NOTICE 2023-80: U.S. FOREIGN TAX GUIDANCE FOR PILLAR 2

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On December 11, 2023, the I.R.S. and Treasury Department issued Notice 2023-55 (the "Notice"), announcing the intention to issue proposed regulations addressing the interaction between the Pillar 2 GloBE Rules and specific U.S. tax provisions, including the foreign tax credit rules and dual consolidated loss rules. Pillar 2 establishes a top-up tax framework through the GloBE rules, which consists of the Income Inclusion Rule ("I.I.R.") and the Undertaxed Payments Rule ("U.T.P.R."). The issuance of this guidance is timely, as the I.I.R.'s of most countries took effect at the start of this year, while the U.T.P.R.'s are scheduled to come online in 2025. The Notice does not cover the U.T.P.R., as the I.R.S and Treasury Department continue to analyze issues related to the U.T.P.R. Although the U.S. has not yet implemented the GloBE rules, in scope U.S.-based multinational enterprises ("M.N.E.'s") will be required to comply with the rules as enforced by other countries.

OVERVIEW OF PILLAR 2

Pillar 2 is part of the two-pillar solution put forth by the O.E.C.D. to address the tax challenges emerging from the digitalization of the economy. Pillar 2 is designed to ensure large M.N.E.'s pay a minimum level of tax on the income generated in each jurisdiction where they operate.

Pillar 2 consists of two main rules:

- The Subject to Tax Rule ("S.T.T.R.")
- The Global Anti-Base Erosion (GloBE) Rules

The S.T.T.R. is effectively a treaty-override provision that allows source jurisdictions to tax certain payments up to a globally agreed 9% minimum tax rate.

The primary rules under Pillar 2 are the GloBE rules, which impose a 15% minimum tax rate on in-scope M.N.E.'s with annual global revenues exceeding €750 million. The GloBE rules establish a top-up taxation framework consisting of the I.I.R. and the U.T.P.R. using a jurisdictional blending approach.

The I.I.R. is the primary mechanism to account for the top-up tax. The home jurisdiction of the Ultimate Parent Entity ("U.P.E.") of an M.N.E. group may impose an I.I.R. on the U.P.E. to the extent the effective tax rate ("E.T.R.") on income earned in any foreign jurisdiction falls below 15%. In cases where the home jurisdiction does not impose an I.I.R., the right to tax extends down the group to the next company where there is an I.I.R.

The U.T.P.R. operates as a backstop to the I.I.R. In cases where the entire top-up tax is not allocated under the I.I.R., the responsibility for addressing the outstanding top-up tax falls upon the group entities. The U.T.P.R. requires an adjustment, such

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as a denial of a deduction, that increases the tax at the level of the group entities. The adjustment is an amount sufficient to ensure that the group entities pay their share of the top-up tax remaining after the I.I.R. Each entity's share of the top-up tax is based on its *pro rata* share of the income, taking into account its relative share of assets and employees. The U.T.P.R. is designed to prevent countries from favoring their resident M.N.E.'s by abstaining from imposing the I.I.R.

The last piece of the puzzle is the Qualified Domestic Minimum Top-Up Tax ("Q.D.M.T.T."). A Q.D.M.T.T. allows the low-tax jurisdiction to apply a top-up tax on the income of a constituent entity of an M.N.E. group in its jurisdiction, as opposed to the tax being collected by other jurisdictions through the I.I.R. or U.T.P.R. Essentially, businesses would generally pay an equivalent level of tax on their profits, whether a Q.D.M.T.T. is in place or not. However, instead of allowing another country to collect that tax through the I.I.R. or U.T.P.R., the Q.D.M.T.T. guarantees the tax is remitted to the domestic government.

In general, Pillar 2 operates as follows. An M.N.E. group first determines whether it is in scope of the GloBE rules. If an M.N.E. group is in scope, it then must calculate its GloBE E.T.R. If the E.T.R. is less than the 15% global minimum rate, the group must calculate the amount of top-up tax, representing the difference between the GloBE E.T.R. and the 15% rate. The amount of top-up tax is reduced by the Q.D.M.T.T. After the reduction for the Q.D.M.T.T., if tax is still payable, the I.I.R. is applied, and then, if necessary, the U.T.P.R.

