October 7, 2024

Peter Blessing
Associate Chief Counsel (International)
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Comments on Proposed Rules Regarding Dual Consolidated Losses and the Treatment of Certain Disregarded Payments (NPRM REG–105128–23)

Dear Mr. Blessing:

The Alliance for Competitive Taxation ("ACT") is a coalition of leading American companies from a wide range of industries that supports a globally competitive corporate tax system.

Attached are ACT's comments on proposed regulations regarding dual consolidated losses ("DCLs") and the treatment of certain disregarded payments, as requested by NPRM REG–105128–23 (the "Proposed Regulations"). We appreciate your consideration of these comments. ACT members welcome the opportunity to discuss these comments further with your staff.

Yours sincerely,

Alliance for Competitive Taxation

cc: William M. Paul, Principal Deputy Chief Counsel, Internal Revenue Service
Scott Levine, Acting Deputy Assistant Secretary, U.S. Department of the Treasury

Member Companies

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ALLIANCE FOR COMPETITIVE TAXATION COMMENTS ON PROPOSED RULES REGARDING DUAL CONSOLIDATED LOSSES AND TREATMENT OF CERTAIN DISREGARDED PAYMENTS (NPRM REG-105128-23)

I. INTRODUCTION

On August 6, 2024, the Treasury Department ("Treasury") and the Internal Revenue Service ("IRS") issued the Proposed Regulations regarding DCLs and the treatment of certain disregarded payments.[1] Prior to issuing the Proposed Regulations, in December 2023, Treasury and the IRS issued Notice 2023-80 announcing their intent to issue regulations addressing the treatment of top-up taxes arising from the implementation of the OECD's Global Anti-Base Erosion Model Rules (the "GloBE Rules") (i.e., the income inclusion rule ("IIR") and the qualified domestic minimum top-up tax ("QDMTT")) under the DCL rules.[2] The topics addressed in the Proposed Regulations extend well beyond the issues addressed in Notice 2023-80, however, and would constitute the most dramatic expansion of the DCL rules since their enactment, fundamentally altering taxpayers' and the IRS's longstanding reliance on intricate and time-tested DCL rules and the principles that undergird them. In the preamble to the Proposed Regulations (the "Preamble"), Treasury and the IRS encouraged comments on the Proposed Regulations. Below are ACT's comments on this guidance.

ACT appreciates the efforts of Treasury and the IRS to address the issues raised by the interaction of the DCL rules with the GloBE Rules. However, the approach adopted by Treasury and the IRS with respect to the GloBE/DCL interaction is not necessary to carry out the provisions of section 1503(d)[3] and is not consistent with the policy concerns that led Congress to enact the DCL rules. More generally, the Proposed Regulations (including the rules with respect to the treatment of stock ownership interests and the disregarded payment loss rules) extend the reach of the DCL rules far beyond their intended purpose as expressed by Congress and are not supported by the text of section 1503(d) or its consistent interpretation by Treasury since its enactment.

As explained more fully below, the significant changes to the U.S. international tax rules since the enactment of the DCL rules in 1986 suggest that, if anything, consideration should be given to narrowing the scope of the DCL rules, particularly as applied to U.S.-headquartered companies, virtually all of whose foreign income is subject to current U.S. tax (as income of a foreign branch or as global intangible low-taxed income ("GILTI") or subpart F income). As a result of these changes, the so-called "double dipping"[4] concerns reflected in the existing DCL regulations have been dramatically reduced or eliminated in the case of U.S.-headquartered companies. Moreover, because of these fundamental changes to the U.S. international tax rules,

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[1] REG–105128–23, 89 Fed. Reg. 64750-64778 (Aug. 7, 2024).

[2] ACT provided its comments on Notice 2023-80, available at https://actontaxreform.com/media-center/current/posts/february-9-2024/.

[3] Unless otherwise noted, all section references are to the Internal Revenue Code of 1986, as amended.

[4] *See* REG-102144-04, 70 Fed. Reg. 29868, 29869 (May 24, 2005) (citing Joint Committee Report in relation to the 1986 Tax Reform and providing "Congress was concerned that this double-dip of a single economic loss could result in an undue tax advantage to certain foreign investors.").

the expansion of the DCL rules as reflected in the Proposed Regulations will, as applied to U.S.-headquartered companies, almost certainly cause taxpayers to restructure preexisting arrangements to avoid their application in a manner that results in an *increase* in their foreign tax liabilities and a commensurate *decrease* in their U.S. tax liability. Accordingly, if changes of this nature are to be made, marking a fundamental shift in both the consistent interpretation and the policy of the DCL rules, ACT respectfully submits that they should be made by Congress, the institution that is constitutionally empowered to assess the broader changes to the U.S. policy landscape since the enactment of section 1503(d), as well as the likely revenue and sovereignty implications for the United States.

II. COMMENTS IN RELATION TO THE PROPOSED EXPANSION OF THE SCOPE OF THE DCL RULES TO ADDRESS PILLAR TWO

A. Inappropriate Outcomes due to the Proposed Application of the DCL Rules in the Context of the GloBE Rules

As a general matter, the DCL rules under section 1503(d) and the regulations thereunder consider whether an impermissible double deduction exists as a result of a loss that yields a net deduction under the laws of the United States and under the income tax laws of another jurisdiction. The Proposed Regulations would extend the application of the DCL rules in the context of the GloBE Rules. Specifically, they do so by proposing a rule to modify the determination of an "income tax" for purposes of applying the DCL rules.[5] Under this proposed rule, the determination of whether a tax is an income tax would be made without regard to whether the tax is intended to ensure a minimum level of taxation on income or the taxpayer computes income or loss by reference to financial accounting net income or loss.[6] Accordingly, under the proposed definition of an income tax, certain top-up taxes implementing the GloBE Rules (i.e., IIRs and QDMTTs)[7] would be income taxes for purposes of the DCL rules.

