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In this article, the authors review recent changes to foreign tax credit rules and their effect on foreign tax redeterminations, especially when amended returns need to be filed. They also examine the impact of the OECD's initiatives on base erosion and profit shifting and the digital economy.

Section 905(c) of the Internal Revenue Code provides rules on how to account for changes to foreign taxes if the amount paid differs from what was accrued for foreign tax credit purposes. Under prior law, one of the most common methods to account for those changes was to prospectively adjust a controlled foreign corporation's foreign tax pools. With the repeal of section 902 and corresponding changes to section 905(c) as part of the Tax Cuts and Jobs Act, it is no longer possible to make prospective adjustments. The change will often require amending prior tax returns in the event of a foreign tax redetermination (FTR). Recently proposed regulations (REG-105495-19) revise the prior section 905(c) regs and address modifications resulting from the TCJA.

The prospect of additional amended returns is even more daunting when considered with the addition of section 951A and the virtually constant indirect credit position of most companies. Completing that trifecta is the prospect of significantly increased controversy resulting from the global adoption of base erosion and profit-shifting types of modifications and the OECD's pillars 1 and 2 initiatives. As this article sets forth, amending U.S. tax returns may become a fact of corporate tax life.

Section 905(c) and Accompanying Regs

Pre-TCJA

Section 905(c) provides rules for adjustments to accrued taxes resulting from an FTR. Generally, if accrued taxes differ when paid, are not paid within two years after the close of the tax year to which they relate, or are refunded, the taxpayer is to notify the secretary, who shall redetermine the amount of U.S. tax for the affected years. Before the 2017 changes, section 905(c)(1) provided for adjustments to the post-1986 foreign tax pools and undistributed earnings determined under sections 902 and 960 in lieu of redetermining U.S. tax liability. Also pre-amendment, section 905(c)(2)(B)(i)(I) provided that when taxes not paid in two years were subsequently paid, no U.S. tax redetermination was necessary for deemed paid credits; again, prospective pool adjustments were made.

The regulations provide extensive guidance on section 905(c). They have a long history and cover a lot of ground, most of which is beyond the scope of this article, which focuses on the treatment of FTRs as related to deemed paid taxes. Under regulations issued in 2007 (addressing pre-TCJA section 905(c)), an FTR was any change in the foreign tax liability that may affect a taxpayer's FTC.[1] As the prior language of section 905(c) indicated, redetermining U.S. tax liability was typically not required as a result of an FTR. Instead, appropriate adjustments to foreign tax pools and post-1986 undistributed earnings were made.[2] Although those regulations were temporary and expired in 2010, identical proposed regulations (REG-209020-86) providing for the same results were issued at the same time. Taxpayers continued to rely on the proposed regs after the temporary ones expired.

The regulations provided that prospective adjustments were not possible in all cases, so a U.S. shareholder would have to redetermine its U.S. tax liability in limited cases: when the foreign tax liability was in a hyperinflationary currency; the taxes deemed paid under section 902 or 960 in the year to which the FTR relates, and any intervening year, were reduced by at least 10 percent; a refund created a negative foreign tax pool for CFCs with an inclusion or that paid a dividend; and a U.S. corporate shareholder of a CFC received a distribution of previously taxed income that was taxed by a foreign country and later reduced.[3] For many FTRs, adjusting post-1986 tax pools and undistributed earnings was the default remedy for taxpayers.

Post-TCJA

To address the fact that pooling foreign taxes no longer occurs, section 905(c) was amended to remove prospective pooling adjustments as an option to adjust accrued taxes after FTRs. In December 2019 Treasury issued final (T.D. 9882) and proposed (REG-105495-19) section 905(c) regulations. The final regs address FTRs of direct — that is, section 901 — credits. The proposed regs primarily address changes to deemed paid credits under section 960, reflecting revised section 905(c), and further clarify instances when an FTR occurs. Notably, an FTR includes not only adjustments to foreign taxes but also changes resulting from an adjustment in foreign taxes that affect U.S. tax liability by changing the amount of distributions or U.S. inclusions under subpart F or the global intangible low-taxed income regime. It also includes, for passive foreign investment companies with qualified electing fund elections, the eligibility to make a subpart F high-tax exception in section 954(b)(4) and changes in tax liability under section 1291 (PFIC excess distribution and stock sale provisions).[4]

The section 905(c) change leaves taxpayers in the position of recalculating their U.S. tax liability, which previously was unnecessary. The CFC's earnings and profits and tested income must also be adjusted because of a change in foreign tax liability. If the U.S. tax liability changes, an amended return must be filed. FTRs that do not change the U.S. tax liability require notifying the IRS but not amending the return.[5]

