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October 7, 2024

CC:PA:01:PR (REG-105128-33)
Room 5203
Internal Revenue Service
P.O. Box 7604
Ben Frankling Station
Washington, DC 20044

Via Online Submission

RE: Proposed Dual Consolidated Loss Regulations [REG-105128-23]

Dear or Sir or Madam:

On August 7, 2024, the Internal Revenue Service (the "Service") and U.S. Department of the Treasury ("Treasury"; together with the Service, the "Government") published proposed rules regarding dual consolidated losses ("DCLs") and the treatment of certain disregarded payments (the "Proposed Regulations"). The Proposed Regulations would revise and clarify several aspects of the DCL rules under section 1503(d)[1] and introduce new disregarded payment loss ("DPL") rules. The Government asked interested stakeholders to submit comments on the Proposed Regulations no later than October 7, 2024. On behalf of Tax Executives Institute, Inc. ("TEI") I am pleased to respond to the Government's request.

About TEI

TEI was founded in 1944 to serve the needs of business tax professionals. Today, the organization has 56 chapters in North and South America, EMEA, and Asia. TEI, as the preeminent association of in-house tax professionals worldwide, has a significant interest in promoting sound tax policy, as well as the fair and efficient administration of the tax laws, at all levels of government. Our over 6,000 individual members represent over 2,800 of the leading companies in the world.[2]

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[1] Unless otherwise stated all "section" references are to the Internal Revenue Code of 1986 (as amended) (the "Code") and all "§" references are to the Treasury regulations promulgated thereunder.

[2] TEI is organized under the Not-For-Profit Corporation Law of the State of New York. TEI is exempt from U.S. Federal Income Tax under section 501(c)(6) of the U.S. Internal Revenue Code of 1986.

TEI Comments

We have divided TEI's comments into three sections:

1. The interaction of the DCL regime and top-up taxes enacted in connection with the Organisation for Economic Co-Operation and Development's ("OECD") Pillar Two project ("Top-Up Taxes");
2. Other aspects of the Proposed Regulations; and
3. The proposed DPL regime.

This letter omits a discussion of the Pillar Two and DCL rules, which are discussed extensively in the preamble to the 2024 Proposed regulations. TEI discussed the background to these rules in our comment letter of February 9, 2024.[3]

I. Interaction Between the DCL Regime and Top-Up Taxes Under Pillar Two

A. *Reconsider how the DCL regime and Top-Up Taxes Interact*

Treasury and the Service should reconsider the relationship between the DCL regime and Top-Up Taxes enacted in connection with Pillar Two.[4] Domestic corporations may deduct business losses incurred through separate units, subject to the domestic use limitation under section 1503(d). When Congress enacted section 1503(d) in 1986 and amended it to include separate units in 1988, there was no global minimum tax similar to the Top-Up Taxes imposed under Pillar Two. Rather, Congress enacted section 1503(d) to prevent double dipping between income taxes imposed by the United States and other jurisdictions. An important feature of typical foreign income taxes is that taxpayers generally have control over the foreign law mechanisms (e.g., fiscal unity, consolidation, group relief) through which a DCL may be put to a foreign use. Therefore, as enacted, the DCL regime generally policed intentional double dipping, and taxpayers have relied on such rules to structure their operations accordingly. Pillar Two, on the other hand, effectively requires mandatory consolidation and will apply to a taxpayer's preexisting structures that were generally not established to double dip losses. Rather, any arguable double dipping that occurs under the Pillar Two Top-Up Taxes will be imposed on taxpayers inadvertently and, most often, against their wishes.

Regarding the unwanted aspect of double dipping losses for U.S. federal income tax and Top-Up Taxes purposes, many taxpayers would welcome the opportunity to forego losses and deductions under Pillar Two, particularly where those items are incurred in countries that impose high rates of tax and do not permit tax consolidation (e.g., China and India), such that foregoing the losses would

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[3] TEI's February 9, 2024, letter is available at: https://www.tei.org/sites/default/files/TEI%20Comments%20-%20Notice%202023-80%20-%20FINAL%20to%20IRS%20February%209%202024.pdf.

[4] Any capitalized term used by not defined herein has the same meaning as used in the Proposed Regulations.

not generate Top Up Tax liability in that jurisdiction.[5] Although we understand that rules along these lines may be under discussion at the OECD, any such future administrative guidance would require prompt, immediately effective, and consistent adoption by all countries to resolve some of the foreign use issues discussed herein. We have not observed this trend in the adoption of existing administrative guidance and, therefore, believe that immediate guidance from the Treasury Department and Service is necessary to address these issues.

The Proposed Regulations make clear that a foreign country's enactment of a Top-Up Tax may cause DCLs that otherwise would be deductible under the Code to be indefinitely deferred or denied, even where the DCLs have no impact on the taxpayer's liability for a Top-Up Tax under Pillar Two. This outcome would be a significant and unanticipated impact on U.S. taxpayers, and the "all or nothing" foreign use standard used in the current Treasury regulations is inappropriate in this context.

When issued in 2007, the Treasury Department justified its adoption of a stringent foreign use standard on administrability grounds; it avoided the need for a "substantial analysis of foreign law."[6] This was understandable, as an alternative standard that looked to the actual foreign tax benefits resulting from a DCL may have required the translation of foreign tax laws into English and a "complex analysis" of such law.[7] This concern is not present with respect to Top-Up Taxes under Pillar Two. The GloBE Model Rules are published in English. They are intended to be implemented consistently by all adopting jurisdictions. And the United States has had a prominent role in crafting the rules. In short, the Service is in a better position than most to understand and analyze Top-Up Taxes under Pillar Two, such that the administrative burden imposed on the agency from having to analyze foreign use under a Top-Up Tax in a granular fashion should be marginal.

