KPMG

TaxNewsFlash

United States

No. 2023-438
December 11, 2023

Notice 2023-80: Guidance on application of FTC and DCL rules to Pillar Two taxes, extension and modification of temporary FTC relief

The IRS today released an advance version of Notice 2023-80 [PDF 189 KB] (27 pages) announcing that the Treasury Department and the IRS intend to issue proposed regulations addressing the application of the foreign tax credit (FTC) rules and dual consolidated loss (DCL) rules to certain types of taxes within the ambit of the Pillar Two global anti-base erosion (GloBE) rules as well as to extend the temporary relief from the 2022 FTC final regulations that was offered by Notice 2023-55 released earlier this year.

- Section 2 describes rules, including examples, that would address the treatment of top-up taxes collected under the GloBE top-up tax provisions. Each of these top-up tax provisions—an Income Inclusion Rule (IIR), an Undertaxed Profits Rule (UTPR) and a Qualified Domestic Minimum Top-up Tax (QDMTT)—must be analyzed for the purposes of determining its creditability as a separate levy (within the meaning of Treas. Reg. § 1.901-2(d)) from any other levy imposed by the same country.

  As a general matter, a top-up tax imposed under an IIR that takes into account the U.S. federal income tax liability of a U.S. shareholder with respect to income subject to the IIR (notwithstanding whether such U.S. shareholder has any U.S. federal income tax liability) is not creditable under section 901. However, such top-up tax will be treated as if it were a creditable tax at the controlled foreign corporation (CFC) or the partnership level and will be included in the section 78 gross-up. A top-up tax may not, however, be taken into account for purposes of the GILTI high-tax exception under section 951A or the high-tax exclusion under section 954(b)(4).

  The notice also provides rules regarding the creditability of a QDMTT computed by reference to the income of two or more persons.

- Section 3 describes the interaction of the DCL rules with the GloBE rules. The notice indicates that proposed rules will address DCLs incurred (1) in tax years ending on or before December 31, 2023, and (2) DCLs incurred in tax years beginning before January 1, 2024 and ending after December 31, 2023 (provided the taxpayer's U.S tax year begins and ends on the same dates as the fiscal tax year of the multinational enterprise (MNE) group under the GloBE rules (DCLs incurred in these periods are referred in the notice as "legacy DCLs"). The notice indicates that proposed rules will provide that the GloBE rules will not create a "foreign use" of a legacy DCL, which means the application of the GloBE rules will not create DCL triggering events for DCLs subject to existing domestic use elections and will not preclude a taxpayer from making a domestic use election incurred in the most current year of the legacy DCL period (e.g., DCLs incurred in the 2023 U.S. calendar tax year). This proposed rule would not apply to any DCL incurred or increased with a view to reducing the jurisdictional top-up tax or qualifying for the proposed rule described in the notice.

  The notice expressly states that taxpayers are entitled to rely on the guidance provided in the notice. The notice also indicates that Treasury and the IRS are currently studying whether the GloBE rules may create a foreign use of future DCLs—thereby preventing a domestic use with respect to such DCLs—and have requested comments addressing this issue. The notice also indicates that Treasury and the IRS are studying other aspects of the interaction of the DCL rules and the GloBE rules, as well as the interaction of the GloBE rules with the anti-hybrid rules under sections 245A(e) and 267A.

It is anticipated that rules under proposed regulations consistent with the guidance provided in section 2 of the notice will apply to tax years ending after December 11, 2023. However, a taxpayer may rely on sections 2.02 through 2.05 of the notice for tax years that end after December 11, 2023, and on or before the date proposed regulations are published in the federal register, provided that the taxpayer consistently follows the guidance in its entirety for all those tax years. Additionally, for tax years that begin on or after December 28, 2021, and end on or before December 11, 2023, a taxpayer may rely on the guidance described in section 2.05 of the notice (relating to the non-duplication requirement for in lieu of taxes). Taxpayers may rely on the guidance described in section 3 of the notice until proposed regulations are published in the federal register.

Comments on the rules described in sections 2 and 3 of the notice are requested, in particular regarding the interaction of the DCL rules with the GloBE rules, including Article 3.2.7 of the GloBE rules (relating to intragroup financing arrangements). Comments are due by February 9, 2024, but consideration will be given to any written comment submitted after February 9, 2024, if such consideration will not delay the issuance of proposed regulations.

