Claiming Foreign Tax Credits Arising from Never-Ending Foreign Audits—An Overview

By Brian Jenn

U.S.-based multinational groups often find themselves in the position of seeking to claim foreign tax credits for taxes arising from settlements of longstanding foreign audits. The general statute of limitations for refunds—which allows three years from the return filing date or two years from the date the taxes were paid (whichever is longer)[1]—may close even before a taxpayer receives notice of a potential foreign audit or audit adjustment. For this reason, Congress provided a special statute of limitations in Code Sec. 6511(d)(3)(A) for claims for credit or refund "related to an overpayment of taxes paid" to any foreign country or U.S. possession. In the case of such foreign taxes, the special refund period "shall be 10 years from the date prescribed by law for filing the return for the year in which such taxes were actually paid or accrued."

Although the special 10-year refund period for foreign tax credit claims is helpful, taxpayers seeking to claim foreign tax credits for an old audit settlement—or seeking to preserve their ability to do so—face a number of important questions. First, taxpayers need to know for what year or years they may need to file an amended U.S. return and claim a foreign tax credit and what other notifications to the IRS are required for years where an amended U.S. return is not filed. Once the appropriate year for filing an amended return is determined, it is essential to determine exactly when the 10-year refund period begins and ends. Finally, taxpayers need to understand how to claim a credit, or protect their ability to claim a credit, when the final resolution of a foreign audit may come after the expiration of the 10-year refund period.

Although the answers to these questions may be more or less straightforward in cases where a U.S. taxpayer directly pays the foreign tax, the analysis can be more complicated where the relevant foreign taxes are paid by a controlled foreign corporation ("CFC")[2] and relate to a year prior to the applicability of the Tax Cuts and Jobs Act ("TCJA).[3] Prior to TCJA, foreign taxes were "pooled" under former section 902 and only taken into account in the year of an inclusion by a United States shareholder ("U.S. shareholder")[4] under Subpart F,

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including under Code Sec. 965 in the last pre-TCJA year. (The "pooling" concept is retained under current law in the narrower form under Code Sec. 960(b), which allows a foreign tax credit for CFC-paid taxes on previously taxed earnings and profits.) Regulations under Code Sec. 905 provide special procedures for claiming a foreign tax credit in these cases but do not specifically address whether the 10-year refund period begins with the date the foreign tax is paid by the CFC or deemed paid by the U.S. shareholder. This column will consider all of these questions at a high level.

Tax Year for Which the FTC May Be Claimed

For an accrual method taxpayer, additional foreign tax paid as a result of a change in foreign tax liability is considered to "relate back" to the foreign tax year with respect to which the tax is imposed (referred to as the "relation back year").[5] For example, if a calendar year U.S. taxpayer reaches a foreign audit settlement in 2025 with respect to the 2015 foreign tax year, the taxpayer generally may claim a U.S. foreign tax credit with respect to its 2015 tax year on an amended return. If the foreign tax resolution is with respect to a multiyear period, it generally will be necessary to file an amended return for each U.S. tax year corresponding to a foreign tax year for which foreign tax liability changes as a result of the adjustment.

If the tax is paid by a CFC with respect to which the U.S. taxpayer is a U.S. shareholder, the U.S. shareholder may claim a foreign tax credit under prior section 902, or under current Code Sec. 960 (as applicable), for the year in which the foreign tax is deemed paid by the U.S. shareholder. For instance, if there is a foreign tax adjustment with respect to a CFC's 2015 tax year but the tax was not deemed paid until the CFC and U.S. shareholder's 2016 tax year, in which year there was a distribution or Subpart F inclusion that "pulled up" the foreign taxes to the U.S. shareholder level under prior section 902 or 960, then the deemed paid foreign tax credit could be claimed on the U.S. shareholder's 2016 tax return. (Post-TCJA, CFC-paid taxes will generally be deemed paid under Code Sec. 960(a) or (d) for the U.S. tax year in which the CFC's tax year to which the foreign taxes relate ends.)

Under a special election provided in Reg. §1.905-5(e), if there is a foreign tax adjustment with respect to CFC-paid taxes in a pre-TCJA year, the U.S. shareholder of the CFC may elect to take into account the foreign taxes as if the foreign tax redetermination occurred in the CFC's last taxable year beginning before January 1, 2018 (the "last pooling year"). Doing so generally will mean that all U.S. tax consequences are accounted for on the return for the last pooling year and may mean that the FTCs associated with the tax adjustment are taken into account in connection with the inclusion required under Code Sec. 965 for that year (subject to the "haircut" of Code Sec. 965(g)).