The application of the "made available" standard should be reconsidered in the context of Pillar Two. Top-Up Taxes differ from most foreign income taxes because they are minimum taxes only applicable when the effective tax rate in a jurisdiction is below 15 percent. Where a DCL is "made available" to offset foreign income, a DCL is likely to produce a current or future foreign tax law benefit under an ordinary foreign income tax. In this context, the strict "made available" standard can be viewed as a background presumption that avoids the need for complex inquiries

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5 A version of this rule was included in the Hybrid Arbitrage Arrangement rules issued in Administrative Guidance by the OECD/G20 Inclusive Framework on BEPS in December 2023. Specifically, the Duplicate Loss Arrangement Rules may cause a DCL to not be taken into account for purposes of the Transitional CbCR Safe Harbor. As discussed further herein, these rules are not comprehensive anti-loss duplication rules and leave several circumstances in which a DCL may still be taken into account for purposes of calculating a Top-Up Tax

6 T.D. 9315 at 12,910 (Mar. 19, 2007).

7 *Id*. at 12,911.

into whether a loss will in fact result in a foreign tax benefit under a foreign income tax law. That presumption is not appropriate in the context of a Top-Up Tax. There, a DCL will frequently not impact a taxpayer's liability under a Top-Up Tax where the foreign income is subject to a sufficiently high rate of tax.[8]

The application of the DCL rules to Top-Up Taxes is also inconsistent with the design of the GloBE Model Rules, which explicitly apply only after application of a jurisdiction's ordinary income tax laws.[9] The intended rule order is that each jurisdiction first applies its ordinary domestic tax laws. Then, countries may impose QDMTTs. Finally, an IIR or UTPR may be imposed. If a country were to subsequently apply its domestic tax laws after the application of a Top-Up Tax, that would create a circular reference (or recursion) problem because the application of the Top-Up Tax would depend upon the application of the domestic tax law and vice versa.[10] This is the same problem addressed by Notice 2023-80 regarding Top-Up Taxes and the U.S. foreign tax credit.

If the DCL rules are to apply after Pillar Two, the likely result would be the same as that in the foreign tax credit context: less U.S. revenue due to greater foreign tax credits. Where an operating loss ceases to be deductible due to the DCL rules, many taxpayers will respond by increasing the taxable income earned in the applicable jurisdiction to avoid a DCL (e.g., by capitalizing debt into equity). These changes, in turn, will tend to increase foreign income taxes paid, and therefore either (i) increase foreign tax credits claimed by U.S. taxpayers to the detriment of the U.S. fisc; or (ii) result in additional double taxation for taxpayers who deduct foreign taxes or have insufficient foreign tax credit limitation to fully credit the additional foreign taxes during the carryforward period.

The application of the DCL rules is not mandatory in all instances. For example, section 1503(d) applies to "separate units" (e.g., foreign disregarded entities or branches) "to the extent provided in regulations." This flexibility provides the Government discretion to apply the DCL rules in a manner that appropriately balances the policy interests of the United States. Given (i) that Top-Up Taxes under Pillar Two were never considered by Congress when the DCL rules were enacted;

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[8] Similarly, a DCL will have no impact on Top-Up Tax liability where a taxpayer has a substance-based income exclusion in excess of their GloBE Income even without the DCL.

[9] OECD Commentary to the GloBE Model Rules, Article 4.3.2, ¶ 45 ("It is intended that the GloBE Rules apply *after* the application of . . . domestic tax regimes.") (emphasis added).

[10] As an example of this circularity, the application of the Pillar Two Duplicate Loss Arrangement or Deduction/Non-Inclusion rules depends in part on the application of the U.S. DCL rules and vice versa. Additionally, the application of the DCL rules may result in the creation of a deferred tax asset with respect to a foreign Constituent Entity (e.g., an expense that is deducted currently for book purposes but may be deducted in a future year for U.S. tax purposes), which will reduce Adjusted Covered Taxes and thereby lower the jurisdiction's effective tax rate in the year in which the deferred tax asset is booked. This adjusted covered tax reduction could result in additional Top-Up Tax in that year, and will not reduce Top-Up Tax in future years in many cases.

(ii) the agreed upon rule order contained in the GloBE Model Rules; (iii) the unexpected, significant impact on U.S. multinationals that would result from applying the DCL rules to a Pillar Two Top-Up Tax; and (iv) the likely behavioral response from taxpayers that would impair the U.S. fisc, it would be prudent to stay the application of these rules until Congress weighs in on the matter.[11]

If the Government declines to stay the application of the DCL rules to Top-Up Taxes, additional relief from foreign use should still be provided. This relief would be broader than the Duplicate Loss Arrangement ("DLA") relief provided in Prop. Treas. Reg. § 1.1503(d)-3(c)(9) (the "DLA Exception"). Under the DLA Exception, a DCL is not treated as put to a foreign use under Pillar Two if the loss is disallowed for purposes of the Transitional CbCR Safe Harbor by reason of the DLA rules if the Safe Harbor is nevertheless satisfied.[12] The DLA Exception is narrow, however, in that it requires the DCL to be disallowed under the DLA rules. That may not occur where an arrangement was entered into prior to the effective date of the DLA rules (at the earliest, December 15, 2022). Additionally, at least one jurisdiction (Luxembourg) has added a condition to its proposed version of the DLA rules such that the DLA Exception only applies where an arrangement is entered into with a purpose to qualify for the Transitional CbCR Safe Harbor. In our experience, most foreign branch structures were not created to qualify for the safe harbor, and, therefore, the Luxembourg DLA rule may not apply to disallow the duplicate loss and thereby prevent a foreign use.

This observation highlights one problem with relying on the DLA rules as a tool to prevent DCLs from being put to a foreign use where Inclusive Framework Members have inconsistently adopted the DLA rules. Another problem is that the December 2023 OECD administrative guidance adopted the rules regarding hybrid arbitrage arrangements, including the DLA rules, as anti-abuse rules to police application of the safe harbor rules. They were not drafted as a comprehensive anti-loss duplication regime, such as the rules in ATAD II and the BEPS Action 2 Report. In light of their incomplete scope, the DLA rules (as actually enacted by various taxing jurisdictions) cannot be relied upon to prevent a foreign use of related DCLs.

To add to this point and provide an illustration of the compliance exercise that would be required under the Proposed Regulations, consider the example of a calendar-year U.S. multinational taxpayer that owns a loss-making branch and a profitable CFC in a high taxed country (e.g., India) in 2025. To make a domestic use election, the taxpayer must demonstrate that its branch losses cannot be put to a foreign use, including because of the application of the Transitional CbCR Safe Harbor. The application of this safe harbor will in turn depend on whether and how the UTPR has been

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[11] To the extent that the Government's application of the DCL rules to Pillar Two is motivated by concerns over taxpayer planning to minimize their Top-Up Tax liability, we suggest that the proper vehicle to address such concerns would be through administrative guidance at the OECD.

