Feedback for REG-101657-20: Guidance Related to the Foreign Tax Credit (FTC); Clarification of Foreign-Derived Intangible

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Prop. Regs. §1.861-9[1]	**Allocation and apportionment of interest expense and rules for asset-based apportionment**			
Prop. Regs. §1.861-9(k)	**Election to capitalize certain expenses in determining tax book value of assets**	Applicability date and treatment of advertising costs	The Chamber recommends: 1. Allowing taxpayers to rely on proposed regs retroactively to tax years beginning after December 31, 2017, and; 2. Treating advertising costs as eligible in full for capitalization and amortization. 3. Allowing independent elections for R&E and advertising expenses	The treatment of R&E as a capitalized expenditure is consistent with the rules contained in §174 for tax years beginning after 2021. As the proposed regulations may not be relied upon until finalized, it is likely that the treatment of R&E as capitalized under Prop. Regs. §1.861-9(k) is limited in effect, as such expenses will require capitalization under §174 regardless of the proposed regulations. Nonetheless, the economic value associated with R&E identified by the proposed regulations exists in tax years prior to the likely finalization date of the proposed regulations. Accordingly, we recommend the final regulations allow taxpayers to rely on the proposed regulations retroactively to tax years beginning after the enactment of the TCJA (i.e., years beginning after December 31, 2017). In the same way that the value generated by R&E expenses is inherently integrated with a product or service, goodwill and name recognition generated by advertising expenses are equally integrated in the value of such product or service. Accordingly, creating a 50% limitation with respect to the capitalization of advertising expenses inherently treats the economic value of advertising as lesser or distinct from those of R&E costs. We believe this treatment is inappropriate as the economic value generated by advertising expenditures is equally integrated with the

[1] Unless otherwise noted, all section references are to the Internal Revenue Code of 1986, as amended, and the regulations promulgated thereunder.

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				underlying product or service as R&E expenses. Moreover, we believe it is inappropriate to rationalize a rule based on a 2014 legislative proposal that was not included in either the House or Senate version of TCJA. Accordingly, we recommend removing the 50% limitation with respect to advertising expenses and allowing the election to apply consistently for both R&E and advertising expenses. Notwithstanding the comments in (2) above, it would be beneficial from a tax administration standpoint to provide for separate elections to capitalize and amortize R&E and advertising expenses. Reducing the burden on both tax administrators and taxpayers, particularly with respect to de minimis amounts of either R&E or advertising expenses that otherwise would need to be taken into account for these purposes, by allowing for separate elections would be in the interest of all parties.
Prop. Regs. §1.861-20	**Allocation and apportionment of foreign income taxes**			
Prop. Regs. §1.861-20(d)	**Assigning items of foreign gross income to the statutory and residual groupings**	Unnecessary compliance burden	Do not require additional tracking of E&P accounts	Treasury requested comments regarding whether taxpayers should, as part of Prop. Regs. §1.861-20(d), maintain separate E&P accounts with annual adjustments to reflect transactions that occurred under foreign law but not under federal income tax law. Between the anti-abuse rule and cross-references to Regs. §1.861-20 contained in Prop. Regs. §1.245A(d)-1, Treasury has adequately addressed foreign law transactions that could be used to circumvent the purposes of §245A(d). Taxpayers are currently required (outside of Regs. §1.861-20(d)) to demonstrate the availability of foreign tax credits. Members do not believe that additional tracking and reporting is necessary for purposes of ensuring compliance with §245A(d).

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				Accordingly, no revisions to Prop. Regs. §1.861-20(d) are recommended.
		Use of tax book value/interest expense apportionment rules to characterize remittances creates inappropriate results	Remittances should be characterized proportionately to the earnings of the taxable unit making the remittance.	When a taxable unit is an operating subsidiary that sells to customers, it accumulates cash and accounts receivable (A/R) throughout the year. The income would be considered general category income upon receipt by the taxable unit. However, when a remittance is made to the CFC-owner of the taxable unit, the remittance is not characterized by the type of income earned by the taxable unit. Instead, it looks to the tax book value of the taxable unit's assets. Many operating entities have few assets besides cash and A/R. Cash and A/R may be considered passive assets for the purposes of interest expense apportionment because they either generate interest income or have no identifiable yield even though they were derived directly from an active trade or business. Use of tax basis for the taxable unit may, therefore, result in distortions in the apportionment of the remittance between general and passive.
Prop. Regs. §1.901-2	**Income, war profits or excess profits tax paid or accrued**			
Prop. Regs. §1.901-2(a)	**Definition of foreign income tax**	Elimination of the "predominant character" test	The predominant character test should be retained as its elimination would frustrate the purpose of §901 and will likely create numerous instances of double taxation	The primary objective of §901 is to avoid double taxation. Double taxation arises whenever income is subject to two income taxes, not only when foreign income tax rules differ from U.S. income tax rules. This is historically why the current regulations and case law refer to the "predominant character" of a tax. Eliminating the predominant character test eliminates the flexibility necessary to recognize that a country's tax system is not a fixed concept but is subject to continuous change over time.