NOTICE 2023-80

GloBE Model Rules and the Foreign Tax Credit

The Notice describes rules addressing the treatment of certain taxes, including the I.I.R., U.T.P.R., and Q.D.M.T.T., under Code §§ 59(l), 78, 275, 704, 901, 903, 951A, 954, and 960. The I.R.S. and the Treasury Department intend to issue proposed regulations consistent with the guidance provided in the Notice.

Code §901 generally allows a credit for foreign income taxes paid or accrued during the taxable year to any foreign country or U.S. territory, and in the case of a domestic corporation, the taxes deemed to have been paid under Code §960. Code §903 adds that foreign income taxes include a tax paid in-lieu-of a generally imposed foreign income tax.

The rules are expected to have adverse implications for U.S. taxpayers, as both the I.I.R. and the U.T.P.R. are likely to be non-creditable for U.S. tax purposes.

Final Top-Up Tax

A foreign income tax is a "final top-up tax" if the foreign tax law takes into account taxes imposed by other countries on the entity's direct or indirect owners or on the entity itself for income earned in the foreign country.

No credit is allowed under Code §§901 or 59(l) to a person for a final top-up tax if the foreign tax law takes into account any U.S. Federal income tax liability in computing the final top-up tax (without regard to whether the person has any amount of U.S. Federal income tax liability).

The final top-up tax is treated as if it were a creditable tax at the partnership and C.F.C. level, with the disallowance of the credit pursuant to the above applying at the partner or U.S. shareholder level. This treatment is intended to facilitate appropriate results where a final top-up tax is creditable as to one partner or U.S. shareholder, but not as to another. Moreover, a final top-up tax is not taken into account in determining whether the high-tax exception under Subpart F or G.I.L.T.I. applies.

Specifically:

- A final top-up tax is treated as a creditable foreign tax expenditure under Treas. Reg. §1.704-1(b)(4)(viii)(b).
- A final top-up tax is treated as an eligible current year tax under Trea. Reg. §1.960-1(b)(5).
- In computing the effective rate of foreign income tax under Treas. Reg. §1.954-1(d)(2) and §1.951A-2(c)(7)(vi),
  - a final top-up tax is excluded from the amount of foreign income taxes described in Treas. Reg. §§1.954-1(d)(2)(i) and 1.951A-2(c)(7)(vi)(A); and
  - increases the amount of the net item of income described in Treas. Reg. §1.951-1(d)(2)(ii) and the amount of the tentative tested income item described in Treas. Reg. §1.951A-2(c)(7)(vi)(B), as applicable.

“The final top-up tax is treated as if it were a creditable tax at the partnership and C.F.C. level, with the disallowance of the credit pursuant to the above applying at the partner or U.S. shareholder level.”

If a taxpayer chooses to claim a foreign tax credit, the gross-up rule of Code §78 and the deduction disallowance rule of Code §275(a)(4) apply to any foreign income tax paid or accrued, including a final top-up tax. Code §78 requires a taxpayer to include a final top-up tax in gross income and Code §275(a)(4) denies a deduction for a final top-up tax.

The following examples illustrate the above rules.

Example 1: I.I.R. that is a Foreign Income Tax

Facts

- Country X imposes an I.I.R. on certain entities resident in Country X.
- The I.I.R. is considered a foreign income tax within the meaning of Treas. Reg. §1.901-2(a) and (b).
- Under Country X law, the I.I.R. calculation includes the foreign tax liability of direct and indirect owners if, under Country X tax law, they are part of the same M.N.E. Group as the Country X taxpayers.
- U.S.P., a U.S. corporation, owns all the stock of C.F.C.-X., a Country X corporation, which in turn owns all the stock of C.F.C.-Y., a Country Y corporation.
- U.S.P. is considered part of the M.N.E. Group with C.F.C.-X. and C.F.C.-Y. under Country X law. Accordingly, any U.S. tax liability of U.S.P. that relates to the I.I.R. is taken into account in computing the I.I.R.
- In 2024, C.F.C.-X. is liable for $5 of Country X I.I.R.