The DCL rules generally prohibit the "domestic use" of a DCL unless a taxpayer can demonstrate that there is no possibility of foreign use or the taxpayer makes a domestic use election.[8] "Foreign use," in turn, is defined very broadly under the DCL rules to encompass circumstances when any portion of a deduction or loss is made available under the income tax laws of a foreign country to offset or reduce, directly or indirectly, any income or gain under such tax laws.[9]

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[5] Although not explicitly addressed in this comment letter, additional modifications under the Proposed Regulations are made to the DCL rules to extend application to the GloBE rules. For example, Prop. Treas. Reg. § 1.1503(d)-1(b)(4)(i)(A) and (B) would modify the definition of "separate units" to include taxable presences arising under the GloBE rules that are not currently within the definition of a "separate unit."

[6] *See* Prop. Treas. Reg. § 1.1503(d)-1(b)(6)(ii).

[7] The Proposed Regulations do not address application of the DCL rules in the context of the undertaxed profits rule ("UTPR"). Per the Preamble, Treasury and the IRS continue to analyze issues related to the UTPR.

[8] A dual resident corporation or separate unit is required to track the domestic use limitation via cumulative separate return limitation year ("SRLY") registers, as modified under the relevant DCL rules. Treas. Reg. § 1.1503(d)-4.

[9] Treas. Reg. § 1.1503(d)-3.

Therefore, under the Proposed Regulations, tax regimes implemented in accordance with the GloBE Rules would be treated in the same manner as other income tax regimes, which will frequently result in a foreign use of a DCL. Specifically, under the Proposed Regulations, where a separate unit has a DCL and that separate unit is included in the computation of a QDMTT, IIR, or the Transitional Safe Harbour, foreign use will occur when an item of deduction that comprises the DCL is taken into account in such GloBE calculations if another entity that is treated as a foreign corporation for U.S. federal income tax purposes is included in the same jurisdictional calculation. As noted in ACT's prior comments on this issue, the GloBE Rules adopt a mandatory jurisdictional blending approach, such that there is no flexibility for taxpayers (either through revisions to their corporate structure or by electing not to share the loss with an affiliated corporation) to exclude the loss of a separate unit from their GloBE computations.

Under the Proposed Regulations, if foreign use is considered to occur as a result of the mandatory jurisdictional blending, taxpayers would be deprived of the ability to make a domestic use election or be required to recapture such loss in a year after the year in which the loss arises.

As ACT has previously noted, however, in most cases an item of deduction that comprises a part of a DCL that is taken into account under the GloBE Rules will cause no change in the actual tax liability for the group under the GloBE Rules. This crucial point was acknowledged by Treasury and the IRS in Notice 2023-80.[10] In effect, Treasury and the IRS recognize that the GloBE Rules are fundamentally different from other foreign tax computations (both because GloBE requires a jurisdictional blending of attributes, without regard to the taxpayer's corporate structure or elections, *and* because, for most taxpayers in most common fact patterns, there will never be a change in tax liability resulting from the inclusion of the attribute in the GloBE computation). Nevertheless, under the Proposed Regulations, foreign use would invariably be triggered merely as a result of the item of deduction being taken into account in the GloBE computation, without providing taxpayers an opportunity to prove that the application of such tax regimes does not have any effect on the taxpayer's liability or otherwise alter any relevant tax computations. In these common situations in which the taxpayer's income has already been taxed at a rate at least equal to the GloBE minimum rate, the GloBE Rules function as a mere verification that sufficient tax has been paid on the taxpayer's income in a foreign jurisdiction. Under the Proposed Regulations, however, this mere verification exercise is wielded against taxpayers to increase their tax, despite the demonstrable fact that the results in question implicate neither the policies of the DCL Rules nor the policies of the GloBE Rules. ACT strongly believes that the policies underlying the DCL rules (as consistently reflected in the existing regulations and prior Treasury guidance) require that taxpayers be given the opportunity to demonstrate that a top-up tax liability would

[10] *See* Notice 2023-80, Section 3.02 (providing that "a loss may never produce a benefit under the Jurisdictional Top-up Tax, for example, if the ETR in the jurisdiction is at or above the Minimum Rate (without regard to the loss) and the loss is not carried over in determining Jurisdictional Top-Up Tax in another year.")

not arise[11] if the item of deduction was not taken into account in the computation of the GloBE income or loss. In such cases, foreign use should not be considered to occur.[12]

The Proposed Regulations do provide a limited exception to foreign use in the context of the computation of the Transitional CbCR Safe Harbour.[13] Under such exception, if the application of the duplicate loss arrangement rules (i.e., the anti-double-dipping rule applying in the context of the Transitional CbCR Safe Harbour) provided in the OECD's December 2023 administrative guidance denies the items of deduction that comprise the DCL for purposes of computing GloBE income or loss and the Transitional CbCR Safe Harbour is satisfied, then no foreign use would occur. This rule, while helpful, is far too limited to provide relief in the numerous circumstances in which a deduction will be inappropriately denied by the Proposed Regulations, despite the absence of any foreign tax benefit. Therefore, ACT respectfully requests that this limited exception be broadened and extended to the application of any top-up tax regime implemented pursuant to the GloBE Rules. Specifically, taxpayers should be provided an opportunity to prevent the application of the DCL rules in cases where they are willing to certify (and demonstrate to the satisfaction of the Secretary) that there will be no change in the taxpayer's tax

[11] ACT acknowledges that, under the existing DCL regulations, a foreign use of a DCL is considered to occur whenever a DCL is "made available" to offset or reduce an item of foreign income. Applying this standard in the context of the minimum tax regimes contemplated by the GloBE Rules is inappropriate, however, as it fails to recognize the unique nature of the computations required by the GloBE Rules (in addition to ignoring the fact that, in the vast majority of circumstances, the GloBE Rules will result in no incremental tax liability for taxpayers). Specifically, in the common situations where the taxpayer's income in the foreign jurisdiction is taxed at a rate above the GloBE minimum rate *before* the application of the GloBE Rules, the rate of "top up" tax imposed on the income under the GloBE Rules is zero, with the result that the inclusion of the DCL in the GloBE computation should not be considered to reduce the "taxable income" of any other affiliate within the meaning of section 1503(d). In effect, when income in a foreign jurisdiction has already borne at least a 15% rate of tax before application of the GloBE Rules, the GloBE Rules themselves subject the income in the jurisdiction to a rate of tax of zero, such that the GloBE Rules should not be considered an "income tax of a foreign country" within the meaning of section 1503(d). *See* Article 5.2.1 of the GloBE Rules, which provides that the rate of tax imposed on the GloBE income in such circumstances is zero. This interpretation is not at odds with the text of section 1503(d), its purpose as enunciated by Congress, or current Treasury regulations. Rather, it simply recognizes the unique nature of the minimum tax computation found in the GloBE Rules, which provides that the taxpayer is not subject to any tax under the GloBE Rules when it has already borne the minimum rate of tax on its income.