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				In many cases, what constitutes gross income and deductions in the U.S. system is a reflection of the evolving political priorities and views of Congress, not necessarily what constitutes best tax policy practices. If Treasury's goal is "to simplify and clarify the application of the rules," the elimination of the predominant character tests runs counter to this goal. Foreign levies will operate as an income tax under the proposed regulations for some taxpayer classes, but not for others, forcing all taxpayers to analyze foreign taxes for the peculiarities of their respective industry. Rather than determine whether a foreign levy applies to net income in the normal instance, the proposed regulations require separate determinations for each class of taxpayers for which the application of the foreign levy results in a significantly different tax base. Each such levy must then be tested against a similarly situated class under the U.S. rules. The foreign levy is considered an income tax only if the foreign tax rules conform in detail to U.S. tax rules with respect to such taxpayer class. For this reason, providing a broader definition of a separate levy under Prop. Regs. §1.901-2(d)(1) in order to allow the evaluation of a tax on a separate basis with respect to a specific class of taxpayers does not mitigate the harm done by the elimination of the more flexible predominant character approach. These determinations would be both fact intensive and nuanced: Fact intensive because all deviations from the "pure" income tax system of the Internal Revenue Code ("Code") will have to be identified and nuanced because some deviations will create a separate class of taxpayers (and therefore a separate levy) while other deviations would simply have to be weighed for significance. Additionally, because neither the U.S. tax system nor foreign tax systems are static, these assessments would have to be done on an annual basis to determine whether even small changes to either system

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				render a previously creditable tax non-creditable (or vice versa). The practical impact will be the government (and taxpayers) will have to undertake much more frequent assessments on the credibility of foreign taxes due to the ever-evolving nature of U.S. and foreign tax rules. The elimination of the predominant character test also prioritizes form over substance, contrary to the fundamental principle emphasized by both the IRS and courts when evaluating the appropriate tax treatment of transactions. The Supreme Court has also found that the substantive effects of a tax should be considered when determining whether a tax constitutes a foreign income tax (*See PPL Corp. v. Commissioner*, 569 U.S. 329, 331 (2013) ("Consistent with precedent and the Tax Court's analysis below, we apply the predominant character test using a commonsense approach that considers the substantive effect of the tax.").
Prop. Regs. §1.901-2(b)	**Net gain requirement**	Overly restricts creditability	Eliminate requirements limiting creditability to foreign tax regimes which are more consistent with U.S. tax principles than current regulations require	As the United States generally imposes tax on a U.S. tax resident's "worldwide" income, the FTC regime provides relief from double taxation. A U.S. person is subject to double taxation when income from foreign sources is taxed both by the United States and by the foreign country in which the income is earned. By imposing significant new limitations on a taxpayer's ability to claim FTCs, the proposed regulations would dramatically increase instances of double taxation (a result that is inconsistent with the fundamental purpose of §901) and harm the global competitiveness of U.S.-based multinational corporations. Section 901 provides for the allowance of a FTC for foreign income, war profits and excess profits taxes. However, §901 does not require foreign income tax laws to be more strictly consistent with the Code than the current regulations in order for an FTC to be allowed. If the proposed