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- U.S.P. is deemed to pay $4 of the Country X I.I.R. under §960(d).
- U.S.P. chooses to credit foreign income taxes for 2024.

<u>Analysis</u>

The Country X I.I.R. is a final top-up tax because it is a foreign tax that takes into account taxes imposed by other countries on the owners of the entity subject to the I.I.R. with respect to income subject to the Country X I.I.R.

U.S.P. cannot claim a Code §901 credit for the $4 of Country X I.I.R. because, according to Country X law, the U.S. Federal income tax liability of U.S.P. may be considered in the Country X I.I.R. calculation.

It does not matter whether U.S.P. has any amount of U.S. Federal income tax liability or whether any of that liability is taken into account in computing the Country X I.I.R.

The amount included in U.S.P.'s income by reason of Code §78 and Treas. Reg. §1.78-1(a) is $5.

<u>Example 2: Minority U.S. Shareholder</u>

<u>Facts</u>

Same as Example 1, but with the following variations:

- U.S.P. and U.S.M., a U.S. corporation, own 70% and 30% of HoldCo, a C.F.C. in Country A.
- HoldCo owns all the stock of C.F.C.-X.
- U.S.M. is not part of the same M.N.E. Group as U.S.P., C.F.C.-X., and C.F.C.-Y. under Country X law.
- C.F.C.-X. is liable for $6.50 of Country X I.I.R.
- Under Code §960(d), U.S.P. is deemed to pay $3.64 of the Country X I.I.R. and U.S.M. is deemed to pay $1.56.

<u>Analysis</u>

Similar to Example 1, the Country X I.I.R. is a final top-up tax.

U.S.P. cannot claim a Code §901 credit for the $3.64 of Country X I.I.R. deemed to be paid because U.S.P.'s U.S. Federal income tax liability may be taken into account in computing the Country X I.I.R. under Country X law.

U.S.M., on the other hand, may be eligible for a Code §901 credit for the $1.56 of Country X I.I.R. deemed to be paid. This is because, under Country X law, no part of U.S.M.'s U.S. Federal income tax liability is considered in the I.I.R. calculation as U.S.M. is not part of the same M.N.E. Group as C.F.C.-X.

Under Code §§78 and 1.78-1(a), the amount included in U.S.P.'s income is $4.55 and the amount included in U.S.M.'s income is $1.95.

Example 3: Q.D.M.T.T. as Foreign Income Tax

Facts

Similar to Example 1, but with the following variations:

- Country Y imposes a Q.D.M.T.T.
- The Q.D.M.T.T. by Country Y is considered a foreign income tax within the meaning of Treas. Reg. §1.901-2(a) and (b)
- Country Y law does not consider the foreign tax liability of owners in the Q.D.M.T.T. calculation. Accordingly, any U.S. tax liability of U.S.P. is not taken into account in computing the Q.D.M.T.T.
- In 2024, C.F.C.-X. has no liability for Country X I.I.R., and C.F.C.-Y. is liable for $10 of Country Y Q.D.M.T.T.
- U.S.P. is deemed to pay $8 of the Country Y Q.D.M.T.T. under Code §960(d).

Analysis

The Country Y Q.D.M.T.T. is not a final top-up tax because Country Y law does not consider taxes imposed by other countries on the owners in the Q.D.M.T.T. calculation.

U.S.P. may be allowed a credit under Code §901 for the $8 of Country Y Q.D.M.T.T. deemed paid under Code §960(d).

The amount included in U.S.P.'s income under Code §78 and Treas. Reg. §1.78-1(a) is $10.

Separate Levy Rules

The Notice provides that the I.R.S. and the Treasury Department intend to issue proposed regulations regarding how the separate levy rules of Treas. Reg. §1.901-2(d) apply with respect to an I.I.R., U.T.P.R., and Q.D.M.T.T. This treatment would reflect that the amount of tax imposed under an I.I.R., U.T.P.R., or Q.D.M.T.T. is computed separately from any other levy imposed by a foreign country and would ensure consistent treatment of an I.I.R., U.T.P.R., and Q.D.M.T.T. no matter how a foreign country constructs an I.I.R., U.T.P.R., or Q.D.M.T.T. Consequently, it does not matter whether the foreign country imposes these taxes independently or by adjusting the base of any other levy (such as through an addition to income or denial of deductions).