[12] In the preamble to the Proposed Regulations, Treasury states, "the GloBE Model Rules can also present a typical *example* of tax residency arbitrage that the dual consolidated loss rules were intended to address." 89 Fed. Reg., at 64757. This statement ignores the material difference between the GloBE Rules and other foreign tax regimes. In most cases, inclusion of a dual consolidated loss in the GloBE computation will not give rise to any "tax residency arbitrage," because the loss will produce no change in the taxpayer's liability for foreign tax in the current year or any other year. Accordingly, taxpayers should be permitted to certify, in a manner similar to the domestic use election found in the current DCL regulations, that the inclusion of the DCL in a taxpayer's GloBE computations will result in no change in the taxpayer's tax liability in the foreign jurisdiction. ACT believes that this approach is consistent with the policies underlying the DCL rules and is no more challenging for taxpayers to demonstrate or for the IRS to audit than a domestic use election under the existing rules. The failure of the Proposed Regulations to permit this approach is simply a failure to acknowledge the fundamental differences between the minimum tax nature of the GloBE computations as compared to other foreign tax computations.

[13] Prop. Treas. Reg. § 1.1503(d)-3(c)(9).

liability in the current year or any other year as a result of the items of deduction that comprise a DCL being taken into account.[14]

B. The Policy Underpinnings of the DCL Rules as Applicable to U.S.-headquartered Companies

Section 1503(d) was enacted in 1986 with respect to dual resident corporations and its scope was extended to separate units in 1988.[15] Congress has not revisited section 1503(d) in the 36 years since 1988. However, the context in which section 1503(d) operates (i.e., the U.S. international tax rules) has changed dramatically since 1988, most notably with the enactment of Public Law 115-97, commonly referred to as the Tax Cuts and Jobs Act ("TCJA") in 2017. As a result of the TCJA, virtually every dollar of income of a U.S.-headquartered company earned anywhere in the world is subject to current U.S. taxation (as income of a foreign branch or, if earned through a controlled foreign corporation ("CFC"), as GILTI or subpart F income[16]). As the Preamble to the Proposed Regulations notes, Congress enacted the DCL rules to address concerns that a dual resident corporation (and, as later enacted, separate units owned by a domestic affiliate) could use a loss twice – once against the income of affiliates of a U.S. consolidated group that is subject to U.S. federal income tax (but not foreign tax), and second against the income of affiliates that are subject to foreign tax in a foreign jurisdiction (*but not U.S. federal income tax*).[17]

Prior to the enactment of the TCJA, U.S. headquartered companies potentially were able to defer indefinitely the U.S. taxation of a significant portion of their foreign earnings by choosing not to repatriate those earnings. In that context, the "double-dipping" concern described above was more readily applicable to U.S. multinational entities with foreign subsidiaries. However, in the current tax landscape, such earnings are subject to U.S. taxation on a current basis with very limited exceptions. ACT readily acknowledges that the DCL rules have not been revisited by Congress, and it would not be appropriate for Treasury, by regulation, to conclude that the DCL rules are inapplicable to U.S. companies on the basis that the double dipping concerns that originally led to the rules have been significantly lessened. However, given the dramatic and relevant changes to the U.S. international tax rules in 2017 and the lack of any Congressional revisions to section 1503(d), Treasury's decision to propose significant expansions to the reach of the DCL rules without Congressional authorization seems questionable as a policy matter. Accordingly, while ACT addresses below several specific concerns with several of the proposed expansions of the DCL rules in the Proposed Regulations, ACT respectfully submits that any policy

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[14] As noted, ACT strongly believes that the mandatory jurisdictional blending feature of the GloBE Rules should not operate as an impediment to a domestic use election for a DCL, provided the taxpayer can certify that there is no change to the taxpayer's tax liability as a result of the inclusion of the item of deduction in the GloBE calculation. ACT also believes that Treasury, which is responsible for negotiating the development of the GloBE Rules on behalf of the United States, can and should seek revisions to the application of the GloBE Rules to ensure that they are appropriately coordinated with the U.S. DCL rules. The lack of clearer coordination between the pre-existing DCL rules and the newly-developed GloBE Rules should not be held against taxpayers whose tax results are not at odds with the policy goals of either set of rules.

[15] Pub. L. 99-514, Sec. 1249(a); Pub. L. 100-647, Sec. 1012(u).

[16] There are few limited exceptions that exempt or exclude CFC income from tax under GILTI or subpart F.

[17] (Emphasis added.) S. Rep. No. 99-313, 99th Cong., 2nd Sess., at 419-421 (1986); 89 Fed. Reg., at 64750.

changes contemplated by the Proposed Regulations merit the attention of Congress, particularly (as noted above and as discussed further below) where such changes seem likely to lead to increased foreign tax liabilities (and, therefore, decreased U.S. tax liabilities) for U.S. companies.[18]

III. COMMENTS IN RELATION TO THE PROPOSED REMOVAL OF INCOME ARISING FROM STOCK FROM THE COMPUTATION OF A DCL

The Proposed Regulations include rules that would require the removal of items arising from the ownership of stock from the computation of a DCL. Under the Proposed Regulations, items arising from the ownership of stock – such as gain recognized on the sale or exchange of stock, dividends (including by reason of section 1248), or inclusions under section 951(a) or 951A(a), as well as related deductions (including under section 245A(a) or 250(a)(1)(B)) – would generally not be taken into account for purposes of computing a dual resident corporation's or separate unit's income or a DCL.

