



Summary of 2021 Final Foreign Tax Credit Regulations

January 2022

2021 final foreign tax credit regulations

Key provisions

On December 28, 2021, Treasury and the IRS issued final foreign tax credit regulations. The official version was published in the Federal Register on January 4, 2022. The final regulations relate to the following:

- Disallowance of foreign taxes under section 245A(d) (Treas. Reg. § 1.245A(d)-1)
- Foreign section 381 transactions (Treas. Reg. § 1.367(b)-4 and -7)
- CFC netting rule for CFC-to-CFC loans (Treas. Reg. § 1.861-10(e))
- Allocation and apportionment of foreign income taxes (Treas. Reg. § 1.861-20)
- Definition of a foreign income tax and in lieu of tax (Treas. Reg. §§ 1.901-1, -2, -3)
- Noncompulsory payments of foreign tax (Treas. Reg. § 1.901-2(e))
- Technical taxpayer rules (e.g., mid-year transfers, reorganizations and entity termination transactions) (Treas. Reg. § 1.901-2(f))
- Updates to foreign branch income rules (Treas. Reg. § 1.904-4(f))
- Miscellaneous foreign tax credit rules (Treas. Reg. § 1.905-1)

Provisions not included in the 2021 final regulations

- Election to capitalize certain R&E expenditures (Treas. Reg. § 1.861-9(k))
- Allocation and apportionment of interest paid by foreign banking branches (Treas. Reg. § 1.861-10(g))
- Financial services income and entities (Treas. Reg. § 1.904-4(e))

Final foreign tax credit regulations (TD 9959)

Effective dates

Effective date	Provision
Generally applicable to taxable years, or foreign income taxes paid or accrued in taxable years, beginning on or after December 28, 2021	
<u>Exceptions:</u>	
Rules relating to the creditability of the Puerto Rican excise tax do not apply until taxable years beginning on or after January 1, 2023	§ 1.901-2
Rules regarding the source of income inclusions under sections 951, 951A, and 1293 and associated section 78 dividends applicable to taxable years ending on or after November 2, 2020	§ 1.861-3(d)
Rules excluding loans between CFCs from related group indebtedness for purposes of the CFC netting rule apply to taxable years <u>ending on or after November 2, 2020</u>	§ 1.861-10(e)
Pre-effective date years included in the foreign base period ratio must be adjusted	
Rules regarding the allocation and apportionment of foreign income taxes for certain transactions and payments (e.g., dispositions of stock, certain transactions involving partnerships, and disregarded payments) are effective for tax years <u>beginning after December 31, 2019</u> and ending on or after November 2, 2020	§ 1.861-20
Rules disallowing a deduction or credit for foreign income taxes related to certain distributions and dispositions are effective for taxable years of a foreign corporation <u>beginning after December 31, 2019</u> and ending on or after November 2, 2020, and to taxable years of U.S. shareholders in or with which such taxable years of the foreign corporation ends	§ 1.245A(d)-1
Modifications to the rules regarding the determination of foreign branch income and taxes attributable to foreign branch income are generally effective for taxable years <u>beginning after December 31, 2019</u> , and end on or after November 2, 2020	§ 1.904-4(f) § 1.904-6(b)
Removal of references to repealed section 902 and minor modifications of ownership requirements in certain foreign 381 transactions apply to taxable years <u>ending on or after November 2, 2020</u>	§ 1.367(b)-4 § 1.367(b)-7

Final foreign tax credit regulations (TD 9959)

Final foreign tax credit regulations (TD 9959)

Treas. Reg. § 1.901-1
Allowance of Credit for
Foreign Income Taxes

- Generally finalized as proposed
- Effective for foreign taxes paid or accrued in taxable years beginning on or after December 28, 2021
- Notable provision: Under new Treas. Reg. § 1.901-1(d), a taxpayer can change from deduction to credit within the 10-year statute of limitations in section 6511(d)(3), but can only change from credit to deduction within the 3-year statute of limitations in section 6511(a).