Determining the Taxpayer for a Q.D.M.T.T.

The Notice provides that the I.R.S. and the Treasury Department intend to issue proposed regulations establishing rules for determining the company deemed to be the payer of a Q.D.M.T.T. for purposes of Treas. Reg. §1.901-2(f) when a Q.D.M.T.T. is computed by reference to the income of two or more companies.

If a Q.D.M.T.T. is computed by reference to the income of two or more persons, foreign tax law is considered to impose legal liability for the Q.D.M.T.T. on each person in proportion to the person's Q.D.M.T.T. Allocation Key. A person's Q.D.M.T.T. Allocation Key is the product derived by multiplying (i) the excess, if any, of the

Q.D.M.T.T. Rate over the person's Separate Pre-Q.D.M.T.T. E.T.R. against (ii) the person's Separate Q.D.M.T.T. Income.

- Q.D.M.T.T. Rate means the minimum E.T.R. stated in the foreign tax law to which the actual E.T.R. of a person or persons is compared for purposes of computing the Q.D.M.T.T.
- A person's Separate Pre-Q.D.M.T.T. E.T.R. means the person's Separate Pre-Q.D.M.T.T. Taxes (whether positive or negative) divided by the person's Separate Q.D.M.T.T. Income.
- A person's Separate Q.D.M.T.T. Income means the income or loss of the person that is taken into account under the foreign tax law for purposes of computing the Q.D.M.T.T.

If a person's Separate Q.D.M.T.T. Income is zero or negative, the Q.D.M.T.T. Allocation Key will be treated as zero. These rules apply regardless of (i) how the foreign tax law distributes the Q.D.M.T.T. liability among multiple persons, (ii) the person who is responsible for paying the tax, (iii) the person who actually pays it, or (iv) the person that may be pursued by the foreign country for collection of the tax if any part of it remains unpaid.

A person's Separate Q.D.M.T.T. Income and Separate Pre-Q.D.M.T.T. Taxes are determined by looking at the relevant amounts stated in any return, schedule, or required document under the foreign tax law for Q.D.M.T.T. purposes. Negative amounts attributable to other persons are ignored. If a separate filing is not required under foreign tax law, the foregoing amounts are determined by referring to the relevant figures in the books of account regularly maintained and used for computing the Q.D.M.T.T.

The following examples illustrate the above rules.

Example 4: Q.D.M.T.T. Imposed on Two or More Persons

Facts

- Country X enacted a Q.D.M.T.T.
- Under Country X tax law, entities that are resident in, or have a taxable presence in, Country X and are in the same M.N.E. Group are jointly and severally liable for the Q.D.M.T.T.
- U.S.P. owns all stock of C.F.C.-1 and C.F.C.-2. Each C.F.C. is a tax resident of Country X and a member of the same M.N.E. Group.
- In Year 1, C.F.C.-1's Separate Q.D.M.T.T. Income is $100, and Separate Pre-Q.D.M.T.T. Tax is $5. C.F.C.-2's Separate Q.D.M.T.T. Income is $50, and Separate Pre-Q.D.M.T.T. Tax is $5.
- The Q.D.M.T.T. Rate in Country X is 15%.
- Country X imposes $12.50 of Q.D.M.T.T. on C.F.C.-1 and C.F.C.-2, collectively.

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Analysis

Under Country X tax law, Q.D.M.T.T. is computed based on the income of both C.F.C.-1 and C.F.C.-2.

The $12.50 of Country X Q.D.M.T.T. is allocated between C.F.C.-1 and C.F.C.-2 proportionally to each entity's Q.D.M.T.T. Allocation Key.

C.F.C.-1's Q.D.M.T.T. Allocation Key is $10 ((15% - ($5 / $100)) x $100), and C.F.C.-2's Q.D.M.T.T. Allocation Key is $2.50 ((15% - ($5 / $50)) x $50).