The removal of items arising from the ownership of stock from the computation of a DCL would represent a radical alteration in the application of the DCL rules. In the Preamble, Treasury and the IRS set forth several justifications for this change, including the prevalence of foreign participation exemption regimes or indirect foreign tax credits, administrability concerns, and rate disparities. Each of these proffered justifications fails to recognize the fundamental policy underpinnings of the DCL rules. In addition, each is inconsistent with the plain meaning of the text of the statute itself and Treasury's long-standing interpretation of it. Accordingly, the proposed changes relating to inclusions from stock ownership should be withdrawn.

Section 1503(d) applies by its terms to a "net operating loss of a domestic corporation." The term "net operating loss" is defined in section 172 of the Code[19] and refers specifically to an excess of the deductions allowed "under this chapter" over gross income. That is, section 1503(d) starts with the determination of whether a domestic corporation has a net operating loss, which exclusively considers items of income and deductions under U.S. law. Existing Treasury regulations under section 1503(d) make this even more unambiguously clear, providing "[t]he fact that a particular item taken into account in computing a dual resident corporation's net operating loss is not taken into account in computing income subject to a foreign country's income tax *shall not cause such item to be excluded from the calculation of the dual consolidated loss.*"[20] In fact, these regulations simply confirm what is clear from the text of section 1503(d) itself and is entirely consistent with its underlying purpose. As noted above and as described by Treasury in the preamble to the Proposed Regulations, Congress's concern in enacting section 1503(d) was the potential for "double dipping" of a loss as a result of the use of that loss to reduce both U.S. income tax and tax on foreign income that is not subject to U.S. tax. If there is no loss for U.S. tax law

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[18] In addition to the significant U.S. tax policy changes in 2017, the approach of foreign jurisdictions has also undergone significant change since 1988, when Congress last revised the DCL rules. The development of the GloBE Rules themselves, as well as the increase in foreign law regimes that address policy concerns that are similar in many respects to the DCL rules, has resulted in an extremely complex landscape that is difficult for even the most sophisticated taxpayers and tax authorities to administer. For all of these reasons, ACT believes that changes in policy that would dramatically expand the reach of the DCL rules are appropriately within the purview of Congress and should not be the result of an attempt by Treasury to reframe the rules without Congressional authorization.

[19] *See* Treas. Reg. § 1.1503-2(c)(5), which explicitly cross-references section 172(c) of the Code and the regulations thereunder in the definition of a dual consolidated loss.

[20] Treas. Reg. § 1.1503-2(c)(5) (emphasis supplied).

purposes, however, there can be no "double dip" of a loss, and the statutory prerequisites for the application of section 1503(d) are simply not present. Further, when Congress revised the DCL rules in 1988 to extend their application to "separate units," Congress made it unambiguously clear that the same approach should apply, stating, "[t]o the extent provided in regulations, any loss of a separate unit of a domestic corporation shall be subject to the limitations of this subsection *in the same manner as if such unit were a wholly owned subsidiary of such corporation*."[21]

The existing regulations with respect to income arising from stock ownership flow directly from the statutory text of section 1503(d) and are entirely consistent with its policy underpinnings. Specifically, an income inclusion (as determined for U.S. tax purposes) of a domestic corporation arising from ownership of stock, whether it is a taxable dividend, a subpart F inclusion, an inclusion under the GILTI regime, or gain on the sale of the stock, is taken into account in determining whether the corporation has a net operating loss. If, taking these income inclusions into account, the corporation does not have a net operating loss, it does not have a dual consolidated loss as defined by Congress. In the case of a separate unit, the statute requires precisely the same analysis and calculation – assuming the separate unit is a domestic corporation and determining whether such corporation would have a net operating loss (as determined for U.S. tax purposes).

In each of these situations, the issues cited by Treasury as justifications for eliminating most income inclusions on stock are simply not relevant. That is, Treasury's purported justifications focus entirely on the treatment of the relevant income inclusions under *foreign* law which is irrelevant to the determination of a DCL under the statute and existing regulations.[22]

In the Preamble, Treasury asserts that "taxpayers may be affirmatively structuring into [the stock ownership rules of the current regulations] to produce inappropriate double-deduction outcomes."[23] The Preamble subsequently asserts that the approach of the Proposed Regulations regarding stock ownership "is simpler and more administrable than an alternative approach that would consider the extent to which an item is, or will be, actually taken into account *under the tax law of the foreign country* in which the separate unit or dual resident corporation is subject to tax and not offset or reduced by an exemption, exclusion, deduction, credit, or other similar relief *particular to the item*."[24] These statements expose the multiple flaws in the approach of the Proposed Regulations with respect to stock ownership. With respect to the first of these assertions, there can be no "inappropriate double-deduction" unless there is, in fact, a double deduction under section 1503(d). If there is not a net operating loss as determined under U.S. law, which necessarily must include the U.S. tax consequences arising from stock ownership (or which would arise, in the case of a separate unit, if it were a separate domestic corporation), then there is no double deduction, and the statute and regulations should be inapplicable. The second

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21 Section 1503(d)(3) (emphasis supplied).

22 As described in the Preamble, such inquiries include whether the foreign country imposes tax on dividends distributed to the dual resident corporation or separate unit (and, if so, whether it allows for indirect foreign tax credits) and whether the foreign rate of tax imposed on the income is sufficient to avoid significant rate disparity between foreign law and U.S. law. Each of these inquiries assumes away the critical threshold issue that Congress believed must be determined before applying section 1503(d) – is there a loss as determined for U.S. federal income tax purposes?

23 89 Fed. Reg., at 64755.