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				regulations are finalized, the wide spectrum and sophistication of tax laws globally would create tremendous uncertainties regarding whether foreign levies paid may be claimed as a FTC. Certain foreign jurisdictions choose to protect their tax base through relatively simple tax regimes that are easier to administer than more complex tax regimes. Provisions like the disallowance of recovery of certain costs, which are intended to protect a foreign jurisdiction's tax base, should not cause a foreign tax levy to fail to qualify for a U.S. FTC. Similarly, the Code protects the U.S. tax base by providing for a complete disallowance of certain fines and penalties under §162(f). Overly restrictive new rules for claiming a FTC is inconsistent with the fundamental purpose of avoiding double taxation. Current regulations provide an appropriate balance. The current regulations require that the predominant character of a foreign tax be that of an income tax in the U.S. sense, and define the term income tax by reference to whether the foreign tax is "likely to reach net gain in the normal circumstances in which it applies," and then apply the net gain requirement by referring to whether the foreign tax satisfies the realization, gross receipts, and net income requirements, "judged on the basis of its predominant character." Each of those detailed requirements in turn reiterates the predominant character standard, and in fact each rule does so multiple times. In fact, the current §1.901-2 regulations refer to the predominant character of a foreign tax a total of 13 times. The regulation's incorporation of 13 separate references to the predominant character of a foreign tax reflects guidance repeatedly provided by the Supreme Court and federal circuit courts of appeal requiring that the creditability of a foreign tax be determined on the basis of its substantive resemblance to an income tax in the U.S. sense (*See, e.g., Biddle v. Commissioner*, 302 U.S. 573, 579

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				(1938) ("whether the stockholder pays the tax within the meaning of our own statute . . . must ultimately be determined by ascertaining from an examination . . . whether it is the substantial equivalent of payment of the tax as those terms are used in our own statute"); *Keasbey & Mattison Co. v. Rothensies*, 132 F.2d 894, 897 (3d Cir. 1943) (holding that to be creditable, tax must "confirm[] [sic] in its substantive elements to the criteria established under our revenue laws"). Finally, changing the standard from a review of the "normal circumstances" in which a tax applies to "solely on the basis of the foreign law governing the calculation" creates a more rigid standard in analyzing whether a foreign law meets the proposed narrowed definition of a "foreign income tax" and likely will lead to double taxation.
		Gross receipts requirement	Retain "alternative gross receipts test" within existing regulations	The current regulations permit gross receipts to be "computed under a method that is likely to produce an amount that is not greater than fair market value." The proposed rule, which eliminates alternative measures of gross receipts, proves problematic in three specifics ways. First, it seeks to deny the credibility of foreign taxes based upon minor differences from the U.S. measure of gross receipts even if those differences result in a tax demonstrably imposed on income. Second, by rejecting estimated measures of gross receipts based on costs, it contradicts the very same regulation's recognition of cost-plus transfer pricing rules, apparently relying on a logically indefensible distinction between transfer pricing rules and rules measuring gross receipts. Third, the proposal ignores relevant regulatory history, and would effectively reverse judicial interpretations of the statute. Considering the related elimination of the predominant character tests, the proposed gross receipts rule would deny credits on the basis that a mere

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				possibility exists the foreign tax could ultimately depart in any significant way from the base under the U.S. law even if it is unlikely. This departure ignores many years of case law emphasizing the substance of a foreign tax determines its credibility and would violate the limited purpose for mitigation of double taxation set forth in the preamble. Especially confusing is the way in which the proposed regulations treatment of gross receipts contradicts the same regulation's treatment of cost-based transfer pricing measures of gross income. The preamble states that an alternative measure of gross receipts that requires those receipts be calculated by applying a markup to costs fundamentally diverges from the measure of gross receipts under the Code. However, the preamble also then says that the proposed rule, which eliminates alternative measures of gross receipts, "is not intended to implicate the allocation of gross income under transfer pricing or branch profit attribution rules." The practical outcome of this is that taxpayers using a cost-plus transfer pricing methodology will be treated as having realized actual gross receipts while a taxpayer using a measurement of gross receipts based upon costs (even if the taxpayer can show that such method is likely to produce an amount that is not greater than fair market value) will not. There is no logical reconciliation of these two statements. For example, a U.S. corporation has two affiliates, one in a country that uses a costs method (computed under a method that is likely to produce an amount that is not greater than fair market value), and one that uses a cost-plus methodology for determining income identical to the U.S. transfer pricing rules. If the affiliates conduct the exact same operations, incur the exact same costs, and pay foreign tax in each jurisdiction (assuming that they have the same tax rates), the taxes of one subsidiary will be fully creditable and the other will not.

