Treatment of Section 78 Gross-Up Amounts
Relating to Section 960(b) Foreign Income Taxes

I. Overview

In 2017, Congress significantly revised the structure of the U.S. international tax system as part of enacting the Tax Cuts and Jobs Act (the "TCJA"). Unlike prior law, where the taxation of most foreign earnings was deferred until such amounts were repatriated as dividends, the new international rules tax a U.S. shareholder on the income of a controlled foreign corporation ("CFC") either immediately (under section 951 and the historical subpart F regime or under section 951A and the newly enacted regime for global low-taxed intangible income or "GILTI"), or not at all (because dividends from foreign corporation generally are entitled to a 100 percent dividends-received deduction ("DRD") under section 245A). As a result, the rules for the deemed paid foreign tax credit were correspondingly restructured. Previously, foreign taxes paid by a CFC were deemed paid in three instances: (1) when the related earnings were distributed as a dividend under former section 902; (2) when there was a subpart F inclusion by applying the rules of former section 902 under former section 960(a)(1); and (3) when the previously taxed income (or "PTI") was actually distributed by also applying former section 902 to the PTI distribution under former section 960(a)(3). Under the revised rules, that first category -- dividend income -- is generally no longer subject to tax and thus deemed paid taxes with respect to such dividends no longer necessary. Accordingly, section 902 was repealed and its deemed paid mechanism was moved and incorporated directly (and exclusively) into section 960.

The TCJA also made numerous other changes to the foreign tax credit provisions of the Code. For example, former section 960(a)(3) (renumbered as section 960(b) by the TCJA) treated distributions of PTI as a dividend for section 902 purposes to permit a U.S. shareholder to claim a foreign tax credit for any taxes imposed with respect to the PTI when such amounts are distributed back to the United States ("PTI credits"). With the repeal of section 902, current section 960(b) now directly provides for the deemed payment of such taxes. The TCJA also made corresponding changes to the gross-up provision under section 78. Specifically, section 960(b) is now explicitly referenced under section 78, while under the pre-TCJA version of section 78, former section 960(a)(3), was not.

In light of these changes, we recommend that Treasury and the Internal Revenue Service ("the Service") issue guidance confirming that although section 78 now specifically provides that an amount equal to the PTI credits deemed to be paid under section 960(b) should be treated as a dividend, the dividend is excluded under section 959(a) because it is paid out of PTI. Such a conclusion is fully consistent with Treasury regulation sections 1.960-3(b) and 1.78-1(b) and ensures that PTI is not subject to double taxation.

We request this clarification because the inclusion of section 960(b) in section 78, in contrast to former section 960(a)(3), its predecessor, might be interpreted as suggesting that the gross-up did not apply under pre-TCJA law, and thus Congress intended to change the operation of section 78 in this case, and the resulting dividend should be subject to tax, especially when contrasted with former section 960(a)(1) (the predecessor of section 960(a)), which addresses deemed paid taxes on the original subpart F inclusion. Because the gross-up for subpart F inclusions were referenced by section 78 before the TCJA (as former section 960(a)(1)) and thereafter (as section 960(a)), and given that the section 78 gross-up for such amounts are taxable income, the reference in section 78 to section 960(b) might, in isolation, be viewed as supporting that the gross-up for PTI taxes also produces taxable income.

However, as discussed below, the inclusion of section 960(b) in section 78 should not have changed its operation; section 78 has always applied, albeit indirectly, to PTI credits going back to its enactment in 1962 because section 78 applied to former section 902, and former section 960(a)(3) relied on former section 902 for purposes of deeming PTI credits to have been paid. This approach is reflected in and consistent with Treasury regulation sections 1.960-3(b) and 1.78-1(b), which specifically provide that to the extent there is a gross-up for PTI credits, such amount is not subject to tax —rules that presumably would not be necessary if section 78 did not apply to PTI credits in the first place.

Moreover, the specific reference in former section 78 to former section 960(a)(1) does not suggest the contrary; former section 960(a)(1) was included in the original version of section 78 because in 1962, taxes on subpart F inclusions were deemed paid directly under former section 960(a)(1) and without any reference to former section 902. In contrast, former section 960(a)(3) was not referenced in former section 78 because it was encompassed in the former section 902 reference and thus a direct reference was, unnecessary. Instead, this difference in section 78 arose because when pre-TCJA section 960(a)(1) was later changed to reference former section 902 by the Tax Reform Act of 1986 (the "1986 Act"), section 78 was not amended to reflect this change, and thus the reference in pre-TCJA section 78 to former section 960(a)(1) was a vestige of prior law. Accordingly, inclusion of section 960(b) in section 78 simply continued prior law after the repeal of section 902.

Finally, this conclusion is appropriate because otherwise PTI would be taxed twice. The following example demonstrates the double taxation that would occur if the gross-up under section 78 produced not just a dividend as a result of any PTI credits, but income that was not exempt.

