



International Tax

United States Tax Alert

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Final Foreign Tax Credit Splitter Regulations Issued

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On February 9, 2015, Treasury and the Internal Revenue Service (IRS) filed final regulations (T.D. 9710)¹ under section 909 of the Internal Revenue Code (the Code) addressing foreign tax credit splitter transactions and removed the temporary regulations (T.D. 9577) issued on February 9, 2012. Section 909, added to the Code on August 10, 2010 by P.L. 111-226, suspends foreign taxes (split taxes) that accrue as a result of a “foreign tax credit splitting event” (FTCSE).

The final regulations retain the four splitter arrangements enumerated in the temporary regulations: (i) reverse hybrid, (ii) loss-sharing, (iii) hybrid instrument, and (iv) partnership inter-branch payment. The final regulations do not add to the existing list of splitter arrangements.

While the final regulations adopt the temporary regulations without significant change, certain clarifying changes were made to the final regulations, as described below.

“Related Income” of Reverse Hybrid Splitter Arrangements

Under both the final and temporary regulations, related income from a reverse hybrid splitter arrangement is defined as “the earnings and profits (computed for U.S. federal income tax purposes) of the reverse hybrid attributable to the activities of the reverse hybrid that gave rise to income included in the payor’s foreign tax base with respect to which the split taxes were paid or accrued.” However, Treasury and the IRS noted that confusion existed as to the amount of related income from a reverse hybrid where the reverse hybrid incurred a loss that reduced earnings and profits for U.S. federal income tax purposes in a year subsequent to the year in which the FTCSE occurred.

Thus, the final regulations include an example in Treas. Reg. §1.909-2(b)(1)(v), Example 2, to clarify that the amount of related income from a reverse hybrid splitter arrangement is reduced by the amount of a

¹ The regulations appear in the February 10, 2015 issue of the Federal Register.

subsequent loss, where the reverse hybrid incurs a loss (both for U.S. federal income tax and foreign income tax purposes) that is attributable to its activities and that is included in the payor's foreign income tax base.

“Usable Shared Loss” of Loss-Sharing Splitter Arrangements

The temporary regulations defined a “usable shared loss” as a loss of a “U.S. combined income group”² that could have offset income of that group but was instead used to offset income of another U.S. combined income group. The final regulations provide that the definition of a usable shared loss includes a loss that could have been used to offset income of a U.S. combined income group in the current year or a prior foreign taxable year. (However, the final regulations do not expand the definition of a usable shared loss to include a loss that could be used to offset the income of a U.S. combined income group in a *subsequent* year - which would have required speculation as to whether the usable shared loss could be used to offset income of a U.S. combined income group in the future.)

Example: If a UK corporation earned income in Year 1 but incurred a loss in Year 2, and surrendered its Year 2 loss to a related UK corporation, the loss in Year 2 may constitute a usable shared loss if the UK corporation could have carried back its Year 2 loss and used it to offset its income in Year 1.

In addition, the final regulations clarified that when determining the amount of related income with respect to a usable shared loss, the income offset by the loss is to be determined under foreign income tax law (and not U.S. federal income tax law).

Definition of a U.S. Equity Hybrid Instrument Splitter Arrangement

The final regulations slightly modify the definition of a U.S. equity hybrid splitter arrangement. Under the final regulations, a U.S. equity hybrid instrument splitter arrangement exists regardless of whether a payment is made on the instrument.

Effective Date

The final regulations are effective for taxable years ending after February 9, 2015.

² See Treas. Reg. §1.909-2(b)(2)(ii) for the definition of a “U.S. combined income group.”

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