[12] This would often occur in the circumstances described above where foreign income tax law imposes a high rate of tax and does not permit tax consolidation, loss sharing, or similar measures.

implemented in every foreign jurisdiction in which the multinational operates.[13] That exercise may involve dozens of countries and would require confirmation of, under each jurisdiction's law, (i) whether the UTPR is currently applicable; (ii) whether the implementing legislation contains a DLA rule; (iii) whether the DLA rule applies to the taxpayer's loss making separate unit or dual resident corporation; and (iv) whether the Transitional CbCR Safe Harbor has been satisfied. Based on our experience, there are subtle differences in each country's implementing legislation, such that a separate analysis must be performed for each country – as opposed to a single analysis under the Pillar Two Model Rules. An erroneous answer in a single country will, under the Proposed Regulations, result in a foreign use of the DCL. As result, the exercise of proving a negative to make a domestic use election may become insurmountable for some.[14] That multinationals may be unable to currently deduct these losses will come as an abrupt shock to many.

A more flexible and robust approach to relief would be simply to ask whether the DCL has impacted a taxpayer's liability for a Top-Up Tax. This question can be answered through a straightforward with-and-without calculation under the simplifying assumption that every jurisdiction has fully implemented the Pillar Two Model Rules and Administrative Guidance.[15] Only to the extent a taxpayer's Top-Up Tax liability would have been higher after taking account the DCL in this hypothetical exercise should there be a foreign use. The following example illustrates this suggested relief.

USP, a domestic corporation, owns a hybrid entity separate unit in Country Y (DEY). USP also owns a CFC that is tax resident in Country Y (CFCY). DEY and CFCY do not consolidate for Country Y income tax purposes, and both are subject to a 30 percent income tax rate. In 2025, DEY incurs a $10x business loss that is a DCL, and CFCY earns $30x, resulting in $9x of foreign income tax. Ten jurisdictions within the USP group have adopted the UTPR for 2025. In assessing whether DEY's losses have impacted the amount of a Top-Up Tax, the with-and-without calculation should be performed by assessing the Top-Up Tax liability attributable to Country Y determined with and without the $10x net loss attributable to DEY. Without considering DEY's net loss of $10x, there would be no liability for the UTPR since the tax rate in Country Y would exceed 15 percent (i.e., $30x x 30% = $9x, which is higher than $4.5x). Accordingly, the DEY DCL should not be deemed to be put to a foreign use, and a domestic use election should be available.

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[13] The Transitional UTPR Safe Harbor from the July 2023 Administrative Guidance only applies to the "UPE Jurisdiction," which in this example is the United States, not India.

[14] The burden will not fall solely on taxpayers. The Service would also be required to understand foreign law, including UTPRs, to determine whether a DCL has in fact been made available to reduce foreign income under a relevant Top-Up Tax

[15] We acknowledge that this relief would depart from the historic "made available" standard in the current DCL regulations, but this departure is warranted for the reasons discussed herein.

We recognize this is a simple example where there are no U.S. and foreign timing mismatches. The example would be slightly more complex should timing differences arise. However, this complexity is mitigated in part by the fact that the GloBE model rules adopt deferred tax rules that attempt to smooth out timing differences between U.S. tax and financial accounting and by the requirement to recapture a DCL that is put to a foreign use during the five-year certification period under existing DCL regulations. We would be happy to further discuss these issues and provide additional examples upon request.

B. *Alternatively, the DLA Exception should be expanded to allow some flexibility where jurisdictions have not fully implemented the OECD administrative guidance*

If the Government determines that the existing foreign use framework should apply to Top-Up Taxes, the final regulations should relax the DLA Exception under Prop. Treas. Reg. § 1.1503(d)-3(c)(9). This would accommodate the fact that some jurisdictions have not timely incorporated the DLA rules into their domestic legislation and some that have incorporated these rules have not done so consistently with the OECD Administrative Guidance.

The DLA Exception provides that there will be no foreign use of a DCL under Pillar Two where the applicable jurisdiction satisfies the Transitional CbCR Safe Harbor and the loss is disallowed under the DLA rules. In essence, the DLA rules are the GloBE Model Rules' double deduction regime. The DLA Exception is a helpful exception to foreign use, as it permits the DLA rules to police double dips first. However, for various reasons, many jurisdictions have not yet incorporated the OECD Administrative Guidance containing the DLA rules into their domestic law. Further, the DLA rules do not yet apply for purposes of the full GloBE Model Rules. This leaves a significant number of jurisdictions that effectively do not apply the DLA rules to relevant determinations of Top-Up Tax. During this implementation period, the DLA Exception should be expanded to assume application of the DLA rules to all relevant Top-Up Tax determinations.

Expanding the DLA Exception to assume consistent application of the DLA rules would ameliorate significant uncertainty during the Top-Up Tax implementation phase. At the same time, however, the exception would not shield abusive transactions that affirmatively rely on taking a DCL into account for purpose of satisfying the Transitional CbCR Safe Harbor. If a taxpayer would not satisfy the safe harbor without the duplicate loss, the related DCL would not satisfy the expanded DLA Exception since the loss would be taken into account for purposes of calculating the taxpayer's Top-Up Tax under the regular GloBE rules. Treasury and the Service could also consider conditioning the expanded DLA Exception on an anti-abuse rule, similar to the anti-abuse rule for the deferred incorporation of Top-Up Taxes into the DCL regime under Prop. Treas. Reg. § 1.1503(d)-8(b)(12)(ii), to distinguish circumstances where taxpayers have intentionally avoided application of the DLA rule from benign circumstances where it does not apply because of an intentionally limited scope. Under this approach, non-application of the DLA rule because, for example, the arrangement

was not entered into with a principal purpose of reducing Top-Up Tax or was not entered into after the effective date could be deemed non-abusive, permitting taxpayers to apply the hypothetical DLA rule for purposes of testing foreign use.[16]

C. *Confirm that tax due under a UTPR is not an income tax for purposes of the DCL Regime*

The UTPR does not resemble the income taxes imposed in chapter 1 of the Code[17] or the foreign income taxes to which section 901 would apply,[18] as a taxpayer's UTPR liability is unrelated to income earned by either the taxpayer or any entity in which it owns a direct or indirect equity interest. Rather, the GloBE Model Rules may impose a UTPR on a taxpayer with respect to the income of a low-taxed constituent entity when it is part of the same multinational enterprise ("MNE") group.