Extension of temporary relief in Notice 2023-55

Notice 2023-80 also extends the relief period for the temporary relief described in Notice 2023-55 in determining whether a foreign tax is eligible for an FTC under sections 901 and 903. Read *TaxNewsFlash*

Specifically, Notice 2023-55 provides that for foreign taxes paid during tax years beginning on or after December 28, 2021, and ending on or before December 31, 2023, taxpayers may apply:

- Former Treas. Reg. § 1.901-2(a) and (b), before it was amended by Treasury Decision 9959 (the 2022 FTC final regulations), but subject to a modification to the non-confiscatory gross basis tax rule as described in section 3 of the notice

- Existing Treas. Reg. § 1.903-1 without the attribution requirement

Thus, the general effect of Notice 2023-55 was that foreign taxes that were creditable under prior regulations could continue to be treated as such at least through the end of 2023.

Notice 2023-80 extends the relief period provided in Notice 2023-55 to tax years ending before the date that a notice or other guidance withdrawing or modifying the temporary relief is issued (or any later date specified in such notice or other guidance). Notice 2023-80 provides, however, that if final regulations consistent with the guidance provided in section 2 of the notice apply in a relief year, those final regulations apply regardless of whether the taxpayer applies the temporary relief described in Notice 2023-55, as modified by Notice 2023-80, for the relief year.

Modification of temporary relief in Notice 2023-55 to address application to partnerships

Notice 2023-80 also modifies the temporary relief described in Notice 2023-55 to address the application of the temporary relief to partnerships, including whether the partnership or its partners would apply the temporary relief with respect to foreign taxes paid or otherwise required to be reported by such partnership.

The notice provides that, with respect to foreign taxes paid or otherwise required to be reported by a partnership, which could include foreign taxes paid by a controlled foreign corporation (CFC), the partnership itself would apply (or not apply) the temporary relief. However, if, before December 11, 2023, a partnership did not apply the temporary relief for a partnership's relief year ending on or before December 31, 2022 (a "partnership 2022 tax year"), a partner may apply the temporary relief to its share of the partnership's foreign taxes for a partnership 2022 tax year. In certain circumstances, the IRS may make adjustments relating to the FTCs claimed by a partner with respect to such foreign taxes on audit of the partner.

Notice 2023-55 also states that if a taxpayer applies the temporary relief, then the taxpayer must apply the temporary relief to all foreign taxes paid by the taxpayer in the taxpayer's relief year and all foreign taxes paid by any other person in a tax year that begins on or after December 28, 2021 and that ends with or within the taxpayer's relief year for which the taxpayer would be eligible to claim a credit, as provided in section 901 (determined without regard to the limitations described in Treas. Reg. § 1.901-1(b)), if the taxpayer applied the temporary relief to such foreign taxes (the "consistent application requirement"). Additionally, the taxpayer may not apply the temporary relief in a relief year to claim a credit, as provided under section 901, for any amount of foreign tax for which a deduction is allowed in the relief year or any other tax year (the "single-benefit requirement").

Notice 2023-80 modifies and clarifies the consistent application and single-benefit requirements with respect to partnerships and their partners. Specifically, the notice states that partnerships and their partners are each subject to the consistent application requirement. Therefore, a partnership that applies the temporary relief to a relief year must apply the temporary relief to all the partnership's foreign taxes. For a partnership's tax year beginning after December 31, 2022, a partnership's application (or non-application) of the temporary relief for a relief year will cause a partner to be required to apply (or to be precluded from applying) the temporary relief for the relief year to all other foreign taxes for which the partner would be eligible to claim a credit as provided in section 901 (determined without regard to the limitations described in Treas. Reg. § 1.901-1(b)), unless the partner does not control whether the partnership applies (or does not apply) the temporary relief for the relief year.

Furthermore, partnerships and their partners are each subject to the single-benefit requirement. Therefore, a partnership cannot apply the temporary relief to report any amount of foreign tax as a creditable foreign tax expenditure if the partnership reports the amount as a deduction in the relief year or any other tax year.

kpmg.com/socialmedia