Amended Return and Notification Requirements

Regulations under Code Sec. 905 include comprehensive rules for determining how a foreign tax redetermination (which includes a redetermination of the amount of foreign taxes paid following a foreign audit) is taken into account for U.S. tax purposes. Describing these rules in detail is beyond the scope of this column. At a high level, however, the regulations provide that a U.S. tax redetermination is required for any year that a U.S. tax attribute must be redetermined.[6] Fortunately, although the general rule is that a U.S. amended tax return is required for every year for which there is a U.S. tax redetermination,[7] Reg. §1.905-4(b)(1)(v) provides an exception from the amended return requirement for years for which there is no change in U.S. tax due as a result of the U.S. tax redetermination. That is, an amended return generally is only required for U.S. tax years for which there is a change in U.S. tax due.[8] For example, if a foreign audit adjustment for a CFC's 2015 tax year results in foreign taxes that are deemed paid by the shareholder only in 2016 (due to a Subpart F inclusion) and in 2017 (due to the inclusion required under Code Sec. 965), then an amended return would be required for 2016 and 2017 but not for 2015.[9]

Determining the Refunds Limitation Period

As noted above, Code Sec. 6511(d)(3)(A) provides a special 10-year limitation period for claiming foreign tax credits. In particular, if the claim for credit or refund "relates to an overpayment attributable to any taxes paid or accrued to any foreign country … the period shall be 10 years from the date prescribed by law for filing the return for the year in which such taxes were actually paid or accrued." Although helpful, Code Sec. 6511(d)(3)(A) is not fully clear with regard to how to determine the start of the 10-year limitation period for an adjustment relating to a CFC-paid tax for which a U.S. shareholder claims a deemed paid foreign tax credit under Code Sec. 960. In particular, which year is the one in which the foreign taxes were "actually paid or accrued"—the year the foreign taxes were paid by the CFC or the year the foreign taxes were deemed paid by the U.S. shareholder. This issue is particularly relevant for years in which old section 902 was applicable but remains important going forward for determining the relevant refund limitations period for claiming FTCs under Code Sec. 960(b) for foreign taxes imposed on distributions of previously taxed earnings and profits.

Notwithstanding the lack of clarity regarding the timing of the start of the 10-year limitation period for a CFC-paid tax, a number of factors support looking to the year the foreign tax is deemed paid by the U.S. shareholder rather than the year the CFC paid or accrued the tax. First, it is clear that in referring to the date for filing the return for the year in which the tax was paid or accrued, "the return" refers to the return of the U.S. taxpayer, and it is therefore logical that the "year in which such taxes were actually paid or accrued" refers to the year they were accrued by the U.S. taxpayer on its return.

Second, the legislative history of amendments to Code Sec. 6511(d)(3)(A) in 1997 supports the conclusion that the beginning of the 10-year limitations period in Code Sec. 6511(d)(3)(A) should be determined by reference to the year foreign taxes are deemed paid under Code Sec. 902 or 960. Prior to the 1997 amendments, Code Sec. 6511(d)(3)(A) referred to "the year with respect to which the claim is made" rather than "the year in which such taxes were actually paid or accrued." Under this prior language, it seems clear that the 10-year limitations period would be determined by reference to the year taxes are deemed paid by the U.S. shareholder rather than the date actually paid by the CFC. Although the 1997 amendments could cloud the issue, the legislative history of those amendments indicates Congress was focused on resolving a conflict regarding the relevance of Code Sec. 905(c) carryovers and carrybacks for determining the starting point for the 10-year limitations period. The legislative history does not reveal any intent to change the application of Code Sec. 6511(d)(3)(A) to deemed paid foreign tax credits generally.[10]

More practically, there is no readily apparent mechanism for determining the beginning of the 10-year limitations period in Code Sec. 6511(d)(3)(A) in the Code Sec. 902 context by reference to the year the foreign corporation paid or accrued the foreign taxes. Code Sec. 902 required the pooling of a foreign corporation's foreign taxes across post-1986 years and deemed an undifferentiated portion of those taxes paid or accrued by a domestic corporation on payment of a dividend by the foreign corporation. Consequently, Congress would have needed to provide additional guidance if it had intended for the Code Sec. 6511(d)(3)(A) period to key off the date the CFC paid the taxes.

Based on all of these considerations, taxpayers have a strong basis for applying Code Sec. 6511(d)(3)(A) based on the year foreign taxes are deemed paid by a U.S. shareholder.[11]

ENDNOTES

1. Code Sec. 6511(a).
2. Code Sec. 957.
3. Generally, Code Sec. 902 applied for taxable years beginning before January 1, 2018.
4. Under Code Sec. 951(b), a U.S. shareholder generally means a U.S. person who owns, or is considered under Code Sec. 951(b) as owning, 10 percent or more of (i) the total combined voting power of stock of a foreign corporation or (ii) the total value of the stock of the foreign corporation.
5. Reg. §1.905-1(d)(1)(ii).
6. *See generally* Reg. §§1.905-3 and -5.
7. Reg. §1.905-4(b)(1)(i).
8. Note that other notification requirements in Reg. §1.905-4 may still apply.
9. If the U.S. shareholder made an election under Reg. §1.905-5(e) to take into account the impact of the foreign tax redetermination in its last pooling year, the U.S. shareholder may be able to file only the 2017 return.
10. The court's opinion in *Albemarle Corp.*, CA-FC, 2015-2 USTC ¶50,432, 797 F3d 1011 (2015) describes its understanding of Congress' intent with respect to the 1997 amendments and the focus on resolving a conflict between Rev. Rul. 84-125 and *Ampex*, CtCls, 80-1 USTC ¶9358, 620 F2d 853, 223 CtCls 428.
11. In this regard, taxpayers with an election under Reg. §1.905-5(e) should consider its interaction with Code Sec. 6511(d)(3)(A), which may add an additional layer of complexity to the analysis.