The UTPR liability is allocated among taxpayers resident and/or located in jurisdictions with qualifying UTPRs based on their relative share of the group's tangible property and employees. Additionally, the UTPR can be collected through mechanisms such as denial of deductions or equivalent adjustments, effectively functioning as an excise tax on the status of being part of an MNE group with low-taxed constituent entities.

It is unclear whether the UTPR should be treated as a foreign income tax for purposes of the DCL rules. Unlike an IIR, there is no analog to the UTPR in the Code. Some commentators have claimed that the UTPR is not a covered tax for purposes of U.S. income tax treaties on the basis that it is not an income tax.[19] If these views are ultimately adopted by the Government, for the sake of

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[16] This expanded DLA Exception would differ from the with-and-without exception described above because the DLA rules can disallow gross losses in excess of a Constituent Entity's net loss where the entity earns income that is not subject to U.S. tax. For example, if a disregarded entity provides services to its owner in exchange for a disregarded reimbursement payment (e.g., a cost-plus arrangement), the entity will incur a DCL comprising its regarded expenses (e.g., employee wages, rent) that is not offset by its disregarded income, even though this income is included in the foreign tax base and will preclude the ability to "double dip" the DCL as a practical matter. This amount will also be subject to the DLA rule since the regarded expenses that are reflected on the disregarded entity's books and records generally are deductible for U.S. tax purposes. Similar to the DCL analysis, the amount subject to the DLA rule is not reduced to account for the disregarded income or other permanent differences. Furthermore, the DLA rule applies separately to each Constituent Entity, as it does not contain a Constituent Entity combination rule. Thus, an expanded DLA rule exception is not our preferred approach, although it may improve if the DLA rules are better tailored in forthcoming Administrative Guidance

[17] *See*, *e.g.*, sections 1, 11, 56A, 59A, 871, 872, 881, and 882.

[18] *See*, *e.g.*, Treas. Reg. § 1.901-2(b)(2)(i)(A)-(C) (as amended by T.D. 9959, 87 F.R. 276-376). Also see, e.g. the prior version of Treas. Reg. § 1.901-2(b)(2)(i)-(iii) (as amended by T.D. 9634, 78 F.R. 54,391).

[19] *See*, *e.g.*, Christians and Shay, "The Consistency of Pillar 2 UTPR With U.S. Bilateral Tax Treaties," 178 Tax Notes Federal 499 (Jan. 23, 2023).

consistency, the Government should also provide that a UTPR is not an income tax for purposes of the DCL regime.

D. *Extend Transition Relief through at least 2025*

On July 17, 2023, the OECD issued its second set of Administrative Guidance on the GloBE Model Rules, which provided guidance on a new transitional UTPR safe harbor. The transitional UTPR safe harbor provides that any taxpayer with a UPE based in a jurisdiction that has a statutory corporate income tax rate of at least 20% may elect to not be subject to the UTPR with respect to the UPE jurisdiction in fiscal years that that begin on or before December 31, 2025, and end before December 31, 2026. However, even where the UPE jurisdiction imposes a corporate income tax with a 20 percent rate, UTPR may be imposed with respect to subsidiaries in other jurisdictions.

On December 11, 2023, the Government issued Notice 2023-80, which announced a transition rule under which no foreign use of a DCL would occur by reason of a legacy DCL being taken into account under the GloBE rules. A legacy DCL generally is a DCL incurred in a taxable year beginning before December 31, 2023. The Proposed Regulations generally extend this relief to losses incurred in taxable years beginning before August 6, 2024. When this transition relief applies, the DCL rules do not consider any QDMTT, IIR, or the Transitional CbCR Safe Harbor.

In light of the continuing uncertainty with respect to the design and implementation of Pillar Two, additional transitional relief should be granted until the rules have settled. It is unfair to taxpayers to apply the DCL rules for foreign income taxes that are still being actively developed at the same time they are being implemented, especially where the United States is negotiating a comprehensive solution to loss duplication issues with respect to its companies. Continued uncertainty on these matters will have real financial reporting consequences for U.S. companies, as tax reserves must be recorded well before any return is filed.

Further, neither Notice 2023-80 nor the Proposed Regulations address the treatment of the UTPR, which the Government has indicated it is analyzing. While this analysis is ongoing, the DCL transition relief with respect to UTPR should be extended at least through calendar year 2025.[20] This extended relief period will permit the Government to propose and/or issue comprehensive guidance regarding the interaction of the DCL rules and the UTPR and will permit taxpayers to participate in the notice and comment process, while also adapting their reporting systems to both comply with the UTPR and evaluate any interaction it has with the DCL rules.

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[20] In 2025, several jurisdictions' UTPRs will come into effect, causing taxpayers to have to analyze the potential foreign use of a DCL under several foreign income taxes. The Transitional UTPR Safe Harbor will not apply for this purpose, given that it only applies for purposes of the UPE Jurisdiction (i.e., the United States in the case of a U.S.-based multinational.

Treasury and the IRS should also consider providing relief on a more permanent basis where the risk of a foreign tax benefit from a DCL is low. This could include a white list of countries with low-risk corporate tax regimes or, alternatively, a safe harbor that applies based on a 20% statutory tax rate, similar to that provided by the transitional UTPR Safe Harbor.