24 *Id.*, at 64756 (emphasis supplied).

assertion not only mistakenly analyzes a stock inclusion on the basis of its treatment *under foreign law,* but it also reflects Treasury's apparent (but mistaken) belief that section 1503(d) operates based on the treatment of each *item of income* under foreign law.

There is no support for either of these assertions in the statutory text or legislative history of section 1503(d), which was not enacted by Congress to authorize Treasury to undertake a generalized item-by-item analysis of the treatment of items of income under U.S. and foreign law to ferret out inconsistencies and prevent outcomes that Treasury regards as "inappropriate." To the contrary, section 1503(d), as enacted by Congress and consistently interpreted by Treasury prior to these Proposed Regulations, addresses a much more straightforward question, i.e., taking into account only items of income and deduction as determined under U.S. law (or which would be determined under U.S. law if a separate unit were a wholly owned domestic corporation), is there a net operating loss of a dual resident corporation or separate unit? As noted above, it is only after establishing the existence of such a loss that there can be a potential for double dipping of the loss. Inclusions on ownership of stock are necessarily part of this analysis, and their treatment under foreign law is not relevant to the threshold question posed by Congress. Existing Treasury regulations correctly utilize this approach, which should continue to apply to carry out the intent of Congress as expressed in the text and legislative history of section 1503(d).[25]

Even applying the approach that Treasury proposes with respect to stock ownership, the Proposed Regulations produce punitive, inappropriate outcomes. In particular, Treasury and the IRS note in the Preamble that adverse double income inclusion outcomes may arise in stock ownership scenarios in the same country. The Preamble states that in cases where a separate unit that is taxed as a resident in a particular foreign jurisdiction holds stock of a CFC that is also taxed as a resident in the same foreign jurisdiction, the income of the CFC may be subject to tax under the subpart F or GILTI regime as well as the foreign income tax laws. The Preamble acknowledges that such amounts may indeed be considered dual inclusion income. However, the Proposed Regulations fail to provide an exception for such stock ownership scenarios in the same country.[26]

[25] In addition to lacking support in the text or purposes of section 1503(d) as articulated by Congress, the proposed rules with respect to stock ownership can often produce results that are completely at odds with any reasonable interpretation of Congressional intent or sound tax policy. As one such example, insurance companies are required by regulators to hold investments to support their future liabilities, and those investments are commonly held in subsidiaries which cannot be treated as disregarded or flow-through entities (either because those investment subsidiaries are organized under foreign law in entities treated as per se corporations or because the subsidiaries are only partially-owned and consent from other shareholders would be required to elect flow-through treatment). Whether investments supporting insurance liabilities are held directly by an insurance company or through an investment subsidiary should not, as a matter of tax policy, dictate a different result under the dual consolidated loss regulations, and no reasonable interpretation of section 1503(d) or its purposes should produce such an outcome.

[26] As part of its justification for not including any relief in the Proposed Regulations with respect to same country stock ownership, Treasury states that adopting such a rule would require complex analysis and tracking, including a determination of any "rate disparities" associated with the same country stock income inclusions. As noted, this strongly suggests that Treasury's views section 1503(d) as an authorization from Congress to undertake a general analysis of items of income that are taxed under both U.S. and foreign law to safeguard against any outcomes that Treasury believes to be inappropriate (with no clear determination of what standards Treasury should apply to this exercise). There is simply no support anywhere in the text or legislative history of section 1503(d) for an analysis of individual items of income to determine if "rate disparities" exist. Moreover, taxpayers are already required to track inclusions from stock for purposes of several other Code sections, including sections 959, 986(c), and 960(b). Therefore, any added burden associated with tracking inclusions from stock ownership is likely to be minimal.

Accordingly, while the removal of items arising from stock ownership is generally inconsistent with both the text and purpose of the DCL rules, by not providing an exception for same-country ownership structures, the proposed rules invite draconian results that cannot be justified even under Treasury's inappropriately expansive interpretation of section 1503(d). In particular, where deductions that would give rise to a DCL (in the absence of inclusions on income from stock) are used to offset income of a foreign corporation in the same country that is subject to tax under both U.S. and foreign law, the dual inclusion income should be included in the determination of whether, even under Treasury's erroneous standard, the taxpayer is achieving an "inappropriate double deduction outcome."[27]

IV. COMMENTS IN RELATION TO THE PROPOSED DPL RULES

The Proposed Regulations would introduce new provisions regarding "disregarded payment losses" or DPLs. Under these rules, a domestic corporation would consent to be subject to the rules and required to include in gross income any disregarded payment loss that gives rise to a foreign use during a certification period.[28] A DPL is the aggregate amount of foreign law deductions allowed to a disregarded payment entity during a foreign taxable year for disregarded payments of royalties and interest (plus certain other items, such as notional interest deductions, imputed interest deductions, and structured payments), less the aggregate amount of foreign law income recognized by the entity during that year from disregarded payments of interest, royalties, or structured payments.[29] The Proposed Regulations also provide rules for calculating and reporting DPLs, the combination of certain disregarded entities, and the triggering events requiring the inclusion in income of DPLs.

The DPL rules would constitute a new anti-hybrid regime, introduced through consent and deemed consent under the entity classification rules, without statutory authorization. Notably, taxpayers would be compelled to be subject to this new regime, not as a result of any specific actions taken by the taxpayer, but simply as a result of the passage of time if the taxpayer owns an entity that is disregarded for U.S. tax purposes. If finalized in their current form, they would produce the extraordinary and unprecedented outcome of phantom income recognition with no corresponding deduction or increase to basis for U.S. tax purposes.

The DPL rules appear to reflect Treasury's view that the specific provisions Congress has enacted to address potential mismatches between U.S. and foreign law, including section 245A(e), section 267A, and section 1503(d) (each of which are cited by Treasury in the preamble to the Proposed Regulations as support for the DPL rules) provide support for Treasury to undertake a much more generalized anti-arbitrage analysis of the Code to protect against outcomes that

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27 As the legislative and regulatory history shows, the DCL rules were intended to address limited circumstances in which outcomes of double-deduction of net losses arise. The rules were not intended to address general hybrid mismatch arbitrage situations, nor were they intended to enable an analysis of individual items of income to prevent "deduction/no inclusion" and "double deduction" outcomes. Notably, the DCL rules differ significantly from the approach taken by the member states of the European Union (EU) that have implemented the EU Directive concerning hybrid mismatches (commonly referred to as ATAD II). The Proposed Regulations appear to be an effort by Treasury to implement the policies of the ATAD II directive into U.S. law without the authorization or input of Congress.