Accordingly, $10 the Country X Q.D.M.T.T. ($12.50 x ($10 / $12.50)) is allocated to C.F.C.-1, and $2.50 ($12.50 x ($2.50 / $12.50)) is allocated to C.F.C.-2.

Example 5: Effect of S.B.I.E.

Facts

Same as Example 4, but with the following variations:

- C.F.C.-1 and C.F.C.-2 collectively have $15 of Substance-Based Income Exclusion ("S.B.I.E.").
- According to Country X tax law, S.B.I.E. can reduce an M.N.E. Group's Q.D.M.T.T. liability.
- After taking into account the S.B.I.E., Country X imposes $11.25 of Q.D.M.T.T. on C.F.C.-1 and C.F.C.-2, collectively.

Analysis

The amount of S.B.I.E. and its attribution are not considered in calculating each entity's Q.D.M.T.T. Allocation Key.

The Q.D.M.T.T. Allocation Key for each of C.F.C.-1 ($10) and C.F.C.-2 ($2.50) remains the same as in Example 4, as the Separate Q.D.M.T.T. Income and Separate Pre-Q.D.M.T.T. Tax for each remains unchanged.

As a result, $9 of the Country X Q.D.M.T.T. ($11.25 x ($10 / $12.50)) is allocated to C.F.C.-1, and $2.25 of the Country X Q.D.M.T.T. ($11.25 x ($2.50 / $12.50)) are allocated to C.F.C.-2.

Example 6: Negative Separate Q.D.M.T.T. Income

Facts

Same as Example 4, but with the following variations:

- U.S.P. also owns all stock of C.F.C.-3, a C.F.C. tax resident of Country X.
- C.F.C.-3 is in the same M.N.E. Group as C.F.C.-1 and C.F.C.-2 under Country X tax law.
- In Year 1, C.F.C.-3's Separate Q.D.M.T.T. Income is a net loss of $50, and its Separate Pre-Q.D.M.T.T. Taxes are zero.
- Country X imposes $5 of Q.D.M.T.T. collectively on C.F.C.-1, C.F.C.-2, and C.F.C.-3.

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Analysis

Country X tax law calculates Q.D.M.T.T. based on the income of C.F.C.-1, C.F.C.-2, and C.F.C.-3.

The $5 of Country X Q.D.M.T.T. is allocated among C.F.C.-1, C.F.C.-2, and C.F.C.-3 proportionally to each entity's Q.D.M.T.T. Allocation Key.

The Q.D.M.T.T. Allocation Key for C.F.C.-1 ($10) and C.F.C.-2 ($2.50) remains the same as in Example 4, given the unchanged Separate Q.D.M.T.T. Income and Separate Pre-Q.D.M.T.T. Taxes for each.

C.F.C.-3's Q.D.M.T.T. Allocation Key is treated as zero since its Separate Q.D.M.T.T. Income is less than zero.

As a result, $4 of the Country X Q.D.M.T.T. ($5 x ($10 / $12.50)) is allocated to C.F.C.-1, $1 of the Country X Q.D.M.T.T. ($5 x ($2.50 / $12.50)) is allocated to C.F.C.-2, and none of the Country X Q.D.M.T.T. ($5 x $0 / $12.50) is allocated to C.F.C.-3.

Example 7: Negative Separate Pre-Q.D.M.T.T. Taxes

Facts

Same as Example 4, but with the following variations:

- In Year 1, C.F.C.-1's Separate Pre-Q.D.M.T.T. Taxes is -$5, representing a negative amount of income tax expense (a tax benefit).
- Country X imposes $22.50 of Q.D.M.T.T. collectively on C.F.C.-1 and C.F.C.-2.

Analysis

Country X tax law calculates Q.D.M.T.T. based on the income of both C.F.C.-1 and C.F.C.-2.

The $22.50 of Country X Q.D.M.T.T. is allocated between C.F.C.-1 and C.F.C.-2 proportionally to each entity's Q.D.M.T.T. Allocation Key.

The Allocation Key for C.F.C.-2 ($2.50) remains the same as in Example 4, given its unchanged Separate Q.D.M.T.T. Income and Separate Pre-Q.D.M.T.T. Taxes.