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				Because the current regulations already provide an appropriate safeguard, foreign income taxes based on alternative measurements of gross receipts should continue to be creditable (so long as the taxpayer could show that they are likely to produce an amount not greater than fair market value, as required under the current regulations). If a foreign jurisdiction imposes a deemed income tax based on a markup to costs, such income taxes should still be creditable (subject to the safeguards under the current regulations). The foreign country is merely protecting their tax base through an easily administrable tax. U.S. transfer pricing rules provide certain safe harbors (e.g., services cost method) that are meant to limit controversy and ease administrability. When foreign taxing jurisdictions make similar policy decisions, the resulting levies should be eligible to be claimed as an FTC. The proposed regulations will result in significant controversy due to the lack of clarity on where the line is drawn between gross receipts that do not meet the test vs. transfer pricing measures of gross income that meet the test. The existing regulations strike an appropriate balance on this question and should be retained.
		Cost recovery requirement	Existing "alternative allowance rule" should be retained.	Proposed regulations would require costs or expenses related to capital expenditures, interest, rents, royalties, services, and research and experimentation to generally be fully deductible in order to meet the cost recovery requirement. The U.S. worldwide tax system operates through a FTC regime whereby U.S.-based multinational corporations generally only owe a residual U.S. income tax on foreign-source income subject to a foreign income tax less than 21%. Most foreign tax regimes generally operate through a participation exemption system whereby foreign-based multinationals

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				generally never owe a residual tax in their home country with respect to earnings from operations outside of their home country. Thus, when the local income tax rate is greater than 21%, U.S.-based multinationals subject to the U.S. FTC regime compete on equal footing with foreign-based competitors subject to participation exemption regimes (presumably, both are subject to the same host country taxes, subject to applicable tax treaties). Removing the FTC with respect to foreign income taxes that do not adequately conform to U.S. tax principles places U.S. multinationals at a competitive disadvantage in jurisdictions imposing rates of tax in excess of the U.S. statutory rate. Once again, the proposed regulations limit creditability for tax regimes that do not comport to the Code. Foreign levies should continue to be eligible to be claimed as a FTC even if the foreign taxing regimes have limitations on the allowance of deductions for interest, rents, royalties, etc. The regulations do allow for disallowances of these items to the extent "consistent with the types of disallowances required" by the Code. This creates significant uncertainty for taxpayers and requires an ongoing evaluation of creditability based on changes to U.S. and foreign disallowances. Further, it is unclear in the proposed regulations where a foreign government disallows a "significant cost or expense" under public policy considerations, whether such policy considerations need to be consistent with U.S. policy goals or simply justified in a manner similar to the U.S. justification for its own goals in various provisions of §162 (i.e., the encouragement or discouragement of certain behaviors of taxpayers). While the preamble purports that the "alternative allowance rule" is unduly burdensome, it has operated for decades, and the proposed regulations provide for new uncertainties and new burdens that are potentially greater. The "alternative

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				allowance rule" which provides for allowances that effectively compensate for nonrecovery struck an appropriate balance between determining which foreign taxes were creditable income taxes and which foreign taxes were not (i.e., property taxes, sales taxes, etc.). Compounding these concerns is the lack of clear guidance on how the proposed cost-recovery rules should be applied. Examples 1 through 5 are not helpful in this regard. Three of the five examples involve situations where no deductions are allowed (therefore, the cost recovery requirement was not met) and the remaining two involve situations where it is assumed that the deductions allowed under the foreign tax rules satisfy the standard of "significant costs and expenses attributable to the gross receipts," other than other income taxes (therefore, the cost recovery requirement was met). We encourage Treasury and the IRS to provide more clarity, including providing examples, how the cost-recovery requirement is applied. U.S. taxpayers should not be subjected to double taxation as a result of foreign taxing regimes making decisions intended to protect their local tax base. Congress has enacted various limitation and disallowance regimes to restrict tax benefits for business expenses due to various policy reasons. Disallowing FTCs when a foreign country similarly incorporates various disallowance and limitation regimes based on their own policy goals would have the effect of punishing U.S. taxpayers that have no control over such policy decisions, subjecting them to double taxation. The alternative allowance rule provides for allowances that effectively compensate for nonrecovery while not requiring foreign law conform to U.S. tax principles in order to reach creditability. The treatment of interest under the Code provides an illustrative example. The Code provides for many limitations on