28 Prop. Treas. Reg. §§ 301.7701-3(c)(4)(iii); 1.1503(d)-1(d)(1)(i) and (3)(i). Likewise, a domestic corporation would be required to include the amount of a DPL by failing to certify the DPL. *See* Prop. Treas. Reg. § 1.1503(d)-1(d)(3)(ii).

29 Prop. Treas. Reg. § 1.1503(d)-1(d)(2)(i), (d)(5)(i).

Treasury regards as inappropriate. As discussed more fully above in the context of section 1503(d), the enactment and subsequent amendments to that provision were enacted to address a very specific issue – the use of a U.S. net operating loss as a deduction against income that is subject to tax under U.S. law (but not foreign law) while also using that same loss as a deduction against income that is subject to tax under foreign law (but not U.S. law). Similarly, section 245A(e) is very specifically directed at preventing the deduction under section 245A for dividends paid to a qualifying corporation where the payment of the dividend gives rise to a deduction under foreign law. Section 267A applies to a payment of interest or royalties to a foreign person which would otherwise be deductible for U.S. tax purposes if such payment does not give rise to taxable income under the law of the foreign country. None of these provisions provides a general grant of authority to Treasury to analyze and police all potential mismatches between U.S. and foreign law. Indeed, these provisions, viewed individually or in the aggregate, provide strong support for the opposite conclusion. That is, when Congress wishes to prevent particular "arbitrage" outcomes, it acts accordingly through specific amendments to the Code – going back as far as 1986 (in the case of section 1503(d)) and continuing until as recently as 2017 (in the cases of section 245A(e) and section 267A).

In addition, since the finalization of the entity classification regulations under section 7701 (the "check-the-box regulations") in 1996, Congress has explicitly acknowledged the existence of these rules.[30] Congress has also amended the Internal Revenue Code numerous times, including multiple amendments that specifically addressed potential mismatches in treatment of items between U.S. and foreign law in specific fact patterns.[31] During this period, to our knowledge, no member of Congress has even proposed legislation that would authorize Treasury to require taxpayers to avoid or limit arbitrage between U.S. and foreign law as a condition for applying the U.S. domestic law entity classification rules.

Against this backdrop, ACT respectfully submits that Treasury should reconsider and withdraw the proposed DPL rules and engage with Congress to determine the appropriate scope for revisions to U.S. law as significant as the changes represented by the DPL rules. As written, the rules would do much more than simply limit or prevent so-called "deduction/no inclusion" outcomes. For example, the rules would apply to an item of disregarded income that is deductible under foreign law when it is paid from one disregarded entity of a U.S. company to another disregarded entity in a different jurisdiction, notwithstanding that the recipient entity includes the item in taxable income in its home jurisdiction.[32] In addition, as noted above, the rules simply deem items of income to exist and impose tax on such items, without addressing the technical or policy implications of this approach. Not only is such an approach unprecedented in the history of the income tax to ACT's knowledge, but the approach also raises fundamental questions about

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30 *See e.g.*, section 56A(c)(6), which provides for adjustments to financial statement income specifically in the case of "disregarded entities."

31 In addition to sections 267A and 245A(e), *see e.g.*, section 901(m), which addresses the foreign tax credit consequences of potential mismatches in treatment between U.S. and foreign law of certain acquisition transactions, and section 894(c), which limits the applicability of reduced withholding rates under U.S. income tax treaties in the case of certain mismatches between U.S. and foreign law treatment of an entity.

32 Of course, the relevant item of income may be deductible in a higher rate jurisdiction of the disregarded entity payor and included in income of a lower rate jurisdiction recipient. Whether or not these differing foreign law consequences should produce a different U.S. law result is just one among the many fundamental policy questions raised by the proposed DPL rules, which Congress should be given the opportunity to consider before taxpayers are subjected to such rules.

the nature of the "tax" imposed on the resulting amount – for example, if it is considered income, what basis, earnings and profits, and other consequences should follow?

The proposed DPL rules are of particular concern to ACT and its member companies because, as applied to U.S.-headquartered companies, the rules will often operate to the detriment of the United States. In particular, the application of the proposed DPL rules will force many companies to modify or eliminate structures that they have had in place for many years for the purpose of helping to manage their foreign tax exposure.[33] Treasury, the IRS and courts have consistently recognized over many decades that actions by taxpayers to reduce or otherwise mitigate foreign tax exposure are consistent with U.S. tax policy principles.[34] In addition, as discussed further above in the context of the proposed revisions to the DCL rules, given that virtually every dollar of income earned by U.S. headquartered companies anywhere in the world is subject to current U.S. taxation, it is not clear how concepts like "deduction/no inclusion" should be assessed. That is, viewed from a U.S. tax perspective, the structures implicated by the DPL rules produce neither a deduction nor an inclusion, but, with or without the DPL structure, the United States is exercising taxing jurisdiction (and imposing current tax) on the worldwide income of the U.S. company and its foreign affiliates. The DPL structure in question is effectively reducing foreign tax liability (which will generally increase U.S. income tax liability), which Congress might rationally consider to be aligned with U.S. policy goals.[35]

For example, consider a fact pattern where a U.S. company licenses its intangible property to a wholly owned disregarded entity which, in turn, licenses such intangible property to third parties. Under existing law, the income generated by the disregarded entity is subject to U.S. federal income tax. Under the proposed DPL rules, if the disregarded entity claims a deduction under foreign law with respect to the royalty expense, such deduction may constitute a DPL regardless of the income generated from third parties. A rational response for many multinationals in this fact pattern would be to eliminate the DPL and resulting deemed income inclusion by transferring, not only the disregarded entity, but the intangible property to a foreign corporation – exactly the opposite of the rationale for Congress enacting the section 250 regime. As noted above, in the current context where virtually all foreign earnings of U.S. multinational entities are already subject to current U.S. taxation under the GILTI and subpart F regimes, compelling

[33] Treasury and the IRS provide in the Preamble to the Proposed Regulations that "the twelve-month delay for deemed consent provides an opportunity to restructure existing arrangements to avoid the application of the disregarded payment loss rules without changing the classification of a specified eligible entity." Accordingly, taxpayers are encouraged to avoid the application of the DPL rules by way of restructuring preexisting arrangements and thereby erode the U.S. fisc. *See* 89 Fed. Reg., at 64762.

