error that results in unnecessary penalties, and streamline tax administration.

Proposal: For purposes of assessing penalties related to international information reporting, grant an automatic 6 month extension time to file international informational returns without requiring the filing of Form 7004, *Application for Automatic Extension of Time To File Certain Business Income Tax, Information, and Other Returns* or Form 4868, *Application for Automatic Extension of Time To File U.S. Individual Income Tax Return*.

Present Law

By filing a properly completed Form 7004, a taxpayer currently receives an automatic extension of time to file certain business income tax, information, and other returns. For calendar year taxpayers, this extension is generally granted to six months from the original due date. International information returns, including Forms 5471,[4] 5472,[5] and 8865,[6] are filed with their associated U.S. federal income tax returns. Thus, international informational return deadlines are extended automatically via the Form 7004 extension when their associated U.S. federal income tax return (*e.g.,* Form 1120, *U.S. Corporation Income Tax Return*, and Form 1065, *U.S. Return of Partnership Income),* is extended. Individuals filing Form 4868 similarly receive an automatic six-month extension of their income and informational tax return filings.

While no tax is directly due with the filing of these returns, the failure to timely file these returns can result in significant penalties, as well as extend the statute of limitation on assessment for the taxpayer's entire return under section 6501(c)(8). For example, the minimum penalty for delinquent Forms 5471 and 8865 is $10,000 per form. The penalty for a late Form 5472 is $25,000 per form. The IRS applies penalties for Forms 5471 and 5472 automatically when they are received with late-filed income tax returns. As a result, taxpayers may face significant penalties for a simple administrative oversight, such as not filing an "automatic" extension.

Description of Proposal

Grant an automatic six-month filing extension without requiring Form 7004 or Form 4868 for international information tax returns, thereby providing prospective penalty relief for failure to timely file penalties.[7]

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[4] Certain U.S. persons who are officers, directors, or shareholders in certain foreign corporations file Form 5471, *Information Return of U.S. Persons With Respect To Certain Foreign Corporations* and schedules to satisfy the reporting requirements of sections 6038 and 6046, and the related regulations.

[5] Corporations file Form 5472, *Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business* to provide information required under sections 6038A and 6038C when reportable transactions occur with a foreign or domestic related party.

[6] A U.S. person files Form 8865, *Return of U.S. Persons With Respect to Certain Foreign Partnerships* to report the information required under (1) Section 6038 (reporting with respect to controlled foreign partnerships); (2) Section 6038B (reporting of transfers to foreign partnerships); and, (3) Section 6046A (reporting of acquisitions, dispositions, and changes in foreign partnership interests).

[7] Note that this proposal solely requests extension of the filing deadline for the purpose of failure to timely file international information return penalties and would leave other penalties intact.

Analysis

An automatic extension of international informational return filing deadlines when no payment is due would facilitate taxpayer compliance and demonstrate Treasury's interest in streamlining processes by eliminating unnecessary filings. The existence of the "automatic" extension under Form 7004 for these filings indicates that Treasury has already concluded that it does not need to evaluate the reasons why such an extension is necessary. Notably, certain foreign and domestic corporations and certain partnerships are already entitled to an automatic extension to file *and pay* without filing Form 7004.[8] Entities entitled to that automatic extension include those that maintain books and records outside the U.S. and/or principally have non-U.S. income.[9] The same reasoning — presumably the increased complexity of those returns and the often-distributed nature of the underlying data required — applies to entities and individuals required to file international information returns.

Moreover, while international information return filing deadlines are currently extendable by extension of their associated Forms 1120 (series), 1065, and 1040 (series) via Form 7004 or Form 4868, the penalties for failure to obtain that extension are significant and largely automatic for the international information returns. Thus, if a taxpayer fails to file Form 7004 to extend its original income tax return compliance deadline but is unaware that it will need to file an international information return in a given tax year, it will automatically be penalized even if it ultimately files a return in a time (*i.e.*, by September or October) that Treasury has determined is acceptable under the current tax system.

For example, a foreign corporation may be looking to invest in the U.S. It does so, but is unfamiliar with the tax rules, and, although it sought advice, late filed its U.S. federal income tax return. If the return had ten Forms 5472 attached to the late filed return, the taxpayer would immediately receive a penalty notice for $250,000. This occurs even though the taxpayer may have filed within what would have been the extended due date had they filed Form 7004, and otherwise owed no federal income tax with the return. Systematically assessing penalties against the taxpayer in this scenario does not enhance voluntary compliance because the taxpayer voluntarily submitted the returns.

Finally, this proposal is in accord with automatic extensions such as the FBAR extension from April 15 to October 15 without filing a form.

Conclusion/Recommendation

Congress should enact legislation to provide an automatic extension of international information return filings for six months from their original due date without requiring filing of an extension form. This will provide prospective penalty relief for failure to timely file.

[8] Instructions for Form 7004 regarding Line 4.
[9] *Id.*

Proposal: Clarify that the section 78 gross up is not necessary when foreign taxes are properly attributable to PTEP distributions.