II. Other DCL Recommendations

A. *Narrow the definition of a "triggering event" to permit taxpayers to make a domestic use election and prevent unintentional recapture if a triggering event besides foreign use occurred before the taxable year in which a DCL is incurred*

Treas. Reg. § 1.1503(d)-6(e)(1) contains several triggering events that Treasury and the IRS determined were generally indicative of foreign use.[21] Under the current final regulations, a dual resident corporation or domestic owner may not make a domestic use election with respect to a DCL if a triggering event occurred in the taxable year in which the DCL was incurred.[22] Further, if a triggering event occurs during the certification period of a DCL, a dual resident corporation or domestic owner that has made a domestic use election must recapture the DCL into income.[23]

Due to timing differences between U.S. and foreign tax law, it is possible for a foreign use to occur before the taxable year in which a DCL is incurred.[24] To address these circumstances, the Proposed Regulations would revise both the definition of a certification period and the prohibition on making domestic use elections in the taxable year in which a DCL was incurred to consider prior periods. However, these revisions are overinclusive and may be interpreted to prevent taxpayers from making domestic use elections with respect to DCLs for which there has been no foreign use. Consider the following example:

> USCorp is a domestic corporation that owns all the equity interests in DRE1, an entity organized under the laws of Country A and subject to Country A corporate income tax at the entity level but disregarded as separate from USCorp for U.S. federal income tax purposes.
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> In 2004, DRE1 operated two businesses: Business X and Business Y. At a time when at least 50 percent of DRE1's assets (measured by fair market value) were used in Business Y, DRE1

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[21] *See* Preamble to 1992 Final DCL regulations, T.D. 8434, 57 Fed. Reg. 41,082 (1992) ("The primary triggering event under the regulations is [foreign use]. With respect to other triggering events, an effort has been made to target more closely than under the temporary regulations transactions that either increase the likelihood that the dual consolidated loss will be used to offset the income of another person for foreign tax purposes or increase the difficulty of monitoring such foreign use.").

[22] Treas. Reg. § 1.1503(d)-6(d)(2).

[23] *See generally* Treas. Reg. § 1.1503(d)-6(h).

[24] *See* Chief Counsel Memorandum AM 2009-11, n.34.

disposed of Business Y to a third party in a transaction described in Treas. Reg. § 1.1503(d)-6(e)(1)(iv). DRE1 continues to operate Business X.

In 2024, DRE1 incurred a DCL in connection with the operation of Business X. None of the items of expense included in the 2024 DCL bear an economic or factual relationship to items incurred by DRE1 in connection with its operation or disposition of Business Y.

DRE1's disposition of at least 50 percent of its assets was a triggering event under Treas. Reg. § 1.1503(d)-6(e)(1)(iv). Under Prop. Treas. Reg. § 1.1503(d)-6(d)(2), "if a separate unit incurs a [DCL] and a triggering event . . . occurs (and no exception applies) with respect to the [DCL] in or before such taxable year, then the [domestic owner] may not make a domestic use election with respect to such DCL and the loss will be subject to the domestic use limitation rule of § 1.1503(d)-4(b)." Apart from foreign use, the other triggering events under Treas. Reg. § 1.1503(d)-6(e)(1) do not describe the relationship between the triggering event and a DCL. For example, it is not clear under what circumstances a disposition of assets is a triggering event "with respect to" a DCL. However, some may conclude that any triggering event related to the separate unit that incurs a DCL is a triggering event with respect to such DCL. In that case, under Prop. Treas. Reg. § 1.1503(d)-6(d)(2), the prior disposition of Business Y assets could prevent USCorp from making a domestic use election with respect to any future DCL incurred by DRE1.

This potential interpretation is inappropriate and appears unintended. To avoid this result, the Government should revise Treas. Reg. § 1.1503-6(d)(2) to only prohibit a domestic use election if (i) any triggering event occurs during the taxable year in which a DCL is incurred, or (ii) if a foreign use of the DCL has occurred before such year. Although the other triggering events generally may be indicative of foreign use, they do not raise any of the concerns that underlie the domestic use limitation rule unless they also cause a foreign use. For the same reasons, the Government should also clarify Treas. Reg. § 1.1503-6(e)(1) to require recapture only upon occurrence of the following events during the certification period: (i) foreign use, or (ii) another triggering event, if that triggering event occurred in a taxable year following the year in which the DCL was incurred.

B. *Clarify the Scope and Application of the Anti-Avoidance Rule*

The Proposed Regulations include a broad anti-avoidance rule that applies "[i]f 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)." In that case, "appropriate adjustments will be made." The final regulations should clarify both the scope of the contemplated transactions and arrangements, as well as the nature of any appropriate adjustments.

As a threshold matter, the anti-avoidance rule should include multiple clear examples of what constitutes an avoidance transaction. Providing specific examples of transactions that would be considered abusive under the rule can help taxpayers understand the boundaries of acceptable

behavior. For instance, the Proposed Regulations could illustrate scenarios where the transfer of assets or the use of disregarded payments would trigger the anti-avoidance rule. The proposed anti-avoidance rule contains one example: a transaction, etc. "engaged in with a view to reduce or eliminate a [DCL] or [DPL] while putting an item of deduction or loss that composes (or would compose) the [DCL] or [DPL] to a foreign use."[25] This appears to illustrate that the purpose of section 1503(d) and the regulations thereunder is to prevent both a domestic use and foreign use of the same or related items. In this regard, the final regulations should clarify that a transaction engaged in with a view to eliminate a (direct or indirect) foreign use does not trigger adjustments under the anti-avoidance rule.

Further, taxpayers need guidance on how to conform DCLs to a local tax base without triggering the anti-avoidance rule. That is, a transaction or arrangement that causes a taxpayer's books and records to align more closely with the treatment of items under foreign tax law may reduce a DCL or DPL, but it should not be recharacterized under the anti-avoidance rule because it does not alter the amount of the DCL or DPL that may be put to a foreign use. As an example, taxpayers may restructure arrangements where a disregarded entity provides services to its owner such that the disregarded payments received in exchange for services become regarded payments (e.g., by transferring the disregarded entity to a new owner within a consolidated group). Such transactions would have the effect of reducing the amount of a DCL, since the disregarded income would become regarded, but should not be viewed as violating the purposes of the DCL rules since the transaction has the effect of conforming the U.S. and foreign tax bases with respect to the operations of the disregarded entity. In this regard, the anti-avoidance rule should explicitly not apply to any transaction or arrangement that only affects the amount of a DCL or DPL by causing items that were previously disregarded for U.S. federal income tax purposes to be regarded.

