March 10, 2022

The Honorable Charles P. Rettig
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Mr. Jose E. Murillo
Deputy Assistant Secretary of Tax Policy
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

RE: Treatment of Disregarded Payments for Dual Consolidated Loss Rules under Section 1503(d)

Dear Commissioner Rettig and Deputy Assistant Secretary Murillo:

The American Institute of CPAs (“AICPA”) appreciates the opportunity to provide comments regarding a topic that we understand is under active consideration by the government, regarding the treatment of disregarded payments for purposes of the dual consolidated loss (“DCL”) rules set forth in section 1503(d) and the regulations thereunder. In this regard, the preambles to the proposed and final anti-hybrid regulations state that the government is actively studying this topic. The preambles also indicate that the government is studying this matter in the context of payments that are not disregarded but are intercompany transactions between two members of a consolidated group. External commentators have also recently addressed this matter, illustrating the current interest.

Our comments include a substantive recommendation for a regulatory change and an associated compliance clarification. Specifically, we recommend that the Department of the Treasury (“Treasury”) and the Internal Revenue Service (IRS or “Service”) reconsider the treatment of disregarded payments for DCL purposes under Treas. Reg. § 1.1503(d)-5(c)(1)(ii) and better harmonize the DCL calculation rules with other provisions that take such payments into account. We also recommend an associated compliance clarification to modify the instructions for Schedule H of IRS Form 8858, Information Return of U.S. Persons with Respect to Foreign Disregarded Entities (FDEs) and Foreign Branches (FBs), to explicitly state that disregarded transactions are (or are not) a type of book-to-tax adjustments that taxpayers should make in converting the foreign book income or loss set forth in Schedule C into the Schedule H result.

1 All references to “section” are to the Internal Revenue Code of 1986, as amended, and all references to “Reg. §”, “Prop. Reg. §”, and “regulations” are to U.S. Treasury regulations promulgated thereunder, unless otherwise specified.


Recommendations

1. Modernize the DCL Regulations’ Treatment of Disregarded Payments, and
2. Clarify the Instructions for Form 8858.

Analysis

1. Modernize the DCL Regulations’ Treatment of Disregarded Payments

The AICPA recommends that Treasury and IRS reconsider and update the Disregarded Payments Rule (“DP Rule”) to give effect to disregarded payments in calculating a DCL to the extent such payments are relevant in determining the foreign taxable income of the separate unit at issue. Such a rule would better align the application of the DCL rules to the intended target of situations where the separate unit incurs a loss from both a U.S. tax and foreign tax perspective.4

In making our recommendation, we note that Treasury and IRS appear, based on the preamble to the proposed anti-hybrid regulations, more focused on potential abusive situations involving disregarded payments made by foreign disregarded entities (“DREs”). In our experience, however, the over inclusiveness of the DCL rules to cases involving disregarded payments received by foreign DREs is a significantly more common occurrence and an ongoing source of taxpayer confusion. Many (if not most) of the instances of missed DCL elections and filings that our members identify at present involve fact patterns of foreign DREs receiving disregarded payments from their tax owners. We suspect that the absence of specific guidance regarding the DP Rule in the Form 8858 instructions (discussed infra) strongly contributes to this common foot-fault.

Under the current DCL regime in effect since mid-2007,5 when a domestic corporation computes whether a DCL is attributable to a separate unit,6 “[i]tems of income, gain, deduction and loss that are otherwise disregarded for U.S. tax purposes shall not be regarded or taken into account for purposes of the DCL computation,” also known as the “Disregarded Payment Rule” or “DP Rule.”7 The effect of the DP Rule is that payments between a domestic corporation and its wholly-owned foreign DRE,8 or between two DREs owned by the same domestic corporation,9 or between a DRE and a foreign branch of the same domestic corporation,10 are excluded for DCL calculation purposes. This result is because such payments are disregarded for U.S. tax purposes generally,