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				the deductibility of interest. The proposed regulations reference the limitations under §§163(j) and 267A. However, interest and interest equivalents are <u>entirely</u> disregarded for purposes of allocating income between a foreign branch and a foreign branch owner (see Regs. §1.904-4(f)(2)(vi)(C)) because, as the preamble to the proposed 2018 regulations states, disregarded interest payments reflect a shift of, or return on, capital. The U.S. rules provide myriad restrictions on interest and, in certain circumstances, recognize that there are situations where interest should not be treated as a deductible cost. If a foreign jurisdiction similarly views interest payments as a return on capital, and therefore prohibits deductions in some or most circumstances, such foreign jurisdiction's income tax would no longer be creditable, even for taxpayers who make no non-deductible interest payments. Foreign levies should not become non-creditable simply because more restrictive limitations on interest deductibility (or rents, services, etc.) are imposed based on such jurisdiction's base protecting policies. For example, it is unclear whether a complete prohibition on deducting related-party interest expense would prevent a foreign income tax from being creditable (even if no related-party interest were paid). Such an exclusion would undermine the FTC regime's policy goal of providing relief from double taxation. The overbroad FTC disallowance rules under the proposed regulations should not be maintained. Otherwise, double taxation for U.S.-based multinationals is an unavoidable, irrational outcome of the stringent cost recovery rules under the proposed regulations. The U.S. government continues to maintain residency-based taxation, subjecting income from

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				foreign sources to U.S. federal income tax. It is therefore imperative for the U.S. tax rules to maintain the FTC regime as described in the existing FTC regulations that were finalized in 1983 to avoid U.S. multinationals from being subjected to double taxation.
		Overly formalistic alternative allowance rule	Existing "alternative allowance rule" should be retained.	The proposed regulations provide that "foreign tax law that does not permit recovery of one or more significant costs or expenses does not meet the cost recovery requirement, even if it provides alternative allowances that in practice equal or exceed the amount of nonrecovered costs or expenses." The preamble explains that the proposed regulations modify the alternative allowance rule under Regs. §1.901-2(b)(4) "to treat alternative allowances as meeting the cost recovery requirement only if the foreign tax law expressly guarantees that the alternative allowance will equal or exceed actual costs ...." Failing to allow for a FTC for an otherwise creditable foreign country's tax levy even if alternative allowances that are economically equivalent to the non-recovered expenses is unduly formalistic and create incoherent outcomes. It would effectively deny FTC relief for non-objectionable, legitimate foreign income taxes. These regulations are certainly not suited for the challenging foreign tax issues that U.S. multinationals face today but creates a significant risk that they face double taxation in foreign jurisdictions with high income taxes in the midst of notable changes within the international tax landscape. There are compelling policy reasons for keeping the current, more rational alternative disallowance rules—it helps ensure U.S. multinationals remain competitive by avoiding the same income being subject to tax twice in high tax jurisdictions. Some countries may implement alternative tax regimes as a practical means of collecting the right amount of income to tax (not all countries have the resources afforded

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				the U.S. government in dealing with tax controversies). Such alternative tax regimes, even allowing equivalent recovery of expenses in most but not all circumstances, will not be creditable under the proposed regulations. Rather, the regulations require that the foreign tax law <u>expressly guarantee</u> that the alternative allowance will equal or exceed actual costs – a guarantee that is likely nonexistent in most foreign tax laws. This is because the point of an alternative allowance is generally to avoid compliance burdens related to the determination of actual deductions. Use of alternative allowances is not unique to the FTC section of the Code (§§901-909). It is actually frequently adopted as a method to ease administrative and compliance burden. For example, the rules regarding travel expense reimbursement permit the use of per diems and standard mileage allowances, and the return on intangible income for GILTI and FDII are formally determined via reference to the adjusted tax basis of tangible depreciable personal property. A foreign tax system which adopts different rules for administrative convenience should not be precluded from being a creditable income tax when U.S. tax rules permit similar types of allowances. The challenge for Treasury and the IRS is to design a coherent set of FTC rules that provides taxpayers the flexibility to avoid double taxation in the midst of foreseeable international tax regime changes. Formalistic rules in the proposed regulations may provide administrative convenience for the IRS but at the considerable cost of double taxation for taxpayers.