Unfortunately, the time to file amended returns differs depending if the taxpayer underpaid or overpaid its tax liability. If the tax liability increases, the amended return must be filed by the due date, with extensions, of the return for the year in which the FTR occurs. The statute of limitations for the affected year is tolled, and the amended return must be filed and additional tax paid regardless of how many years have elapsed from the original return and the FTR.[6] If the taxpayer is entitled to a refund, the rules of section 6511 still apply in determining when the amended return is due, including the extended limitations period for changes to the FTC in section 6511(d)(3)(A).[7] The different periods mean, for example, that a taxpayer that wishes to elect the high-tax exception to subpart F income after a foreign assessment may have a limited window in which to do so; however, a taxpayer with the same subpart F income that receives a refund of foreign taxes, thereby decreasing the FTC, is liable for additional U.S. tax for a much longer period. The regulations provide alternative notice, but not timing, requirements for taxpayers under the jurisdiction

[1] Reg. section 1.905-3T(c).

[2] *See generally* reg. section 1.905-3T(d)(2).

[3] Reg. section 1.905-3T(d)(3).

[4] Prop. reg. section 1.905-3(a). Prop. reg. section 1.905-5 provides rules for FTRs that change pre-TCJA deemed paid credits as well.

[5] When U.S. tax liability is unchanged, only notification is required.

[6] *See* IRC section 6501(c)(5) and prop. reg. section 1.905-4(d).

[7] Prop. reg. section 1.905-3(b)(iii). Section 6511(d)(3)(A) increases the statute of limitations from three years to 10 years for refunds attributable to changes in FTCs.

of the IRS Large Business and International Division.

GILTI

With the addition of section 951A to the IRC and the corresponding deemed paid credit associated with GILTI,[8] the universe of U.S. corporate taxpayers claiming a credit yearly has greatly increased.[9] Accordingly, the changes to section 905(c) and the proposed regulations will certainly be relevant to many U.S. taxpayers, and the unique features of GILTI may require several iterations of a GILTI calculation for the same tax year.

As mentioned, a change in U.S. tax due as a result of an FTR necessitates filing an amended return. The interdependencies of the U.S. international tax system make a change in U.S. tax a distinct possibility, even if at first blush that does not seem to be the case. At the very least, a taxpayer will need to rerun its GILTI calculation to assess whether an amended return is necessary. Taxpayers will also need to revisit any previous GILTI high-tax election calculations, possibly making an election where they failed to satisfy the tax rate previously or, in the event of a refund, failed to no longer satisfy the 18.9 percent threshold.[10]

Consider a simplified example with one CFC that is subject to an audit and must pay an additional $250,000 of foreign tax. (See Table 1.)

Table 1. One CFC

	Original	Amended
CFC Tested Income[a]	$5,500,000	$5,250,000
Tax Attributed to GILTI[b]	$750,000	$1,000,000
Total Inclusion[c]	$6,250,000	$6,250,000
Section 250 Deduction	($3,125,000)	($3,125,000)
Net Before Section 861	$3,125,000	$3,125,000
Tax Before Section 861	**$656,250**	**$656,250**
Section 861	**Original**	**Amended**
Interest Expense	($450,000)	($450,000)
SG&A	($75,000)	($60,000)
Stewardship	($50,000)	($50,000)
Net Before Section 861	$2,550,000	$2,565,000
FTC Limitation	**$535,500**	**$538,650**
Tax	$656,250	$656,250
FTC	($535,500)	($538,650)
Net	$120,750	$117,600

[a]Tested income decreases despite the additional foreign tax because the increased foreign income subject to foreign tax does not change tested income.

[b]Of those taxes, 80 percent are creditable (original = $600,000, and amended = $800,000). *See* IRC section 960(d)(1).

[c]The GILTI inclusion percentage is assumed to be 100 percent.

In the example, it is assumed that interest expense and stewardship allocation and apportionment will not change under the asset method, including the proposed regulations on allocation and apportionment.[11] Selling, general, and administrative (SG&A) expenses, on the other hand, are allocated and apportioned using an income method. When tested income changes because of the additional tax, so does the total section 861 allocation and apportionment, creating an additional FTC limitation and a refund. To claim that refund, the U.S. taxpayer must file an amended return, keeping section 6511 in mind. Few people will turn down a refund, especially if it is GILTI-related — out of spite, if nothing else. However, that an amended return is required is itself a departure from the historic application of section 905(c). If the CFC had no subpart F and if section 902 still existed, no amended return would be needed at all.

As further illustrated below, one amended return might not be the end of the story. If the expense allocation did not change, the U.S. tax liability would be the same. As a result, only a notification of the FTR would be necessary under prop. reg. section 1.905-4(b)(1)(v).