C.F.C.-1's Q.D.M.T.T. Allocation Key is now $20 ((15% - (-$5 / $100)) x $100), reflecting the change in C.F.C.-1's Separate Pre-Q.D.M.T.T. Taxes.

As a result, $20 of the Country X Q.D.M.T.T. ($22.50 x ($20 / $22.50)) is allocated to C.F.C.-1, and $2.50 of the Country X Q.D.M.T.T. ($22.50 x ($2.50 / $22.50)) is allocated to C.F.C.-2.

The Nonduplication Requirement for In-Lieu-of Taxes

The I.R.S. and the Treasury Department also intend to amend the nonduplication requirement in Treas. Reg. §1.903-1(c)(1)(ii).

In essence, in order to qualify as an in-lieu-of tax, a foreign tax need only be in substitution for a generally-imposed net income tax and not in substitution for all net

income taxes imposed by that country. Accordingly, the first sentence of the non-duplication requirement in Treas. Reg. §1.903-1(c)(1)(ii) will be revised as follows:

> The generally-imposed net income tax for which the tested foreign tax is imposed in substitution is not also imposed, in addition to the tested foreign tax, on any persons with respect to any portion of the income to which the amounts (such as sales or units of production) that form the base of the tested foreign tax relate (the 'excluded income').

The modification is a result of a technical issue because the foreign tax credit regulations follow a twofold approach, offering two credit methods based on the presence of either an income tax or a Code §903 in-lieu-of-an-income-tax. Since the Code §903 tax is designed to serve as a substitute, the absence of direct counterparts for I.I.R.'s and Q.D.M.T.T.'s necessitated the incorporation of a specific carveout tailored for the GloBE rules.

The following example illustrates the above rule.

Example 8: Country X Net Income Tax and Q.D.M.T.T.

Facts

- Country X imposes a net income tax within the meaning of Treas. Reg. §1.901-2(a)(3) on the income of nonresident companies attributable to activities within Country X ("N.R.C.I.T.").
- The tax constitutes a generally-imposed net income tax.
- The N.R.C.I.T. excludes nonresident corporations engaged in Industry B activities, which are instead subject to the Industry B Tax.
- Country X also enacts a Q.D.M.T.T. that is a net income tax within the meaning of Treas. Reg. §1.901-2(a)(3).
- The Country X Q.D.M.T.T. is imposed on gross income that is also included in the Industry B Tax base.

Analysis

The Industry B Tax fulfills the requirement in Treas. Reg. §1.903-1(c)(1)(i) because Country X has a generally-imposed net income tax, the N.R.C.I.T.

Additionally, the Industry B Tax meets the requirement in Treas. Reg. §1.903-1(c)(1)(ii) (modified as described above) because the N.R.C.I.T., the substituted generally-imposed net income tax, is not imposed on excluded income when the Industry B Tax is applied.

It is not relevant that the Country X Q.D.M.T.T. is also imposed on the excluded income.

Applicability Date and Reliance

It is anticipated that the proposed regulations consistent with the Notice will apply to taxable years ending after December 11, 2023. Moreover, taxpayers may rely on the

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guidance described in the Notice for taxable years ending after December 11, 2023, and on or before the date proposed regulations are published.

GloBE Rules and Dual Consolidated Losses

Background

Code §1503(d) and the regulations issued thereunder (the "D.C.L. rules") aim to prevent "double dipping" of losses where the same economic loss offsets both U.S. taxable income and foreign taxable income. A dual consolidated loss ("D.C.L.") is the combined net operating loss of a dual resident corporation and the net loss of a domestic corporation that is attributable to foreign branches or interests in hybrid entities.

Under the D.C.L. rules, a D.C.L. cannot offset the income of a domestic affiliate, subject to certain exceptions. One exception allows a domestic use of D.C.L. if the taxpayer makes a domestic use election, certifying no foreign use of the D.C.L. Foreign use occurs when any portion of the D.C.L. offsets income under a foreign country's tax laws that, under U.S. tax principles, would be considered income of a foreign corporation or an owner of certain interests in hybrid entities. If foreign use happens during the certification period, the taxpayer must recapture the D.C.L. as ordinary income and pay an interest charge. However, exceptions exist. One such exception involves a fact pattern in which a foreign country allows a foreign use election with regard to the loss, but the election is not made. In essence, the domestic use election under foreign law gives the taxpayer the choice to apply the D.C.L. for domestic or foreign use, but not both.