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Prop. Regs. §1.901-2(c)	**Jurisdictional nexus requirement**	Jurisdictional Nexus Requirement	Delete jurisdictional nexus requirement	The jurisdictional nexus requirement is the most fundamental change to the definition of creditable income tax under §§901 and 903. The preamble of the proposed regulations state that the purpose of this standard is to "require that a foreign tax conform to traditional international norms of taxing jurisdiction as reflected in the Internal Revenue Code." The preamble notes that this standard in large part is a reaction to novel extraterritorial taxes that "diverge in significant respects from traditional norms." The denial of foreign tax credits for US multinationals operating in jurisdictions which impose novel extraterritorial taxes is not only unlikely to persuade the jurisdictions from imposing such taxes but is actively penalizing the very companies in which the novel taxes are likely to impact. Alternative options should be exhausted before taking unilateral and discriminatory steps against the very same companies which suffer the taxation regime imposed as a result of these extraterritorial taxes. Instead, the focus, at least in the first instance, should be on utilizing other international forums to dissuade the enactment of discriminatory taxes on US MNEs (e.g., OECD/G20, Bi-lateral treaty negotiations, etc.)
Prop. Regs. §1.901-2(h)	**Applicability date**	Application to FTC carryforwards	Clarify that FTCs paid or accrued in taxable years prior to finalization and carried forward to taxable years post-finalization are not subject to the new rules.	The proposed applicability date regulation provides that the proposed FTC regulations apply to foreign taxes "paid or accrued in taxable years beginning on or after" the date of finalization. For the avoidance of doubt, Treasury should confirm that the proposed FTC regulations only apply to taxes that are actually paid or accrued in taxable years following finalization, and that the regulations do not apply to excess foreign taxes that are carried forward and "deemed" paid or accrued under §904(c) in taxable years following finalization. Otherwise, these rules could potentially apply to foreign taxes that were actually paid or accrued 9 or 10 years prior to the finalization of these rules.

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Prop. Regs. §1.903-1	**Taxes in lieu of income taxes**			
Prop. Regs. §1.903-1(c)	**Substitution requirement**	Non-duplication requirement is overly restrictive	Modify non-duplication rule to focus solely on the application of foreign law to the specific taxpayer and where only a portion, but not all, of the tested foreign tax base is also subject to a generally-imposed net income tax, only a proportionate amount of the tested foreign tax should fail the non-duplication requirement.	Under the proposed regulations, a tested foreign tax fails the non-duplication requirement if a generally-imposed net income tax or any separate levy that is an income tax is imposed on <u>any persons</u> with respect to <u>any portion</u> of the income to which the amounts that form the base of tested foreign tax relate. This is the case "even if not all of the persons subject to the tested foreign tax are subject to the net income tax." The preamble explains that the revisions to the substitution requirement is "consistent with the interpretation of the substitution requirement in prior judicial decisions" (citing *Metropolitan Life Ins. Co. v. United States*, 375 F.2d 835, 837-40 (Ct. Cl. 1967) ("Metropolitan Life"). However, the proposed rules contradict the cited case in the preamble because the new rule revives a formerly rejected IRS interpretation of the statute. In *Metropolitan Life*, the court rejected the IRS's argument that for a foreign tax to be an "in lieu" of an income tax, all persons subject to the "in lieu" tax must be exempt from the income tax. The proposed regulations simply reinsert this rejected argument by requiring no generally-imposed income tax be imposed in addition to the in lieu tax, "on any persons with respect to any portion of the income" related to the base of the in lieu tax. Additionally, the proposed regulations conclude an in lieu tax therefore fails the substitution requirement, "if a net income tax imposed by the same foreign country applies to the excluded income of any persons that are subject to the tested foreign tax, even if not all of the persons subject to the

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				tested foreign tax are subject to the net income tax." That is, an in lieu tax is noncreditable if "any person" subject to that tax is also subject to the general income tax, even if the relevant taxpayer itself is only subject to the in lieu tax. Thus, contrary to the preamble's claim, the proposed rule is not "consistent with the interpretation of the substitution requirement in prior judicial decisions," as that argument was squarely rejected in *Metropolitan Life*. The proposed regulations also create substantial administrative burdens. Section 903 taxes by their nature may be imposed on a basis other than income, and thus it may be difficult to determine how the tax will apply across all taxpayers, potentially in different industries, and to determine how the base of the in lieu tax relates to the income of all such taxpayers across the economy. Any degree of overlap between an in lieu tax and an income tax would disqualify a tax. For example, assume Country X imposes a gross income tax on inventory sales in lieu of an income tax, as well as an income tax on one specific industry such as consumer electronics in light of perceived profit margins on electronic devices. The gross income tax will fail the non-duplication requirement and thus not be creditable for all market participants, without regard to their product lines and thus without regard to whether they were actually subject to the income tax. The non-duplication rule should thus be modified to focus solely on the application of foreign law to the specific taxpayer and should limit the loss of creditability to those portions of a taxpayer's operations that are in fact subject to both taxes in order to ensure that §903 properly eliminates double