Treas. Reg. § 1.901-2
Income, War Profits, or
Excess Profits Tax Paid or
Accrued

- Proposed regulations finalized with some substantive changes
- Generally effective for foreign taxes paid in taxable years beginning on or after December 28, 2021 (but see special rule for Puerto Rico excise tax)
- Under 1983 final regulations, a foreign levy was creditable if it was a tax and had the predominant character of an income tax, meaning that it was designed to reach net gain in the normal circumstances in which it applied. Net gain requirement had 3 sub-requirements: realization, gross receipts and net income.
- 2021 final regulations limit ability to use empirical evidence and instead focus on specific terms of foreign law. Net gain requirement now has 4 sub-requirements: realization, gross receipts, cost recovery, and attribution.
- Treas. Reg. § 1.901-2(a)(2)(iii) added to address coordination with income tax treaties:
 - If a US taxpayer pays a foreign levy that is an income tax under a treaty and elects the benefits of the treaty, the tax is a creditable foreign income tax and no need to apply regulations.
 - Regulation makes clear that payments from one CFC to another do not qualify for benefits under a U.S. income tax treaty, so taxes imposed on those payments must meet requirements of the regulations.
- Realization and gross receipts requirements largely unchanged. See Treas. Reg. § 1.901-2(b)(2) and (3)

Final foreign tax credit regulations (TD 9959)

Final foreign tax credit regulations (TD 9959)

- Cost Recovery requirement (Treas. Reg. § 1.901-2(b)(4)):
 - Taxpayers must be able to recover all significant costs and expenses attributable to foreign gross receipts. Certain expenses (as characterized under foreign law) are per se significant and if disallowed as deductions, a tax cannot meet the cost recovery requirement (capital expenditures, interest, rents, royalties, payments for services, and R&E).
 - Final regulations backtrack from proposed regulations rule that would have provided that a foreign tax imposed based on gross receipts or gross income can never satisfy the cost recovery requirement, even if in practice there are few costs and expenses attributable to the gross receipts included in the foreign tax base. Instead, generally revert to 1983 final regulations and provide that in limited cases a foreign gross receipts tax can satisfy the cost recovery requirement, e.g., no significant costs and expenses attributable to foreign gross receipts included in the foreign tax base.
 - Final regulations also backtrack from proposed regulations and allow a tax to meet the cost recovery requirement if a deduction or expense is disallowed but an alternative cost allowance is provided under foreign law that results in the recovery of an amount that may be greater, but never less than, the actual amount of significant costs and expense.
- Attribution Requirement (Treas. Reg. § 1.901-2(b)(5)) (the jurisdictional nexus requirement under the proposed regulations):
 - Rule provides limits on the scope of gross receipts and costs that are attributable to a taxpayer's activities and thus appropriately included in the foreign tax base for purposes of applying the other components of the net gain requirement, i.e. overlay U.S. law principles.
 - Retains the activities, source of income and property tests from the proposed regulation's jurisdictional nexus requirement with a few clarifications/modifications:
 - Activities test provides that tax must be imposed based on gross receipts attributable to activities in the country under U.S. ECI principles. Reasonable attribution principles under foreign law do not include "rules that deem the existence of a trade or business or [PE] based on the activities of another, or that attribute gross receipts or costs to a nonresident based upon the activities of another person."
 - Source test provides that tax must be imposed on income from sources within the foreign country, determined under rules reasonably similar to U.S. rules. The character of gross income is determined under foreign law, but the rules for sourcing that income must be similar to U.S. rules.
 - Property test clarifies that the rule applies to sales of stock or a partnership interest, and expressly requires that foreign law provide rules reasonably similar to the section 897 rules applicable to dispositions of real property

Treas. Reg. § 1.901-2
Income, War Profits, or
Excess Profits Tax Paid or
Accrued

Final foreign tax credit regulations (TD 9959)

Final foreign tax credit regulations (TD 9959)

Amount of tax that is creditable (Treas. Reg. § 1.901-2(e)):

Treas. Reg. § 1.901-2
Income, War Profits, or
Excess Profits Tax Paid or
Accrued

- Treas. Reg. § 1.901-2(e)(2)(ii) finalizes the proposed rule treating a credit as reducing foreign income tax liability regardless of whether the credit is refundable to the extent it exceeds income tax liability. This rule also applies to credits that are transferred from one taxpayer to another.
- Treas. Reg. § 1.901-2(e)(2)(iii), however, (in a change from the proposed regulations) provides a limited exception for refundable tax credits that may be treated as a means of paying, rather than reducing, a foreign income tax liability. This exception would apply if the taxpayer has the option of receiving the full amount of the credit in cash, rather than just the portion that exceeds foreign income tax liability.
- Treas. Reg. § 1.901-2(e)(5) (noncompulsory payments). Final regulations clarify that
 - In general, the final regulation applies on a taxpayer-by-taxpayer basis, but decision to join in a foreign consolidation or group relief regime does not make a payment noncompulsory. Exception for foreign law hybrid mismatch rules (which increase one person's foreign income tax liability and reduce another person's foreign income tax liability). A hybrid mismatch rule under foreign law means a rule substantially similar to section 245A(e) and section 267A.
 - If taxpayer has an option to pay tax under more than one regime, each of which is creditable, it must choose the one that results in least tax