Interaction with the GloBE Rules

"Under the GloBE rules, if an M.N.E. Group's E.T.R. for a jurisdiction is below the 15% minimum rate, it needs to calculate the Jurisdictional Top-up Tax owed for that jurisdiction."

Under the GloBE rules, if an M.N.E. Group's E.T.R. for a jurisdiction is below the 15% minimum rate, it needs to calculate the Jurisdictional Top-up Tax owed for that jurisdiction. This tax is determined based on factors like Adjusted Covered Taxes and the Net GloBE Income of constituent entities within the jurisdiction.

To compute this, the GloBE rules adopt a jurisdictional blending approach, where all income and loss of constituent entities in the same jurisdiction are generally combined. However, this aggregation raises concerns similar to those the D.C.L. rules were designed to address. For instance, if a loss resulting in a D.C.L. is combined with items that, according to U.S. tax principles, belong to a foreign corporation in that jurisdiction, the loss could be used to offset both U.S. tax (if a domestic use election is allowed) and the Jurisdictional Top-up Tax.

These concerns may arise even for a D.C.L. incurred in a taxable year ending before the anticipated effective date of the GloBE rules (*e.g.*, a year ending on December 31, 2023) if timing differences between U.S. tax law and financial accounting standards lead to a portion of the loss contributing to the D.C.L. being recognized as an expense under the GloBE rules in a later year.

Moreover, the GloBE rules have some features that differ from traditional foreign income tax systems. Unlike traditional systems, these rules lack a mechanism for a taxpayer to opt-out of aggregation. Consequently, a taxpayer might be compelled to apply a D.C.L. to a foreign use, eliminating the choice between domestic and foreign use. Furthermore, a loss may not yield any benefit under the Jurisdictional Top-up Tax. This can happen if the E.T.R. in the jurisdiction is at or above the Minimum

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Rate, irrespective of the loss, and the loss is not carried over to calculate the Jurisdiction Top-Up Tax in a subsequent year.

The I.R.S. and the Treasury Department are examining how the D.C.L. rules should apply to the GloBE rules. This includes looking at whether combining certain items through aggregation should lead to a foreign use of a D.C.L. The I.R.S. and the Treasury Department are also assessing whether the GloBE rules should classify an entity, not otherwise subject to a foreign jurisdiction's income tax, as a dual resident corporation or a hybrid entity under Treas. Reg. §§1.1503(d)-1(b)(2) or (3). Additionally, the I.R.S. and the Treasury Department are considering whether these rules should prevent such an entity from being treated as a transparent entity under Treas. Reg. §1.1503(d)-1(b)(16).

Finally, the I.R.S. and the Treasury Department are exploring similar issues in the context of other provisions, such as how the anti-hybrid rules under Code §§245A(e) and 267A interact with the GloBE rules.

Treatment of Legacy D.C.L.'s

To provide clarity while the I.R.S. and Treasury Department work on guidance regarding the interaction of the D.C.L. rules with the GloBE rules, proposed regulations will be issued with respect to D.C.L.'s incurred in taxable years ending on or before December 31, 2023. Proposed regulations also will be issued covering cases where the taxpayer's taxable year aligns with the fiscal year of the M.N.E. Group, but losses in taxable years beginning before January 1, 2024, and ending after December 31, 2023 are taken into account.

Under this proposal, a foreign use would not be considered to occur for a legacy D.C.L. solely because deductions or losses that comprise the D.C.L. are factored into determining the Net GloBE Income for a specific jurisdiction. However, this proposed rule would not apply to any D.C.L. incurred or increased with the intent of reducing the Jurisdictional Top-Up Tax or qualifying for the rule described in the Notice.

Taxpayers may rely on the guidance in the Notice until proposed regulations are published.

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