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				taxation. In the event the bases of a generally-imposed net income tax and tested foreign tax under §903 overlap, only the portion of overlap should be excluded.
		But for requirement is unnecessary	Delete requirement	The proposed regulations require taxpayers to show proof that the generally-imposed income tax would otherwise be imposed but for the existence of the tested foreign tax. This rule goes beyond the language of the statute which only requires the non-income tax be imposed in place of the income tax. There is no requirement in the statute that the foreign income tax would otherwise apply to the taxpayer. The proposed regulations anticipate a foreign government first design an income tax, impose it, then exclude some taxpayers based on them being subject to an in lieu tax. This would, therefore, exclude a scenario in which a foreign government determines that the scope of its income tax will not under any circumstances extend to include certain categories of taxpayers, and it will instead impose ab initio a non-income tax on those taxpayers in place of the inapplicable income tax. This requirement does not reflect reality. Foreign governments routinely exclude entire categories of taxpayers from the scope of a general income tax for numerous reasons including administrative convenience, tax policy, economic policy, or other goals and instead impose a tax calculated on something other than net income. While it is clear that the excepted group of taxpayer is never subject to the general income tax for the aforementioned policy reasons, it is also clear the in lieu tax is nevertheless imposed in substitution for the foregone income tax. Such a system of taxation would certainly fall within the plain language of §903; however, this system would be excluded from the proposed regulations' requirement of showing that the foreign income

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				tax "would be imposed" on the taxpayer that is subject to an in lieu tax. Taxpayers would be left in an impossible situation, being forced to demonstrate what foreign law would require if the foreign law required something other than what it actually does require. Lastly, the "would be imposed" test is odd given it is inconsistent with the *Metropolitan Life* decision which the preamble cites as an authority for the proposed regulations' interpretation of the statute. The court recognized that the foreign government would not impose its income tax on insurance companies for tax policy reasons (*Metropolitan Life* at 840). The proposed regulations' requirement the taxpayer provide proof the foreign tax "would be imposed" absent the in lieu tax contradicts the court's finding in *Metropolitan Life* that a tax imposed was creditable even though it was clear the companies in question would not be subject to the country's income tax. In addition, this "but for" requirement would result in significant administrative burdens and uncertainties since jurisdictions with less sophisticated legislative processes and tax regimes may lack specific statutory language or legislative histories to determine whether there was a close connection between the in lieu of tax and generally imposed income tax. The operation of the regime itself should be able to provide sufficient proof of intent without requiring express provisions in the terms of the foreign tax law or looking to legislative intent.
		Jurisdiction to tax excluded income within the substitution requirement	Delete jurisdictional nexus requirement	If the generally-imposed net income tax does not qualify as a net income tax under §901, a tax imposed in lieu of such tax is unable to qualify as a tax under §903. However, the proposed regulations contain a number of new restrictions which could cause a net income tax to become ineligible for creditability. This could lead to entire jurisdictions with high income tax

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		unnecessary requirement		rates in which U.S. multinationals face competitive disadvantages compared to foreign based multinationals. Requiring an evaluation of the generally-imposed net income tax under the proposed §901 regulations requires an in-depth analysis of a tax regime which taxpayers are not subject and imposes additional and unnecessary administrative burdens upon taxpayers. Taxpayers are required to evaluate in depth two separate levies, including a tax which they are not paying, to determine whether a tax is creditable under §903. The language of §903 does not require such an evaluation. Further, a levy otherwise qualifying for creditability under §903 should not become non-creditable simply because the jurisdiction at issue provides for a limitation on interest which is not comparable to §163(j) with respect to its generally-imposed net income tax (i.e., an entirely separate levy). Together, the proposed amendments to §§901 and 903 could create jurisdictions without any creditable foreign income taxes. Finally, the broad application of the jurisdictional nexus requirement to §903 taxes goes beyond the stated goal of responding to extraterritorial taxes that diverge from international norms. The extension of the jurisdictional nexus requirement to §903 will have the effect of disallowing foreign tax credits for certain withholding taxes on services provided by taxpayers outside the taxing jurisdiction. While attempting to capture novel extraterritorial taxes, the broad application of the rule may capture well-established taxes on cross-border services. Withholding taxes on services, while an evolving area of law internationally, are neither novel nor recently emerging. In fact, the Treasury Department, in promulgating the existing

