¶720 Deemed-Paid Foreign Tax Credit

NEW LAW EXPLAINED

Code Sec. 902 deemed-paid credit repealed.— The Code Sec. 902 deemed-paid foreign tax credit is repealed. The credit was allowed for income tax paid with respect to dividends received by a domestic corporation that owned 10 percent or more of the voting stock of a foreign corporation. The deemed-paid credit is repealed as a result of the implementation of the participation exemption system (Code Sec. 902, stricken by the Tax Cuts and Jobs Act).

Under the participation exemption system, a specified 10-percent owned foreign corporation (i.e., a foreign corporation with domestic corporate shareholders that own 10 percent or more of the foreign corporation's stock by vote or value) is provided a 100-percent deduction for the foreign-source portion of the dividends received from the foreign corporation (Code Sec. 245A, as added by the 2017 Tax Cuts Act). This deduction is referred to as the "participation DRD". No foreign tax credit or deduction is allowed for any foreign taxes paid or accrued with respect to the deductible portion of the dividend (see ¶705).

COMMENT

The House Committee Report states that to continue to provide a Code Sec. 902 deemed-paid credit in light of the participation DRD would provide a double tax benefit, by allowing the dividend exemption and then reducing U.S. tax with a credit for taxes paid on the foreign source income (House Committee Report for Tax Cuts and Jobs Act (P.L. 115-97) (H. R. Rep. No. 115-409)).

Code Sec. 960 deemed-paid credit for subpart F inclusions. The Code Sec. 960 deemed-paid foreign tax credit for subpart F inclusions is retained, but modified as a result of the repeal of Code Sec. 902. The deemed-paid credit for subpart F inclusions is no longer computed under the principles of Code Sec. 902. Rather, the credit is determined on a current year basis. If income is included in the gross income of a domestic corporation that is a U.S. shareholder of a controlled foreign corporation (CFC), the deemed-paid credit is the amount of the foreign corporation's foreign income taxes properly attributable to the subpart F income inclusion (Code Sec. 960(a), as added by the 2017 Tax Cuts Act).

COMMENT

The provision changes the method for computing the deemed-paid taxes, which required the domestic corporation to multiply the foreign subsidiary's post-1986 foreign income tax payments by the ratio of: (1) the Code Sec. 951(a)(1) inclusion, to (2) the foreign subsidiary's post-1986 undistributed earnings pool. The provision eliminates the need for tracking cumulative tax pools.

The look-through rule that applied for purposes of determining the foreign tax credit limitation for dividends received from a Code Sec. 902 noncontrolled foreign corporation now applies to dividends received from a noncontrolled 10-percent owned foreign corporation. A noncontrolled 10-percent owned foreign corporation is a specified foreign corporation, defined in Code Sec. 245A(b). The term also includes a passive foreign investment company, defined in Code Sec. 1297(a), with respect to which the taxpayer meets the stock ownership requirements of Code Sec. 902(a) or (b), as in effect before repeal by the 2017 Tax Cuts Act. A CFC will not be treated as a noncontrolled 10-percent owned foreign corporation with respect to any distribution out of its earnings and profits for periods during which it was a CFC (Code Sec. 904(d)(2)(E)(i) and Code Sec. 904(d)(4), as amended by the 2017 Tax Cuts Act).

COMMENT

The limitation on the Code Sec. 960 deemed-paid credit with respect to Code Sec. 956 inclusions of domestic corporate shareholders in Code Sec. 960(c) was eliminated (Act Sec. 14301(b)(1), striking Code Sec. 960(c)). Note that provisions in the House-passed bill would have made the Code Sec. 956 amount zero with respect to a domestic corporation, while the Senate-passed bill excepted domestic corporations from Code Sec. 956. Code Sec. 956 was not modified in the final version of the 2017 Tax Cuts Act.

Code Sec. 960 deemed-paid credit and distributions from previously taxed earnings and profits. The amount of foreign taxes deemed paid upon a distribution of previously taxed income is also no longer determined under the principles of Code Sec. 902. If a domestic corporation that is a U.S. shareholder receives a distribution from a CFC, any part of which is excluded from gross income as previously taxed income under Code Sec. 959(a), the domestic corporation is deemed to pay the foreign corporation's foreign income taxes as: (1) are properly attributable to the previously taxed income, and (2) that were not deemed paid by the domestic corporation under Code Sec. 960, for the tax year or any prior tax year (Code Sec. 960(b)(1), as added by the 2017 Tax Cuts Act).

If a CFC receives a distribution from another CFC, any portion of which was excluded from gross income of the CFC because the amounts were attributable to previously taxed income under Code Sec. 959(b), the CFC receiving the distribution will be deemed to have paid so much of the other CFC's taxes as: (1) are attributable to such portion, and (2) have not been deemed to have been paid by a domestic corporation under Code Sec. 960, for the tax year or any prior tax year (Code Sec. 960(b)(2), as added by the 2017 Tax Cuts Act).

Adjustments to the Code Sec. 960 deemed-paid credit. Accrued foreign income taxes that were not paid within two years from the close of the tax year to which they relate and so reduce the foreign tax credit, but that are subsequently paid, are taken into account for the tax year to which the taxes relate. The same rule applies for both taxes deemed paid under Code Sec. 960 and foreign income taxes directly paid (Code Sec. 905(c)(2)(B)(i), as amended by the 2017 Tax Cuts Act).

COMMENT

Temporary Reg. §1.905-3T(d)(2), which requires adjustments to the earnings and tax pools, in lieu of a foreign tax redetermination, is inconsistent with the determination of the Code Sec. 960 deemed-paid credit on a current basis.