Treas. Reg. § 1.903-1
Taxes in Lieu of Income
Taxes

- Generally finalized as proposed
- To be creditable under section 903, a foreign levy must be a tax, and also must (1) satisfy the attribution requirement (formerly jurisdictional nexus), (2) taxpayer must show that the foreign country made a "deliberate and cognizant choice to impose the in lieu of tax instead of a net income tax," and (3) the imposition of the in lieu of tax must bear a close connection to the failure to impose the net income tax.
- Effective for foreign taxes paid in taxable years beginning on or after December 28, 2021

Treas. Reg. § 1.904-4(f)
Foreign Branch Income

- Changes finalized as proposed

Final foreign tax credit regulations (TD 9959)

Final foreign tax credit regulations (TD 9959)

Treas. Reg. § 1.904-6
Allocation and
Apportionment of
Foreign Income Taxes

- Finalized as proposed
- Generally effective for taxable years beginning after December 31, 2019. Paragraph (b)(2) (disregarded payment rules) effective for taxable years beginning after December 31, 2019 and ending on or after November 2, 2020

Treas. Reg. § 1.905-1
When Credit for Foreign
Income Taxes May Be
Taken

- Generally finalized as proposed
- Effective for foreign taxes paid in taxable years beginning on or after December 28, 2021. The election to claim a provisional credit for contested taxes may be made with respect to amounts of contested tax that are remitted in taxable years beginning on or after December 28, 2021 and that relate to a taxable year beginning before December 28, 2021 (amended return required).
- Notable final rules:
 - Provisional credit may be claimed for foreign taxes that are paid and then contested, but must comply with specified requirements, including annual certification requirement and agreement to not assert a statute of limitations defense if IRS asserts remedies not exhausted and tax is noncompulsory payment
 - A change from an improper method of accruing foreign taxes is a change in method of accounting and Form 3115 must be filed. Change is not an automatic change. Improper methods of accruing foreign taxes include:
 - Accrual in a taxable year other than the year in which the all events test is met (e.g., accrual method taxpayer claims credits on paid basis) and failure to apply the relation back rule of section 905(c), but does not include corrections to estimated accruals.
 - Modified cut off rule in Rev. Proc. 2015-13 applies (no section 481(a) adjustments)
 - Credit for foreign income taxes imposed on blocked income is allowed proportionately in any subsequent year in which such amount or portion thereof is includible in gross income of a taxpayer

Final foreign tax credit regulations (TD 9959)

Final foreign tax credit regulations (TD 9959)

Treas. Reg. § 1.905-3
Adjustments to US Tax
Liability and to Current
Earnings and Profits as a
Result of a Foreign Tax
Redetermination

- Proposed regulation finalized without change
- Effective for foreign tax redeterminations that occur in taxable years beginning on or after December 28, 2021

Treas. Reg. § 1.164-2
Deduction Denied in
Case of Certain Taxes

- Finalized as proposed
- Effective for taxable years beginning on or after December 28, 2021

Treas. Reg. § 1.960-1
through Treas. Reg. §
1.960-7 (Related to
Deemed Paid Credits)

- Finalized as proposed
- Effective for taxable years of foreign corporations beginning on or after December 28, 2021, and to each taxable year of a domestic corporation that is a United States shareholder of the foreign corporation in which or with which such taxable year of such foreign corporation ends

Treas. Reg. § 1.861-3
Source of Section 78
Dividends associated
with Inclusions under
Sections 951, 951A, and
1293

- Finalized as proposed.
- For sourcing purposes, the amount included in gross income of a United States person under sections 951, 951A, and 1293 and the associated section 78 dividend for the taxable year with respect to a foreign corporation are treated as dividends received directly by the United States person from the foreign corporation that generated the inclusion. See section 904(h) and § 1.904-5(m) for rules concerning the resourcing of inclusions under sections 951, 951A, and 1293.
- Effective for taxable years ending on or after November 2, 2020

Final foreign tax credit regulations (TD 9959)

Final foreign tax credit regulations (TD 9959)

Treas. Reg. § 1.861-8
Computation of Taxable
Income from Sources
within the United States
and from Other Sources
and Activities

- Proposed rules generally finalized without change, except proposed advertising and research and development expense rules not finalized
- Effective for taxable years ending on or after November 2, 2020

Treas. Reg. § 1.861-9
Allocation and
Apportionment of
Interest Expense and
Rules for Asset-Based
Apportionment

- Finalized without change, but added clarification that statutory and residual groupings of income that an asset generates is determined after taking into account Treas. Reg. § 1.904-4(f)(2)(vi) reallocation rules
- Effective for taxable years beginning on or after December 28, 2021