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				§903 regulations in 1983, specifically identifies withholding taxes on technical services performed outside the country of incorporation as creditable taxes. To deny creditability of withholding taxes on technical services is to redefine international norms, rather than recognizing long-standing principals of international taxation.
Prop. Regs. §1.904-4	**Separate application of §904 with respect to certain categories of income**			
Prop. Regs. §1.904-4(e)	**Financial services income**	Clarify the definition of gross income used in the entity and group tests	For purposes of the 70% tests in the financial services entity and group tests, consider defining gross income as not reduced by amounts described in §§803(a)(1)(B) and 832(b)(4)(A) and 832(b)(5).	Gross income for this purpose should not be reduced by losses or premiums paid for reinsurance; this treatment is consistent with gross income computations under Subpart F and BEAT. See §59A(d)(3).
		Inbound reinsurance from foreign entities to U.S. entities and intragroup reinsurance between U.S. entities are excluded from the numerator when applying the 70% test for determining a financial service entity and from the denominator and	For purposes of applying the 70% test under the financial service entity rule and for purposes of applying the financial services group rule, income derived from reinsurance transactions (regardless of whether with a domestic or foreign person) should be treated as active financing income under Prop. Regs. §1.904-4(e)(2) and under Prop. Regs. §1.904-4(e)(3)(ii).	Although the definition of active financing income under Prop. Regs. §1.904-4(e)(2)(W) permits "related party insurance income" as defined by §953(c)(2), this rule only applies in the context of the proposed 70% test and could be interpreted to only allow income from reinsurance transactions with a related *foreign* corporation to be considered active financing income. Thus, this section should be clarified to capture domestic reinsurance (including to §953(d) companies or U.S. pooling arrangements) or inbound reinsurance from foreign to U.S. companies. For purposes of the proposed financial service group rules, any income from transactions with affiliated group members is eliminated when applying the 70% test.

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		numerator when applying the 70% test for determining a financial services group		
		Related party service income is similarly excluded when calculating the entity and group tests	For purposes of the entity test, include insurance services income from related parties identified in Prop. Regs. §1.904-4(e)(2)(i) in the definition of active conduct.	In some cases, there are local regulatory requirements which require the use of service companies that are legally separate from the insurance company. It also is common to have related underwriter structures in various jurisdictions. The income from these entities should be considered qualifying insurance company income for purposes of the entity and group tests.
		The investment asset limitation thresholds apply without taking into consideration the types of business being written by a company and the different capital needs required to conduct those businesses	Consider increasing the investment asset limitation threshold where the insurance business being conducted is more capital intensive – e.g., surety, guarantee, and/or warranty.	Surety, warranty, and financial guaranty companies often are required to have a higher capital to liability ratio than other lines of property and casualty insurance business for regulatory, rating or market facing purposes.

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		Proposed change to FSE rules will create significant uncertainty for taxpayers to determine whether income is financial services income and change the definition of a qualified deficit for purposes of §952	Maintain the existing standard. Alternatively, the rules should focus the standard only on the types of income earned by the entity (without requiring that transactions be with unrelated customers) and permit taxpayers to rely on current-law definitions with respect to any pre-existing attributes such as qualified deficits.	The proposed regulations would introduce a new requirement that income be earned only from unrelated customers to be treated as qualifying income. Companies that maintain treasury centers that lend to related parties and enter into hedging transactions with related and unrelated parties to manage foreign exchange or interest rate risk on an overall group basis would in many cases fail to qualify under the revised definitions. In addition, taxpayers would be unable to use prior year treasury center losses to reduce current year treasury center income under the qualified deficit rules, introducing volatility and resulting in double taxation in many fact patterns without an identifiable policy reason. Treasury should reconsider these proposed changes and either retain current law definitions or revise the definitions to provide entities that operate as treasury centers for a group of related companies be permitted to treat related party income (i.e., from lending or hedging activities) as qualifying financial services income. We respectfully urge Treasury to permit taxpayers to rely on current-law definitions with respect to any pre-existing attributes such as qualified deficits that were generated in the years before the proposed definition change, so that future income that could be offset with a qualified deficit under the current, long-standing regulations can continue to be offset (as if there were no definition change).