The final regulations should also address the nature of adjustments under the anti-avoidance rule. The proposed anti-avoidance rule gives an open-ended example of contemplated adjustments as including "adjustments to disregard the transaction, plan, or arrangement, or adjustments to modify the items that are taken into account for purposes of determining the income or [DCL] attributable to a dual resident corporation or separate unit . . . ." This high-level illustration only addresses adjustments to the amount of a DCL. The final regulations should also clarify that the anti-avoidance rule cannot deem a foreign use or other triggering event to arise. If there is in fact no foreign use of a DCL (e.g., because items of expense that compose the DCL are not deductible under

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25 The phrase "with a view to" is used elsewhere in regulations, such as Treas. Reg. § 1.367(b)-10, and is a source of confusion, as it is unclear whether the standard means that a tax benefit must have been a significant motivation for a decision or, rather, mere awareness of a tax benefit would be sufficient to meet the standard. A more useful standard, therefore, would be the commonly used "with a principal purpose" standard.

the relevant foreign tax laws), the regulations should not deem one to occur, even if the taxpayer engages in a transaction with the explicit intention of eliminating the foreign use.

III. Disregarded Payment Loss Rules

A. *The Government should withdraw the Proposed DPL Rules*

As discussed above, Congress enacted section 1503(d) to prevent double dipping of a single economic loss. The Proposed Regulations would add to the regulations under section 1503(d) a new set of rules addressing a deduction / no inclusion ("D/NI") hybrid mismatch arising when certain deductions accrue under foreign law with respect to transactions between disregarded entities and their owners (or between two disregarded entities of the same taxpayer)[26] for U.S. federal income tax purposes. The Code does not mention or allude to disregarded payment losses, nor does it contain any provision requiring taxpayers to include an amount in income corresponding to the amount of a deduction under foreign tax law. It is Congress's prerogative whether to require taxpayers to include novel amounts in income, and Congress has not enacted such an income inclusion. Following the Supreme Court's decision in *Loper Bright*,[27] Treasury and the Service should apply their rulemaking power consistently with congressional intent. *Chevron* deference no longer permits an agency to use any ambiguity in a statute as an invitation to make policy. For this reason, the proposed DPL rules should be withdrawn.

If the absence of congressional direction were an insufficient reason to abandon the proposed DPL regime, the Government should also withdraw the proposed DPL rules because of the significant uncertainty they would inject into the entity classification regulations. Subject to well-established limitations, the entity classification regulations permit taxpayers to elect to treat business entities as associations, partnerships, or disregarded entities.[28] These regulations have significantly reduced tax controversy, and the associated administrative burden involved in determining an entity's classification. The Proposed Regulations would undermine this certainty by conditioning entity classification elections on taxpayers' consent to an anti-hybrid regime that Treasury and the Service have created from whole cloth, and which is subject to numerous ambiguities and cliff effects.

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[26] In circumstances in which a DPL arises due to a payment between two disregarded entities, a D/NI outcome may not occur. Considering the widespread adoption of BEPS anti-hybrid rules, it is likely that either (i) the payor jurisdiction would deny a deduction for a payment that is not taxed by the recipient or (ii) the payee jurisdiction would include the payment in income. Thus, the policy rationale for applying the DPL rules will not be present in many circumstances involving payments between disregarded entities.

[27] *Loper Bright Enterprises v. Raimondo*, 144 S. Ct. 2244 (2024)

[28] *See* Treas. Reg. §§ 301.7701-1 through -3.

B. *Should the Government finalize the DPL rules, we recommend the following adjustments*

1. The DPL rules should not apply where the applicable jurisdiction has enacted anti-hybrid rules consistent with BEPS Action 2

The preamble to the Proposed Regulations describes foreign anti-base erosion concerns as the motivation for the DPL rules; in particular, that a foreign tax base can be eroded through D/NI arrangements. Where a foreign jurisdiction has enacted anti-hybrid rules consistent with BEPS Action 2 (e.g., the ATAD II anti-hybrid rules), however, that foreign jurisdiction has taken appropriate steps to police the erosion of its own tax base and, therefore, the DPL rules should not be necessary. One might argue that this type of exception is implicit in the proposed DPL rules in that a DPL only arises if an amount is deductible in a foreign jurisdiction. Presumably, if the deduction has been disallowed under local anti-hybrid legislation, the DPL rules would not apply to the underlying payment. This rule is overbroad, however. Local anti-hybrid rules may not apply for a number of reasons, such as the where foreign law treats a payment as subject to tax and therefore not as a D/NI outcome (e.g., a disregarded loan from a German disregarded entity to a French disregarded entity is certainly "subject to tax" in the eyes of the foreign jurisdiction). For this reason, the DPL rules, if applied in addition to a local country's anti-hybrid legislation, may have the effect of undoing the jurisdiction's carefully crafted anti-hybrid policies. The DPL rules would also needlessly add to taxpayers' compliance burdens where a foreign country has policed its own tax base through domestic legislation.

2. Deductions considered in computing a DPL should include only disregarded interest and structured payments and not disregarded royalties

Under the Proposed Regulations, the DPL rules would apply to transactions giving rise to foreign deductible payments that, if regarded for U.S. federal income tax purposes, would give rise to a financing or license arrangement. If the Government ultimately finalizes the DPL rules, they should limit the covered transactions to financing arrangements and exclude disregarded licenses because, unlike disregarded financing arrangements, disregarded licenses within domestic corporations do not create a significant risk of double-non taxation.

In a disregarded financing arrangement, a lender provides capital to a disregarded entity in exchange for compensation that is deductible under foreign tax law. Such a financing arrangement may arise from an advance of funds or property or from the settlement of a liability. Further, the funded entity may use the funds to directly finance ongoing operations or to fund a short- or long-term investment that may take the form of debt or equity. In other words, because money is fungible, there is no definite relationship between interest expense and any specific items of income. But in any case, financing can give rise to deductible interest expense even if it does not result in income-producing assets.

Unlike interest, royalty expense only arises from the license of intangible property and disregarded royalty expense subject to the DPL rules only arises from the license of intangible property that is treated as held or licensed by a domestic corporation for U.S. federal income tax purposes. Unlike financing, intellectual property rights are not fungible. Rather, a disregarded license will in almost all circumstances create substantial dual inclusion income, which the proposed DPL rules do not take into account. Specifically, most royalties are structured as a percentage of sales, where the sales income would constitute dual inclusion income.