[34] *See e.g.*, Rev. Rul. 89-101, 1989-2 C.B. 67 (Aug. 28, 1989) (reduction to foreign withholding tax was a valid business purpose for a spin-off transaction), Private Letter Ruling 199952029 (Sept. 29, 1999) (reduction of foreign income taxes is a corporate business purpose in context of a spin-off transaction). *See also* Treas. Reg. § 1.901-2(e)(5) (requiring taxpayers to "reduce, over time, the taxpayer's reasonably expected liability under foreign tax law for foreign income tax" to claim certain foreign tax credits).

[35] The proposed DPL rules appear to assume that taxpayers can readily restructure their operations to avoid any negative impact of the rules. As already noted, such restructuring, if undertaken, will generally result in an increase in foreign tax liability and a reduction in U.S. tax liability. In addition, for many common structures, the assumption that taxpayers can readily restructure is at odds with reality. Many taxpayers operate in the form of "true" branches that have significant operations, have been in place for many years, and are practically required for regulatory or other non-tax reasons. Many taxpayers have also undertaken recent restructurings to convert separate legal entities into disregarded entities in order to manage the potential application of the BEAT rules (*see* Section 59A and the regulations thereunder). In these (and other) fact patterns, the assumption that taxpayers readily can and should restructure to avoid the application of the DPL rules seems particularly misplaced.

companies to pay more foreign tax would result in not only more double taxation but also less tax revenue for the United States.[36]

V. COMMENTS IN RELATION TO THE PROPOSED ANTI-AVOIDANCE RULE

Treasury and the IRS include a new anti-avoidance rule in the Proposed Regulations.[37] This rule is proposed to apply if "a transaction, series of transactions, plan, or arrangement is engaged in with a view to avoid the purposes of section 1503(d) and the regulations in this part issued under section 1503(d)…"[38] According to the Preamble, transactions potentially within the scope of the proposed anti-avoidance rule include transactions that "may facilitate a double-deduction outcome by manipulating the computation of income or a dual consolidated loss with items that are not included in income, or do not give rise to tax, in the foreign country."[39] As discussed more fully above, however, whether an item of income is or is not included in income or gives rise to tax in a foreign country is, according to the statutory text of section 1503(d) and its purposes as articulated by Congress, irrelevant to the computation of a dual consolidated loss. Further, as noted above, Treasury's existing, long-standing regulations explicitly provide, "[t]he fact that a particular item taken into account in computing a dual resident corporation's net operating loss is not taken into account in computing income subject to a foreign country's income tax shall not cause such item to be excluded from the calculation of the dual consolidated loss."[40]

Reviewing this regulatory language against the description of avoidance provided in the Preamble suggests that the current Treasury regulations, by explicitly *requiring* taxpayers to take into account items of income that are not taken into account under foreign law, are guilty of "manipulating the computation of income or a dual consolidated loss" and thus run afoul of the anti-avoidance rule in the Proposed Regulations. ACT respectfully submits that it will be virtually impossible for taxpayers or the IRS to apply a general anti-avoidance rule that is so strikingly inconsistent with the text and purpose of the statutory provision it is attempting to police. As a result, the inevitable result of including the proposed anti-avoidance rule will be a significant increase in controversy between taxpayers and the IRS.

As with the other issues addressed above, ACT believes that the proposed anti-avoidance rule needs to be fundamentally reconsidered so that, if any such rule is included, it is aligned to the text and purposes of section 1503(d) as articulated by Congress and as consistently interpreted by Treasury for decades. To align with those purposes, the touchstone for applying the DCL rules must continue to be whether the dual resident corporation or separate unit has a net operating

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[36] ACT acknowledges that the potential for increases in foreign tax liability (and resulting reductions in U.S. tax payments) is not the sole consideration that guide formulations of U.S. tax policy. It is nevertheless appropriate for such issues to be considered fully by Congress, which is best positioned to weigh the potential revenue considerations against other policy concerns to determine the appropriate path forward.

[37] Prop. Treas. Reg. § 1.1503(d)-1(f).

[38] *Id.*

[39] 89 Fed. Reg., at 64757.

[40] Treas. Reg. § 1.1503-2(c)(5). *See* also footnote 20 above and accompanying text.

loss *within the meaning of U.S. tax law*, without regard to the treatment under foreign law of the items that comprise the DCL.[41]

VI. COMMENTS IN RELATION TO THE EFFECTIVE DATES OF THE PROPOSED REGULATIONS

Other than limited exceptions, the Proposed Regulations are proposed to be effective on a retroactive basis for calendar year 2024 and tax years ending on or after August 6, 2024.[42] Accordingly, if finalized as proposed, the Proposed Regulations would apply on a retroactive basis without any transition rule. The lack of a transition rule coupled with the retroactive application of the proposed rules will result in extremely severe consequences for certain taxpayers as the proposed rules would immediately take effect with respect to ownership structures and operations that have been in existence, in many cases for a long period.[43] Most importantly, as discussed above, with respect to certain parts of the Proposed Regulations, Treasury and the IRS propose to introduce new rules without Congressional authorization or undo prior guidance in a manner that is contrary to their own prior pronouncements. This rushed approach is particularly difficult to fathom given that the existing section 1503(d) regulations were last revised in 2007, and the statutory text of section 1503(d) has not been amended in over thirty-five years.