Present Law

The TCJA repealed section 902, modified section 960, and generally changed the system for determining the deemed paid credit to a "properly attributable" standard – that is, taxes are deemed paid by a U.S. shareholder of a CFC only to the extent that those taxes are properly attributable to certain subpart F income, GILTI, or PTEP. If a CFC makes a distribution of PTEP to another CFC or to a U.S. shareholder, section 960(b) generally treats the recipient corporation as having paid the taxes that are properly attributable to the distribution. Section 78, as amended by the TCJA, generally provides that an amount equal to the taxes deemed paid under sections 960(a), 960(b), and 960(d) for the taxable year will be treated (except for sections 245 and 245A purposes) as a dividend received by such domestic corporation from the foreign corporation.[10]

The purpose of section 78 is to ensure that a U.S. shareholder cannot effectively both deduct and credit the foreign taxes deemed paid by the U.S. shareholder.[11] Requiring a gross-up with respect to taxes deemed paid under section 960(a) and (d) is consistent with this purpose. Failure to require a gross-up for taxes deemed paid under sections 960(a) and (d) would have the effect of first allowing the foreign taxes paid by the CFC as a deduction (because Subpart F income and GILTI inclusions are net of expenses, including taxes)[12] and then, allowing a portion of such foreign taxes paid by the CFC as a tax credit of the U.S. shareholder against its U.S. tax.

Description of Proposal

Legislation is needed to clarify that the section 78 gross up is not necessary when foreign taxes are properly attributable to PTEP distributions. The reference to section 960(b) in section 78, to the extent it is interpreted as resulting in a dividend that is included in the gross income of the recipient domestic corporation, does not serve any clear purpose and effectively creates non-economic income.

Analysis

In December 2018, the Joint Committee on Taxation issued an explanation of the TCJA in which it noted that section 78 may require a technical correction to remove the reference to section 960(b) indicating that deemed paid taxes related to the distribution of PTEP to a U.S. shareholder should not be grossed-up.[13] About one year after the TCJA was signed into law, the House Ways and Means Committee released a discussion draft of technical and clerical corrections (the "Technical

[10] *See also* Staff of the Jt. Comm. on Technical Explanation of the House Ways and Means Committee Chairman's discussion draft of the "Tax Technical and Clerical Corrections Act.", at 16 (JCX-1-19) (Jan. 2, 2019).

[11] *See* T.D. 9882, 84 Fed. Reg. 69022, 69048 (Dec. 17, 2019); Notice of Proposed Rulemaking ("**NPRM**"), 83 Fed. Reg. 63200, 29319 (Dec. 7, 2018).

[12] Specifically, under sections 954(b)(5) and 951A(c)(2)(ii), the creditable foreign tax reduces the foreign corporation's foreign base company income (which includes FPHCI) and tested income, respectively.

[13] *See* Joint Committee on Taxation, *General Explanation of Public Law No. 115–97* (JCS–1–18), at 394 n.1784 (December 2018) (the "JCT Technical Explanation").

Corrections Discussion Draft") "that are needed to properly reflect the original Congressional intent or that provide clarifications consistent with such intent."[14] The Technical Corrections Discussion Draft proposed to strike the reference to section 960(b) in section 78 "to clarify that foreign tax credits taken by reason of withholding tax imposed on a distribution of PTEP do not result in an additional section 78 gross-up."[15]

In addition, in the preamble to the final foreign tax credit regulations released on December 17, 2019,[16] the IRS and Treasury acknowledged that requiring a section 78 gross-up with respect to taxes deemed paid on distributions of PTEP under section 960(b) does not serve the purpose of section 78:

> Section 960(b) addresses taxes deemed paid on distributions of previously taxed earnings and profits. Before the TCJA, section 78 did not reference former section 960(a)(3), which at the time addressed taxes deemed paid on distributions of previously taxed earnings and profits. This is consistent with the purpose of the section 78 dividend, which is to ensure that a U.S. shareholder cannot effectively both deduct and credit the foreign taxes paid by a foreign subsidiary that are deemed paid by the U.S. shareholder. However, there is no deduction taken into account by the U.S. shareholder for U.S. tax purposes with respect to taxes deemed paid under either former section 960(a)(3) or section 960(b) that would need to be reversed by section 78.[17]

Conclusion/Recommendation

Section 78, as amended by the TCJA, references section 960(b); however, there is no policy justification for this rule. Specifically, PTEP distributions are excluded from the gross income of a U.S. shareholder. Consequently, there is no deduction available to a U.S. shareholder for U.S. tax purposes with respect to taxes deemed paid under section 960(b) that would need to be grossed-up by section 78.

[14] Tax Technical and Clerical Corrections Act, Discussion Draft, 115th Cong. 2nd Sess. (Jan. 2, 2019).
[15] *See* Tax Technical and Clerical Corrections Act, Discussion Draft, 115th Cong. 2nd Sess., § 14301 (Jan. 2, 2019); *see also* Staff of the Jt. Comm. on Technical Explanation of the House Ways and Means Committee Chairman's discussion draft of the "Tax Technical and Clerical Corrections Act.", at 16 (JCX-1-19) (Jan. 2, 2019).
[16] T.D. 9882, 84 Fed. Reg. 69022 (Dec. 17, 2019). The proposed foreign tax credit regulations were published on December 7, 2018 (the "2018 Proposed FTC Regulations"). *See* NPRM, 83 Fed. Reg. 63200 (Dec. 7, 2018). Treas. Reg. § 1.78-1 was finalized before the issuance of the 2019 Final FTC Regulations, as part of the Treasury Decision published in the Federal register on June 21, 2019. *See* T.D. 9866, 84 Fed. Reg. 29288 (June 21, 2019).
[17] T.D. 9882, 84 Fed. Reg. 69022, 69048 (Dec. 17, 2019) (internal citations omitted).