Disregarded royalties also are less likely to arise from artificial transactions motivated primarily by tax avoidance. Section 267A and BEPS Action 2 target D/NI arrangements by denying deductions for certain interest and royalty expenses because financing and royalty income are highly mobile and may be located in low-tax jurisdictions. By contrast, locating intangible property ("IP") ownership in a domestic corporation is likely to increase the total U.S. and worldwide tax on IP returns (i.e., the United States is not a tax haven). Accordingly, disregarded royalties are a poor target for an aggressive anti-hybrid regime.

More plainly, applying the DPL rules to disregarded royalties imposes additional tax costs on taxpayers that have developed or acquired IP in the United States. As one of the consistent bipartisan goals of U.S. international tax policy is to ensure that valuable IP is developed and located in the United States, Treasury and the Service should not discourage domestic ownership of such intellectual property. The DPL rules will directly incentivize the outbound transfer and offshore development of such assets.[29]

3. Reduce the amount of any DPL by other income items attributable to the disregarded payment entity; or, alternatively, modify the DCL rules to account for disregarded transactions

The DPL rules operate independently of the DCL rules. This means that items regarded for U.S. tax purposes are only considered in computing a DCL, while certain items that are disregarded for U.S. tax purposes are only considered in computing a DPL.

A disregarded payment entity may have both a DCL and a DPL for the same taxable year, attributable to its regarded and disregarded expenses, respectively. These losses could be triggered by a single event, such as a foreign use pursuant to a foreign loss surrender regime.

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[29] For the avoidance of doubt, the scope of the DPL rules should not be expanded to include other deductible amounts, such as service payments. Likely royalties, deductible services payments are particularly likely to produce dual inclusion income, which the Proposed Regulations do not consider. Imposing additional tax on services performed in the United States would also increase the incentive to relocate economically productive services to other jurisdictions.

The Government has stated that the decision to keep the DPL rules separate from the DCL rules reflects a balance between policy objectives and administrative simplicity, as integrating the two regimes could result in considerable complexity and administrative burden. However, requiring taxpayers to track, certify, and potentially recapture into income two separate attributes creates significantly more complexity. Combining the DCL rules and DPL rules can be justified for the following reasons:

i. Comprehensive Coverage: Integrating the two sets of rules could provide a more comprehensive framework for addressing tax avoidance. By considering both regarded and disregarded transactions, the combined rules could more effectively neutralize double-deduction and D/NI outcomes. For example, the DPL rules could merely be used as a tool to adjust a separate unit's DCL and DCL cumulative register or to use disregarded payments to attribute items of income or expense to or from a separate unit for purposes of computing DCL items.

ii. Consistency in Tax Treatment: A unified set of rules could ensure consistent treatment of similar transactions, regardless of whether they are regarded or disregarded for U.S. tax purposes. This consistency could reduce opportunities for tax planning that exploit differences between the two regimes.

iii. Simplified Compliance: Having a single set of rules to follow could simplify compliance for taxpayers. Instead of navigating two separate regimes, taxpayers would only need to understand and apply one integrated set of rules, potentially reducing administrative costs and the risk of error.

4. Clarify the effective date of the DPL regime and the scope of consent to the rules

The Proposed Regulations implement the DPL regime through a consent mechanism. Prop. Treas. Reg. § 301-7701-3(c)(4)(i) provides, in relevant part:

> If a specified eligible entity elects to be (or is formed or acquired after August 6, 2024 and classified without an election as) disregarded as an entity separate from its owner, then a domestic corporation, if any, that on the effective date of the election (or on the date of formation or acquisition absent an election) owns directly or indirectly interests in the specified eligible entity consents to be subject to the disregarded payment loss rules of § 1.1503(d)–1(d) of this chapter. For this purpose, a specified eligible entity means an eligible entity (regardless of whether domestic or foreign), provided that the entity is a foreign tax resident or is owned by a domestic corporation that has a foreign branch.

Once a taxpayer has consented, Prop. Treas. Reg. § 1.1503(d)-1(d) would require compliance with the DPL rules, including the proposed income inclusion:

> As provided in § 301.7701–3(c)(4)(i) of this chapter, a domestic corporation that directly or indirectly owns interests in a specified eligible entity (as defined in § 301.7701–3(c)(4)(i) of this chapter) classified as a disregarded entity consents to be subject to the disregarded payment loss rules of this paragraph (d). Pursuant to such consent, the domestic corporation agrees that if the specified eligible entity or a foreign branch of the domestic corporation (the specified eligible entity or such a foreign branch, a disregarded payment entity, and the domestic corporation, a specified domestic owner) incurs a disregarded payment loss (other than a disregarded payment loss described in paragraph (d)(7)(iii) of this section) and a triggering event occurs with respect to the disregarded payment loss during the DPL certification period, then, for the taxable year of the specified domestic owner during which the triggering event occurs, the specified domestic owner includes in gross income the DPL inclusion amount.

Neither the consent nor the operative rule is specific to the specified eligible entity to which the "election, formation, or acquisition" relates. As a result, the Proposed Regulations appear to require taxpayers to consent to application of the DPL rules with respect to all the taxpayers' disregarded entities if a consent transaction occurs with respect to a single disregarded entity. Often these will be ordinary business transactions. For example, if a taxpayer owns a foreign branch, its formation of a domestic disregarded single-member LLC to operate a domestic business appears to require the taxpayer to apply the DPL rules with respect to all its disregarded entities.

Further, because individual domestic corporations consent to application of the DPL rules, transactions between members of a consolidated group (e.g., the acquisition of an interest in a partnership that holds foreign disregarded entities into an affiliate) may also trigger consent.

If the Government maintains a consent mechanism, it should be narrow, requiring taxpayers to consent only in connection with transactions through which they plausibly might incur a DPL and limiting any such consent to DPLs incurred through the entity for which an election is made.

The final regulations should also clarify that deductions accruing under foreign law are not considered in computing a DPL until after the taxpayer consents. As discussed above, the operative rules requiring taxpayers to include in income the DPL inclusion amount only apply to taxpayers who have consented to be subject to the DPL rules. However, the Proposed Regulations do not clearly limit the amount of a DPL to the portion of deductions under foreign law that accrue after a

taxpayer has consented.[30] Amounts accruing under law before consent should not be considered in computing a DPL or DPL inclusion amount because the DPL rules only apply to consenting taxpayers.