Further, as described above, the DPL rules would apply upon taxpayer's consent. The Proposed Regulations adopt the concept of deemed consent according to which a domestic corporation would be treated as consenting to the application of the DPL rules when it forms, acquires, or files an entity classification election for a specified eligible entity[44] after August 6, 2024, regardless of when the election is effective.[45] Under the application of this proposed delayed effective date for deemed consent, a domestic corporation that owns a specified eligible entity would be deemed to have consented to the application of the DPL rules as of August 6, 2025, unless an election is made to classify such entity as an association.[46]

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[41] As noted in the Preamble, the proposed anti-avoidance rule would also apply to transactions that attempt to avoid the purposes of the proposed DPL rules. As described more fully above, the proposed DPL rules suffer from numerous defects. In addition to lacking any apparent support in the text or purposes of section 1503(d) as articulated by Congress, the proposed DPL rules would apply in circumstances that go well beyond even the rationale for the rules as articulated by Treasury in the Preamble. As one example, the rules would apply in circumstances where it is clear that there is no "deduction/no inclusion" outcome. In these situations, the rules apparently apply literally notwithstanding that the stated purpose for the rules is not implicated. Attempting to apply an anti-avoidance standard in these circumstances will inevitably lead to controversy.

[42] *See* Prop. Treas. Reg. §§ 1.1503(d)-8(b)(11); 301.7701-3(c)(4)(vi).

[43] The immediate application of the proposed rules would result in the alteration of the definition of "foreign use" during the tax year, creating immense difficulties for taxpayers in tracking the DCL amounts for that tax year.

[44] Under the Proposed Regulations, a specified eligible entity is defined as an eligible entity that is (regardless of whether domestic or foreign) a foreign tax resident or is owned by a domestic corporation that has a foreign branch. Accordingly, generally, a specified eligible entity would be an entity that, when classified as a disregarded entity, could pay or receive amounts that could give rise to a deduction/no inclusion outcome by reason of being disregarded for U.S. tax purposes but deductible for foreign tax purposes. Prop. Treas. Reg. § 301.7701-3(c)(4)(i); *see also* Preamble, 89 Fed. Reg., at 64762.

[45] Prop. Treas. Reg. § 301.7701-3(c)(4)(i), (vi).

[46] Prop. Treas. Reg. § 301.7701-3(c)(4)(iii), (iv), and (vi)(B).

Accordingly, it appears that under the Proposed Regulations, the deemed consent would apply on a domestic entity basis. Under such reading, it may be suggested that when a domestic entity is deemed to consent to the application of these rules with respect to a specified eligible entity, the deemed consent would apply to all pre-existing entities owned by the domestic owner as of the time of the deemed consent. Applying the proposed rules in that manner would render the delayed effective date of deemed consent futile in many cases as it would bring any specified entity owned by the domestic entity within the scope of the DPL rules as a result of a formation, acquisition, or entity classification election of another specified eligible entity of the domestic owner.

As ACT's comments set forth above demonstrate, the Proposed Regulations would introduce enormous uncertainty and instability into an area of the law that has not been revisited by Congress since 1988 or by Treasury since 2007. Given this context, Treasury's decision to apply the rules retroactively seems wholly difficult to justify. Accordingly, ACT respectfully requests that Treasury reconsider the overall approach of the Proposed Regulations and make clear that any changes resulting from the revisiting of the rules should apply on a prospective basis only.

VII. CONCLUSION

Section 1503(d) is not a general anti-arbitrage rule, and neither that section nor the other sections cited in the preamble to the Proposed Regulations authorize Treasury to undertake a generalized item-by-item analysis of U.S. and foreign income items to determine whether there is a mismatch between U.S. and foreign law that requires a change to the U.S. law treatment of an item. ACT believes the measured approach by Congress to questions of U.S. and foreign law mismatch is appropriate, and this measured approach should continue to guide U.S. tax policy. As noted above, limiting such foreign mismatches can often result, particularly in the case of U.S.-headquartered companies, in an increase in the foreign tax liability of such companies and a concomitant decrease in their U.S. tax liability, which may be contrary to U.S. interests (and should certainly be considered by Congress before such rules are applied to taxpayers).

More fundamentally, the question of whether the U.S. law treatment of an item of income should yield to the foreign law treatment of that item raises broad policy concerns that extend far beyond narrow questions of whether a taxpayer is potentially achieving a tax benefit in a particular fact pattern. Congress alone determines whether an item of income is taxable, an expense is deductible, at what rate such items should be taxed, etc. With the notable, limited exceptions of U.S. bilateral tax treaties and the specific instances where Congress has authorized a different approach, U.S. law does not yield to foreign law determinations of these items.[47] The Proposed Regulations represent an unwise deviation from this core principle of U.S. tax policy and must be reconsidered in that light.

In furtherance of the above, ACT respectfully recommends that:

- With respect to the application of the DCL rules in the context of Pillar Two, taxpayers be given the ability to demonstrate that a top-up tax liability would not arise if the item of deduction was not taken into account in the computation of the GloBE income or loss and, in such cases, foreign use should not be considered to occur.

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[47] *Biddle v. Commissioner*, 302 U.S. 573, 578-579 (1938).

- The rule that proposes to remove the income arising from stock from the computation of a DCL be withdrawn.

- If the rule regarding the removal of income arising from stock from the computation of a DCL is not withdrawn, the regulations provide an exception for same-country stock ownership.

- The DPL rules be withdrawn in their entirety.

- The proposed anti-avoidance rule be withdrawn or appropriately tailored to apply in circumstances where the transaction is inconsistent with the statutory text and purpose of section 1503(d) as articulated by Congress.

- The Proposed Regulations be revised as described above and applied prospectively.

ACT representatives express our appreciation to Treasury for the solicitation and consideration of comments on the Proposed Regulations. We would welcome the opportunity to discuss these matters with you at your convenience.