Increased Tax Controversy

Following the OECD/G-20 developments over the last years, as well as several EU initiatives, we should expect more scrutiny for multinational

[8]*See* IRC section 960(d).

[9]Although there is not yet any empirical data supporting that conclusion, yearly inclusions from CFCs will certainly do so.

[10]*See* T.D. 9902 for final GILTI high-tax election regulations.

[11]Prop. reg. section 1.861-8(e)(4)(ii)(B).

companies, which could result in an increase of international disputes. For instance, in response to the OECD's BEPS projects, many countries have adopted, or are in the process of adopting, changes to their international tax systems, and have signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS, which allows them to quickly adopt key treaty-related measures of the OECD's BEPS tax avoidance guidance.

Further, the EU's mandatory disclosure rules, as well as the OECD's country-by-country reporting and recommended changes to rules on transfer pricing and allocation of profit, introduce new provisions and require new data reporting that could also trigger controversy.

The OECD inclusive framework acknowledges in the pillar 1 proposal that it would be very complex and nearly impossible for all affected tax administrations to assess and audit the calculation and allocation of profit. Enhanced dispute resolution is a key component of pillar 1, which, for instance, emphasizes the need for improved dispute resolution processes under amount C. However, even the use of bilateral dispute resolution mechanisms to address potential disputes could cause problems because they generally operate after the event and will likely affect taxation in multiple jurisdictions.

All those developments could lead to a surge in tax controversy and tax complexity in multiple jurisdictions at the same time. Hence, they could affect foreign tax liability for U.S. tax purposes, which could also affect the U.S. tax amount and ultimately result in the need for U.S. multinationals to notify the IRS and file amended returns.

Implications

The implications of section 905(c) can be significant when the recent and anticipated changes to the U.S. and global tax systems are considered. What makes the analysis more challenging is the unique feature of GILTI compared with subpart F.

In the example in Table 1, the U.S. taxpayer had only one CFC, resulting in one change in tax liability. While that scenario is probable, it is certainly not the most likely. Most U.S. multinational corporations have multiple CFCs operating in more than one jurisdiction. For GILTI purposes, the U.S. parent aggregates the tested items — that is, tested income, tested loss, qualified business asset investment, tested interest expense, and tested interest income[12] — and the aggregate foreign income taxes paid by the CFCs, multiplied by the GILTI inclusion percentage.[13] That aggregate feature means the GILTI calculation in a given year depends on the tax posture of all the U.S. shareholder's CFCs, an important difference when compared with the one-off nature of subpart F.

To illustrate the point, assume that in addition to the one CFC in the first example the U.S. parent has another CFC with $8 million of net tested income and $1.2 million of foreign tax. The CFCs operate in separate countries. In year 1 the U.S. shareholder's GILTI position is shown in Table 2.

Table 2. Multiple CFCs, Year 1

	Original
CFC Tested Income	$13,500,000
Tax Attributed to GILTI	$1,950,000
Total Inclusion	$15,450,000
Section 250 Deduction	($7,725,000)
Net Before Section 861	$7,725,000
Tax Before Section 861	**$1,622,250**
Section 861	**Original**
Interest Expense	($450,000)
SG&A	($75,000)
Stewardship	($50,000)
Net Before Section 861	$7,150,000
FTC Limitation	**$1,501,500**
Tax	$1,622,250
FTC	($1,501,500)
Net	$120,750

[12]Reg. section 1.951A-1(f)(5).

[13]IRC section 960(d)(1).

In year 3, CFC 1 is audited and assessed another $250,000 of tax. The GILTI calculation is shown in Table 3.

Table 3. Multiple CFCs, Year 3

	Original	Amended
CFC Tested Income	$13,500,000	$13,250,000
Tax Attributed to GILTI	$1,950,000	$2,200,000
Total Inclusion	$15,450,000	$15,450,000
Section 250 Deduction	($7,725,000)	($7,725,000)
Net Before Section 861	$7,725,000	$7,725,000
Tax Before Section 861	**$1,622,250**	**$1,622,250**
Section 861	**Original**	**Amended**
Interest Expense	($450,000)	($450,000)
SG&A	($75,000)	($60,000)
Stewardship	($50,000)	($50,000)
Net Before Section 861	$7,150,000	$7,165,000
FTC Limitation	**$1,501,500**	**$1,504,650**
Tax	$1,622,250	$1,622,250
FTC	($1,501,500)	($1,504,650)
Net	$120,750	$ 117,600

The U.S. shareholder is eligible for a refund of $3,150, and it must file an amended return within the section 6511 limitations period.[14] In year 5, the U.S. taxpayer realizes that CFC 2 overpaid its year 1 taxes. Assuming the relevant limitations period is still open, CFC 2 amends its return and receives a $600,000 refund, which results in the GILTI calculation shown in Table 4.