Finally, the DPL rules should apply prospectively. We anticipate a robust notice and comment process in respect of the Proposed Regulations and, consequently, would expect material changes to the DPL rules. Taxpayers should have advance notice of these rules before they apply to their existing businesses, which have been structured against a backdrop of decades of stable tax rules. While the preamble to the Proposed Regulations notes certain policy concerns underlying the DPL rules (i.e., addressing D/NI outcomes), we do not believe these concerns, which relate to reductions of a foreign country's tax base, warrant retroactive application. Rather, the rules should apply to future periods after stakeholders have had the opportunity for input and advance notice, thereby reflecting best practice under the Administrative Procedure Act.[31] More specifically, the DPL regulations, if and when finalized, should apply to taxable years beginning after the date of publication in the Federal Register.

5. Clarify that the DLA Exception and DCL transition relief apply to both the DPL rules and the DCL rules

The Proposed Regulations provide that the determination of whether there is a foreign use of a DPL is to be made under the principles of Treas. Reg. § 1.1503(d)-3. This includes the exceptions outlined in Treas. Reg. § 1.1503(d)-3(c). Specifically, the DLA Exception limits foreign use where a DCL is subject to the DLA rule and the jurisdiction nonetheless satisfies the Transitional CbCR Safe Harbor. If the Transitional CbCR Safe Harbor is satisfied, the Top-up Tax in that jurisdiction is deemed to be zero for that taxable year, and no foreign use is considered to occur solely because any portion of the deductions or losses that compose the dual consolidated loss is taken into account in determining the Net GloBE Income in that jurisdiction for that taxable year.

The application of Treas. Reg. § 1.1503(d)-3(c)(3) should be clarified to ensure that, with respect to Top-Up Taxes, items composing a DPL can first offset the income of the separate unit before it offsets the income of a related foreign corporation. For example, where a hybrid entity has positive GloBE Income, such entity's contribution to GloBE Income in its jurisdiction is positive, so, even where there is a DPL attributable to the hybrid entity, there should be no foreign use under a Top-Up Tax.

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30 *See* Prop. Treas. Reg. § 1.1503(d)-1(d)(6)(ii) (defining disregarded payment income and DPL as the difference between certain expense and income items under foreign law, without reference to whether the taxpayer has consented to apply the DPL rules).

31 *See, e.g.*, Cass Sunstein and Adrian Vermeule, *Law and Leviathan: Redeeming the Administrative State*, Harvard University Press (2020), pp. 8, 40 (arguing that the "morality of administrative law" should limit retroactive rulemaking to circumstances involving the prevention of abuse).

Further, the Government should clarify that the DLA Exception applies when determining the foreign use of a DPL. The Proposed Regulations indicate that if the Transitional CbCR Safe Harbor is satisfied and the DLA rules apply to the deduction or loss, no foreign use is considered to occur with respect to the DCL solely because any portion of the deductions or losses that compose the DCL are taken into account in determining Net GloBE Income in that jurisdiction for that taxable year. Because the GloBE Model Rules' jurisdictional blending and the Proposed Regulations' approach to Top-Up Taxes creates significant risk of inadvertent foreign use, it is important to confirm that the DLA Exception applies to determine whether there has been a foreign use of a DPL.

The Government should also clarify that the transition relief under Treas. Reg. § 1.1503(d)-8(b)(12) is available with respect to DPLs. The transition relief applies to "losses" incurred in taxable years beginning on or before August 6, 2024. It is unclear whether this relief would also apply to a disregarded amount. However, the preamble to the Proposed Regulations indicates that the transition relief is designed to provide taxpayers more certainty, particularly while Treasury and the Service consider comments to the Proposed Regulations and consider future developments at the OECD. This reasoning is equally applicable to the DPL rules, as Top-Up Taxes are equally likely to trigger a foreign use of a DPL as a DCL.

6. Expand the DLA Exception to foreign use prevented through other Hybrid Arbitrage Arrangement Rules

The December 2023 OECD administrative guidance included three distinct rules governing the treatment of hybrid arbitrage arrangements under the Transitional CbCR Safe Harbor: a rule that applies to D/NI arrangements, the DLA rule, and a rule addressing duplicate tax recognition arrangements. As discussed above, the DLA rule roughly corresponds to the DCL rules, as a double-deduction anti-abuse rule. However, it is unlikely to prevent foreign use of a DPL because it only applies to an expense or loss that included in the financial statements of one Constituent Entity while also being included in the financial statements or a deduction for purposes of determining taxable income of another constituent entity in another jurisdiction.

By contrast, the D/NI rule under the OECD administrative guidance is likely to apply to certain arrangements that also give rise to DPLs, as it applies to:

> an arrangement under which one Constituent Entity directly or indirectly provides credit or otherwise makes an investment in another Constituent Entity that results in an expense or loss in the financial statements of a Constituent Entity to the extent that:
>
> a. There is no commensurate increase in the revenue or gain in the financial statements of the Constituent Entity counterparty; or
>
> b. The Constituent Entity counterparty is not reasonably expected over the life of the arrangement to have a commensurate increase in its taxable income.

If an expense included in a DCL or DPL is unavailable for purposes of the Transitional CbCR Safe Harbor, but a jurisdiction nonetheless satisfies the safe harbor, there should be no foreign use of the DCL or DPL, regardless of whether the expense disallowance occurs under the OECD's DLA rule or the D/NI rule. For the same reasons discussed above regarding the DLA rule, the D/NI rule should also apply to expenses that would be disallowed for purposes of the Transitional CbCR Safe Harbor if it applied to them. This will create parity between the DCL and DPL rules and their corresponding exceptions under the OECD administrative guidance.

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TEI appreciates the opportunity to comment on the Proposed Regulations. TEI's comments were prepared under the aegis of its Tax Reform Task Force, whose Chair is Andreia Veríssimo of Amazon.com. Should you have any questions regarding TEI's comments, please do not hesitate to reach out to Ms. Veríssimo at alveriss@amazon.com or to Benjamin R. Shreck of TEI's Legal Staff at bshreck@tei.org or 202.464.8353.

Respectfully submitted,

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