Other provisions related to the Code Sec. 960 deemed-paid credit. For purposes of the Code Sec. 960 deemed-paid credit, the term foreign income taxes means income, war profits, or excess profits taxes paid or accrued to any foreign country or possession of the United States (Code Sec. 960(e), as added by the 2017 Tax Cuts Act).

The IRS may provide regulations or other guidance necessary to carry out the provisions of Code Sec. 960 (Code Sec. 960(f), as added by the 2017 Tax Cuts Act). According to the House Committee Report, this could include providing regulations with rules similar to those in Reg. §1.904-6(a) for allocating taxes to specific foreign tax credit baskets. Under these rules, taxes are not attributable to an item of subpart F income if the base upon which the tax was imposed does not include the item of subpart F income. For example, if foreign law exempts from tax certain income from its tax base, no deemed credit can result from the subpart F inclusion. Tax that is not imposed on subpart F income is not attributable to subpart F income (House Committee Report for Tax Cuts and Jobs Act (P.L. 115-97) (H. R. Rep. No. 115-409)).

A domestic corporation that owns or is treated as owning under the attribution of ownership rules of Code Sec. 1298(a), the stock of a qualified electing fund (QEF) can claim the Code Sec. 960 deemed-paid credit for the inclusion of income of the QEF. The domestic corporation must meet the stock ownership requirements in Code Sec. 902(a) and (b), prior to repeal by the 2017 Tax Cuts Act (Code Sec. 1293(f)(3), as added by the 2017 Tax Cuts Act).

Code Sec. 78 gross-up. The Code Sec. 78 gross-up for foreign taxes deemed paid under Code Sec. 902, no longer applies, as a result of the repeal of Code Sec. 902. The gross-up applies to taxes deemed paid under Code Sec. 960(a) and (b). The Code Sec. 78 gross-up also applies to foreign income taxes deemed paid with respect to amounts of global intangible low-taxed income (GILTI) included in the gross income of a domestic corporation under Code Sec. 951A (see ¶735). A domestic corporation's deemed-paid credit for GILTI is 80 percent of the product of the corporation's inclusion percentage and the aggregate tested foreign income taxes paid or accrued, with respect to tested income, by each CFC with respect to which the domestic corporation is a U.S. shareholder. The Code Sec. 78 gross-up, however, takes into account 100 percent of the product of the inclusion percentage and aggregate tested foreign taxes. The Code Sec. 78 gross-up applies for all purposes, except for the deductions for dividends received under Code Sec. 245 and Code Sec. 245A. The amounts are treated as a dividend received by a domestic corporation from a foreign corporation (Code Sec. 78, as amended by the 2017 Tax Cuts Act and Code Sec. 960(d), as added by the 2017 Tax Cuts Act).

Code Sec. 909 matching rule. The special matching rule that applied to Code Sec. 902 corporations is replaced with a rule that applies to specified 10-percent owned foreign corporations. Under the rule, if there is a foreign tax credit splitting event, a foreign income tax paid or accrued by a specified 10-percent owned foreign corporation will not be taken into account, for purposes of Code Sec. 960 or determining earnings and profits under Code Sec. 964(a), before the tax year in which the related income is taken into account by the corporation or a domestic corporation which is a U.S. shareholder of the corporation (Code Sec. 909(b), as amended by the 2017 Tax Cuts Act). A specified 10-percent owned foreign corporation is any corporation with respect to which a domestic corporation is a U.S. shareholder. The definition is modified for this purpose to include passive foreign investment companies, as defined under Code Sec. 1297, that are not CFCs (Code Sec. 245A(b), as added by the 2017 Tax Cuts Act) (see ¶705). A U.S. shareholder is a U.S. person who owns, either directly, indirectly, or constructively: (1) 10 percent or more of the total combined voting power of all classes of stock of the foreign corporation, or (2) 10 percent or more of the total value of shares of all classes of stock of the foreign corporation (see ¶745) (Code Sec. 951(b), as amended by the 2017 Tax Cuts Act).

Foreign tax credit limitation look-through rule. The look-through rule that applied for purposes of determining the foreign tax credit limitation for dividends received from a Code Sec. 902 noncontrolled foreign corporation now applies to dividends received from a noncontrolled 10-percent owned foreign corporation. A noncontrolled 10-percent owned foreign corporation is a specified 10-percent owned foreign corporation, defined in Code Sec. 245A(b) (see ¶705). The term also refers to a passive foreign investment company, defined in Code Sec. 1297(a), with respect to which the taxpayer meets the stock ownership requirements of Code Sec. 902(a) or (b), as in effect before repeal by the 2017 Tax Cuts Act. A CFC will not be treated as a noncontrolled 10-percent owned foreign corporation with respect to any distribution out of its earnings and profits for periods during which it was a CFC (Code Sec. 904(d)(2)(E)(i) and (d)(4), as amended by the 2017 Tax Cuts Act).

Dividends received deduction. The U.S. source portion of a dividend received from a 10-percent foreign corporation that may be deducted under Code Sec. 245 is the amount of the dividend multiplied by the ratio of post-1986 undistributed U.S. earnings to the post-1986 undistributed earnings. Post-1986 undistributed earnings were defined by reference to Code Sec. 902(c)(1). The definition of post-1986 undistributed earnings from Code Sec. 902(c)(1) is now included in Code Sec. 245 (Code Sec. 245(a)(4), as amended by the 2017 Tax Cuts Act).

Effective date. The amendments made by this section apply to tax years beginning after December 31, 2017, and to tax years of U.S. shareholders in which or with which such tax years of foreign corporations end (Act Sec. 14301(d) of the Tax Cuts and Jobs Act).