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4 See, e.g., H.R. Rep. 100-795 at p. 293 (describing example of intended scope of section 1503(d)(3) regulations to address a case where domestic corporation owned a foreign branch that incurred a loss of $100 for both U.S. tax and foreign tax purposes).
5 See Treas. Reg. §§ 1.1503(d)-1 through -8, as promulgated by T.D. 9315 (March 16, 2007).
6 The DCL regulations applicable to separate units fulfill the grant of authority in section 1503(d)(3) allowing Treasury and IRS to issue regulations that impose the DCL restriction of section 1503(d)(1) to “any loss of a separate unit of a domestic corporation…”
8 Id. at -7(c), Exs. 6, 23, and 25.
9 Id., Ex. 6 (alt. facts) and 24.
10 Id., Ex. 8.
and the DP Rule makes explicit that this treatment carries over for DCL calculation purposes. The DP Rule applies to both sides of the transaction, such that the payor of the disregarded item does not take into account a deduction and the recipient does not take into account the corresponding income item. The DP Rule, with its effect on the definition of a loss (that is, DCL) attributable to a separate unit was first proposed in 2005\textsuperscript{11} and then finalized without substantive change in the 2007 DCL regulations.

As a result of the DP Rule, disregarded payments create a base difference between the income or loss attributable to a separate unit for DCL and U.S. tax purposes and the income or loss attributable to the separate unit for foreign tax purposes. The result is agnostic, depending on the facts. For example, if a DRE makes a disregarded deductible payment that is excluded under the DP Rule, the associated separate unit’s DCL income or loss result would be higher than the foreign tax result that reflects a deduction; whereas if the DRE receives a disregarded payment and the DP Rule excludes the income, the separate unit has less income attributable to it for DCL purposes. In such cases the separate unit may be treated as incurring a DCL even though a corresponding loss does not exist in the relevant foreign tax jurisdiction.\textsuperscript{12}

The DP Rule, by de-linking the DCL computation from the foreign tax result, therefore presents the possibility for the DCL regulations to be both under and over inclusive in their goal of attempting to prevent the “double dipping” of tax losses in the U.S. and another foreign jurisdiction.\textsuperscript{13} The ordinary meaning of a dual loss presupposes the existence of a loss in two countries. The DP Rule can, however, also be a more natural interpretation of whether a loss exists for purposes of a U.S. tax provision such as section 1503(d), because the DP Rule simply confirms that items that are generally excluded for U.S. tax purposes remain so for DCL computation purposes.

In several instances since the issuance of the 2007 DCL regulations, however, Treasury and IRS have taken a different approach to disregarded payments in the context of U.S. tax rules whose application depends upon the application of foreign law. For example, in the context of the U.S. withholding tax regime’s anti-conduit rules, Treasury and IRS issued an explicit rule to treat DREs as persons, such that applying the anti-conduit rules\textsuperscript{14} must take into account disregarded financing transactions involving DREs.

\textsuperscript{12} This point was acknowledged by commentators soon after finalization of the 2007 DCL Regulations. See, e.g., Calianno and Petersen, “An Opportunity and a Possible Trap Under the U.S. Dual Consolidated Loss Regs,” Tax Notes Int’l 499 (May 12, 2008).
\textsuperscript{13} See, e.g., the preamble to the 2007 DCL Regulations, T.D. 9315, 72 Fed. Reg. at 12,902 (“Congress enacted section 1503(d)…to prevent a… [double dip].”)
\textsuperscript{14} See T.D. 9562 (December 8, 2011); first proposed by [REG-113462-08], 73 Fed. Reg. 78,252 (December 22, 2008).
More recently, as part of the extensive new guidance implementing the TCJA’s\textsuperscript{15} changes to the foreign tax credit regime, Treasury and IRS issued detailed rules that give effect to certain disregarded payments for purposes of determining the income and foreign income taxes attributable to the separate section 904(d) categories. These disregarded payment reattribution rules were first set forth as part of the new foreign branch basket rules in Treas. Reg. § 1.904-4(f) but have been extended more holistically into the new Treas. Reg. § 1.861-20 architecture for allocation and apportionment of foreign income taxes.\textsuperscript{16} Treasury and IRS also incorporated these reattribution concepts into the GILTI high-tax exception rules in Treas. Reg. § 1.951A-2(c)(7) for purposes of determining the amount of the foreign income taxes attributable to tested units of a CFC for which the high-tax election could be made.

Given these changes in the post-TCJA world, U.S. corporations must now track and account for disregarded payments involving DREs and foreign branches for which they are the tax owner or that are owned by their controlled foreign corporation and controlled foreign partnership subsidiaries.

Therefore, the AICPA recommends removing the DP Rule and giving effect to disregarded payments. The present time is ripe for this change. First, given the foreign tax credit regime changes noted above, U.S. taxpayers should now, and in the coming years, focus more on disregarded payments and better process and adjust for such items. Second, better aligning the likelihood of DCL status for a foreign DRE with its foreign taxable income posture will reduce the friction when U.S. taxpayers must also concurrently apply the new anti-double deduction legislation that has been implemented by numerous foreign countries pursuant to the BEPS Action 2 and ATAD initiatives.