Treas. Reg. § 1.861-10
Special Allocations of
Interest Expense

- Effective for taxable years ending on or after November 2, 2020, loans between CFCs are not related group indebtedness (see Treas. Reg. § 1.861-10(e)(8)(v))
- Foreign banking branch rule not finalized
- Finalizes rule for indebtedness of regulated utilities without change, effective for taxable years beginning on or after December 28, 2021

Treas. Reg. § 1.861-14
Special Rules for
Allocating and
Apportioning Certain
Expenses of an Affiliated
Group of Corporations

- Section 818(f) rules (related to life insurance companies) finalized without change and effective for taxable years beginning on or after December 28, 2021

Final foreign tax credit regulations (TD 9959)

Final foreign tax credit regulations (TD 9959)

Treas. Reg. § 1.861-20
Allocation and
Apportionment of
Foreign Income Taxes

- Finalized with limited substantive changes
- Generally effective for taxable years beginning after December 31, 2019 and ending on or after November 2, 2020. New rule for section 903 taxes effective for taxable years beginning on or after December 28, 2021.
- Notable changes:
 - Simplifies definitions of remittances and contributions
 - Revises remittance rules to clarify that assets of a taxable unit include not only its own assets and stock but also the taxable unit's pro rata share of the assets of another taxable unit (other than a corporation or a partnership), including the portion of any reattribution assets assigned to the other taxable unit, in which it owns an interest.
 - Where a taxable unit owns an interest in a taxable unit that is a partnership, the assets of the taxable unit that is the owner include its interest in the partnership or its pro rata share of the partnership assets, as applicable, determined under the principles of Treas. Reg. § 1.861-9(e).
 - Adds definition of foreign gross income included by reason of U.S. equity hybrid instrument ownership. Accrual of income under foreign law or foreign gross income included by reason of a payment of interest under foreign law considered to arise from the same transaction or realization even as a foreign law distribution under Treas. Reg. § 1.861-20(d)(3)(i) or Treas. Reg. § 1.861-20(d)(3)(ii).

Final foreign tax credit regulations (TD 9959)

Final foreign tax credit regulations (TD 9959)

Treas. Reg. § 1.245A(d)-1
Disallowance of Foreign
Tax Credit or Deduction

- Effective for taxable years of a foreign corporation that begin after December 31, 2019, and end on or after November 2, 2020, and with respect to a United States person, taxable years in which or with which such taxable years of the foreign corporation end
- General rule – No foreign tax credit or deduction allowed for the following foreign taxes:
 - Foreign income taxes paid or accrued by a domestic corporation, a successor to a domestic corporation, or a foreign corporation to the extent such taxes are attributable to “section 245A(d) income” or “non-inclusion income” of a foreign corporation
 - With respect to a domestic corporation, generally includes a dividend (including a section 1248 dividend and a dividend received indirectly through a pass-through entity) or an inclusion under section 951(a)(1)(A) for which a deduction under section 245A(a) is allowed, a distribution of section 245A(d) PTEP, a hybrid dividend, or an inclusion by reason of a tiered hybrid dividend
 - Foreign taxes disallowed as credit or deduction at U.S. level still reduce foreign corporation’s E&P
- Attribution of foreign income taxes:
 - Taxes are attributable to section 245A(d) income or non-inclusion income to the extent they are allocated and apportioned under Treas. Reg. § 1.861-20 to the relevant income group.
 - Special rule for taxes on remittances, U.S. return of capital amount, and U.S. return of partnership basis amount based on characterization of CFC stock, and special rule for foreign taxes on income of a reverse hybrid or foreign law CFC
- An item that qualifies for the deduction under section 245A(a) is considered section 245A(d) income regardless of whether the domestic corporation claims the deduction on its return with respect to the item.
- Anti-avoidance rule: foreign income taxes are treated as attributable to section 245A(d) income of a domestic corporation or foreign corporation, or non-inclusion income of a foreign corporation, if a transaction, series of related transactions, or arrangement is undertaken with a principal purpose of avoiding the purposes of section 245A(d) and Treas. Reg. § 1.245A(d)-1 with respect to such foreign income taxes



This presentation contains general information only and Deloitte is not, by means of this presentation, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This presentation is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte shall not be responsible for any loss sustained by any person who relies on this presentation.

As used in this document, "Deloitte" means Deloitte Tax LLP, a subsidiary of Deloitte LLP. Please see www.deloitte.com/us/about for a detailed description of our legal structure. Certain services may not be available to attest clients under the rules and regulations of public accounting.

Copyright © 2022 Deloitte Development LLC. All rights reserved.