Table 4. Multiple CFCs, Year 5

	Original	Amended
CFC Tested Income	$13,500,000	$13,850,000
Tax Attributed to GILTI	$1,950,000	$1,600,000
Total Inclusion	$15,450,000	$15,450,000
Section 250 Deduction	($7,725,000)	$7,725,000)
Net Before Section 861	$7,725,000	$7,725,000
Tax Before Section 861	**$1,622,250**	**$1,622,250**
Section 861	**Original**	**Amended**
Interest Expense	($450,000)	($450,000)
SG&A	($75,000)	($90,000)
Stewardship	($50,000)	($50,000)
Net Before Section 861	$7,150,000	$7,135,000
FTC Limitation	**$1,501,500**	**$1,498,350**
Tax	$1,622,250	$1,622,250
FTC	($1,501,500)	($1,498,350)
Net	$120,750	$123,900

That second change increases the U.S. tax liability from the original year 1 return by $3,150. Combined with the first amended return, the net change in tax liability from the originally filed year 1 to the twice amended year 1 is $0. At first blush it seems as if no amended returns are due because the U.S. tax liability for the year is unchanged. That could indeed be the case if in year 3 the taxpayer thought CFC 2 may have overpaid its tax liability, so that it just waited until that CFC's liability was settled. While those facts are plausible, they are not probable. U.S. multinationals are complex and multifaceted, and corporate tax departments face dwindling resources. Maybe new facts came to light that changed CFC 2's taxable income or a court case changed the relevant tax law. It is very likely for many reasons that the CFC 2 adjustment was not identified until after the first amended return was filed.

Prop. reg. section 1.905-4(b)(1)(iv) also provides a simplifying procedure in that multiple redeterminations that affect the same tax year can be filed on one amended return. In Example 1 in the regs, the two redeterminations occur in consecutive years (years 5 and 6).

[14] As discussed, section 6511(d)(3)(A) provides for a 10-year statute of limitations for any refund that "relates to an overpayment attributable to any taxes paid or accrued" to a foreign country. In the facts at hand, the FTC changed only by virtue of the change to expense apportionment. Without delving into all the authorities, section 6511(d)(3)(A) has been somewhat broadly interpreted to include incorrect FTC calculations and other similar changes to the size of the credit, which is the case in the example. *See* Rev. Rul. 63-248, 1963-2 C.B. 623. Future interpretations of the phrase "attributable to" in the 905(c) context are certainly open — for example, the ability to make a high-tax exception election with a 10-year statute of limitations.

The future international tax landscape outside the United States adds major complexity not contemplated by the example. Taxpayers could be faced with controversy in multiple jurisdictions at the same time that might not be solved in the same tax year. Further, taxpayers may pursue competent authority or other treaty relief if the same income is subject to double taxation, further complicating matters. Not that they neglected to do so before, but taxpayers will really need to take a holistic view of their audit positions, keeping in mind the limitations on "noncompulsory" payments,[15] considering their GILTI positions (and related TCJA interdependencies) and the application of revised section 905(c).

The regulations require taxpayers to constantly look into a crystal ball and anticipate possible FTRs in multiple jurisdictions. Given that the globe is rife with anti-base-erosion efforts, and GILTI imposes worldwide taxation on U.S. multinationals, that kind of forecasting seems impossible. Tax controversies can be lengthy and the pressure to settle just for U.S. tax certainty because of the aggregate nature of GILTI may lead to foreign tax concessions not previously made by taxpayers. While filing one amended return may be possible in Example 1 in the regulations or even the example in this article, most taxpayers will not know what lies several years out (for example, years 3 and 5) across numerous tax jurisdictions. Even ignoring that uncertainty, if the fact pattern above is reversed, and the increase to U.S. tax occurred first — that is, in year 3 — there is no option to take a wait-and-see approach. The amended return is due with the U.S. taxpayer's tax return in the year the FTR occurs.

Conclusion

The change to section 905(c) in isolation would not cause a great deal of consternation. The incidence of amended returns would probably be limited to instances when a CFC had subpart F income. However, the addition of GILTI and the perpetual FTC position of U.S. taxpayers increases the times when amended returns are necessary. All those changes are occurring in the rapidly shifting post-BEPS landscape with increasingly tech-savvy foreign governments. While the regulations provide some relief for filing amended returns, because of timing concerns and the general ambiguity about tax controversies in multiple jurisdictions, U.S. taxpayers will need to be aware of the possibility of filing multiple Forms 1120X and that their GILTI calculations become perpetual drafts, pending the tolling of the statute of limitations in foreign jurisdictions. All of that puts additional pressure on increasingly stretched U.S. tax departments. ■

[15] Reg. section 1.902-2(e)(5)(i).