We also submit that Treasury is fully within its authority to make this change in defining the amount of a loss of a separate unit because there is not a mandated statutory definition for the quoted language. Moreover, the “to the extent” prefatory language in section 1503(d)(3) gives Treasury broad leeway on this matter. In terms of conformity between this change and the calculations for net operating losses of dual resident corporations, Treasury’s authority here would also support extending the recognition of disregarded payments in that context, certainly at least to the extent the disregarded payments involve a separate unit or transparent entity as the counterparty.

Lastly, removing the DP Rule and giving effect to disregarded payments could also help solve the matter of how DCL-relevant payments should be addressed under the Treas. Reg. § 1.1502-13 redetermination rules. That is, if the payment between the DRE or branch and its tax owner were given effect normally, the need to redetermine the attributes of an identical payment between

\textsuperscript{14} See, e.g., the preamble to the 2007 DCL Regulations, T.D. 9315, 72 Fed. Reg. at 12,902 (“Congress enacted section 1503(d)…to prevent a… [double dip].”)


consolidated group members may not exist because leaving the payment’s treatment as is would be consistent (that is, not inconsistent) with the single-entity approach to consolidated taxable income.

2. Clarify the Form 8858 Instructions

The AICPA also urges the IRS to update the instructions to Schedule H of Form 8858 to explicitly state that one of the required adjustments to Federal income tax principles is to reverse out disregarded payments, if this is indeed what the government intends. Alternatively, if this is not what was intended, then the Form 8858 instructions should explicitly state that such an adjustment is not required.

Schedule H is where U.S. filers must report the book-to-tax, Schedule M-type adjustments that are made in conforming the foreign DRE or branch’s net income or loss from its regular books of account (i.e., the Schedule C disclosure) into U.S. tax accounting principles. The adjusted result then feeds into the Form 8858 filer’s taxable income or earnings and profits determinations. The instructions to the Schedule H contain a list of several common adjustments that should be made, including cost recovery allowances and charges to statutory reserves. The instructions, however, do not explicitly state that disregarded payments are disregarded in preparing the Schedule H results.

In our experience, there is significant inconsistency regarding whether practitioners apply the DP Rule and adjust for disregarded payments in Schedule H preparations. Disregarding a disregarded payment is certainly a reasonable interpretation of an adjustment needed to conform the foreign book result to U.S. tax accounting principles. The other enumerated items in the Instructions’ list are more in the nature of routine timing differences between financial reporting and taxable income determinations, and they do not suggest the need for an application of deeper taxable income concepts such as the effects of entity status classifications. Whatever IRS’ intent on this point is, the taxpayer community would benefit from the instructions being explicit.

When practitioners do not apply the DP Rule to the Schedule H results, the disconnect grows between the Form 8858 information result and the technical answer under the DCL rules. This difference further exacerbates the likelihood of error and potential trap of the DCL rules applying to a foreign DRE that receives disregarded income payments. For example, if the DP Rule is not applied and the Schedule H result shows a net profit for the foreign DRE, the preparer may be unaware of the need to answer yes to the Schedule G questionnaire about there being a DCL attributable to the DRE. This omission in turn fails to alert the tax owner to the need for the DCL compliance items such as domestic use elections and annual certifications.

In sum, regardless of whether Treasury and IRS decide to adopt our substantive recommendation above, we strongly urge IRS to clarify the Form 8858 instructions in this regard as soon as feasible.
The AICPA is the world’s largest member association representing the accounting profession, with more than 428,000 members in the United States 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 appreciate your consideration of these comments and welcome the opportunity to discuss these issues further. If you have any questions, please contact Robert Russell, Chair, AICPA International Tax Technical Resource Panel, at (202) 790-6996 or RRussell@kflaw.com; Edward Karl, AICPA Vice President – Tax Policy & Advocacy, at (202) 355-4892 or Edward.Karl@aicpa-cima.com; or me at (601) 326-7119 or JanLewis@HaddoxReid.com.

Sincerely,

Jan F. Lewis, CPA
Chair, AICPA Tax Executive Committee

cc: Mr. William Paul, Principal Deputy Chief Counsel and Deputy Chief Counsel (Technical), Internal Revenue Service