> Assume "US," a domestic corporation, wholly owns "CFC 1," which in turn wholly owns "CFC 2." CFC 2 earns $100 of subpart F income and pays $10 of foreign income taxes. As a result, US is required under section 951 to include $90 in gross income with respect to CFC 2. Under section 960, US is entitled to claim the $10 deemed paid foreign tax credit, and thus US is also required to include $10 in gross income under section 78. CFC 2 then distributes $90 to CFC 1. Although CFC 1 includes $90 as a dividend, under section 959(b) and Treasury regulation section 1.959-2, this amount is not included in gross income for purposes of applying section 951 to US, and consequently, the dividend is not FPHC income.[1] An income tax of 10 percent is required to be withheld from the dividend by the foreign country under the laws of which CFC 1 is created. Thus, CFC 1's earnings and profits are $81 ($90–[0.10 × $90]). CFC 1 then distributes the $81 to US. Below is a chart that compares the results if US either includes or excludes the $9 relating to the foreign income tax paid by CFC 1 in connection with the dividend received from CFC 2.
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> If US was required, upon distribution of PTI from CFC 1 to US, to gross up and pay tax on the additional $9 of foreign tax credits it received under section 960(b), then the US would be required to pay tax on $109 of income, even though there was only $100 of income earned in the example. This over inclusion of income is attributable to the fact that $9 of taxes effectively was paid by amounts

[1] Such was the case even without the look through exception under section 954(c)(6), which was enacted in 2006.

that have already been included in gross income of US, and illustrates why the gross-up under section 78 for these taxes should be excluded under section 959(a) to avoid double taxing this amount.

	Including PTI FTC as a § 78 Gross-Up	Excluding PTI FTC as a § 78 Gross-Up
Subpart F Inclusion Amount	$ 90	$ 90
Add § 78 (§960(a)(1) foreign income tax)	10	10
Add § 78 (§960(a)(3) foreign income tax)	-	9
Total Gross Income	**100**	**109**

Accordingly, guidance clarifying that the application of section 78 to PTI taxes does not result in double taxation would be consistent with longstanding jurisprudence on this issue. In order to find that a statute imposes double taxation, the statute itself must contain a clear statement of that result. *Neptune Mutual Ass'n v. United States*, 862 F.2d 1546 (Fed. Cir. 1988) ("If the tax laws are to impose double taxation, it must be because the legislature has unmistakably so enacted."). The Supreme Court has repeatedly required a clear statement by Congress to support a finding that a statute imposes double taxation.[2]

In the present, the legislative history to section 78 nowhere suggests that Congress intended to change the operation of the gross-up in the case of PTI credits let alone that PTI should be subject to double taxation. Instead, the Conference Report notes the following about the House version of revised section 78: "These conforming amendments include amending the section 78 gross-up provision to apply solely to taxes deemed paid under the amended section 960."[3] The report explains that "[t]he conference agreement applies the existing language of section 78, which treats the gross-up as a dividend to the domestic corporation, to foreign income taxes deemed paid under section 960(a), (b), and (d) (without regard to the phrase '80 percent of' in section 960(d)(1), except with respect to section 245 and new section 245A (i.e., the deemed dividend would not receive the benefit of the participation exemption)."[4] Nothing suggesting a change in the operation of section 78, let alone a decision that PTI should be subject to double taxation.

Finally, as a conclusion that the gross-up on PTI should be taxable income would result in double taxing the PTI, there appears to be no policy or other reason to do so.

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[2] This approach was well-settled by 1886, when the Supreme Court noted: "Sometimes tax laws have that effect [of double taxation], but if they do it is because the legislature has unmistakably so enacted. All presumptions are against such an imposition." *Tennessee v. Whitworth*, 117 U.S. 129, 137 (1886). In a 1924 case, the Court ended its opinion with the admonition that double taxation "is to be avoided, unless required by express words." *United States v. Supplee-Biddle Hardware Co.*, 265 U.S. 189, 196 (1924). Since that time, the Court has repeatedly adhered to a clear statement rule for double taxation, as an acknowledgment of "the congressional policy against double taxation." *United California Bank v. United States*, 439 U.S. 180, 194 n.14 (1978); *see also United States v. Hemme*, 476 U.S. 558, 572 (1986) ("We need not decide here whether that inclusion results in double taxation, for even if it did, the Constitution would not be offended as long as Congress had clearly expressed its intention to occasion the result." (emphasis added)); *Hellmich v. Hellman*, 276 U.S. 233, 238 (1928) ("When, as here, Congress has clearly expressed its intention, the statute must be sustained even though double taxation results.").

[3] Conf. Rept. No. 115-466, at 628.

[4] *Id.* at 629

Accordingly, guidance confirming that the gross-up of PTI credits does not produce additional taxable income would eliminate any argument that the underlying PTI that funded the payment of those taxes might somehow be taxed again.

II. Classification as a Dividend Does Not Require Taxability

Even without regard to the historical development of sections 960 and 78 discussed elsewhere, it is clear under both the statute and regulations that the PTI credits deemed paid under section 960(b), although treated as a dividend under section 78, should not be give rise to taxable income.

Section 78 simply designates the amount as a dividend and does not address how to treat the dividend. Section 959(a) provides that if a dividend is a distribution of earnings that constitutes PTI, then such amounts are not again included in the gross income of the U.S. shareholder. Because such amounts are thus exempt, section 959(d) then provides that distributions excluded from gross income under section 959(a) are treated as a distribution which is not a dividend.

These rules should apply to a distribution of PTI accompanied by section 960(b) taxes as follows. If a U.S. shareholder receives a distribution of PTI that has additional taxes attributable thereto (for example, withholding taxes on distributions of the PTI from a lower-tier CFC to an upper-tier CFC), section 960(b) treats the amount as a dividend for purposes of such taxes being deemed paid by the shareholder. Section 78 further provides that to the extent of such taxes deemed paid under section 960(b), the shareholder is treated as having received a dividend in such amount. But neither provision says that such amount is taxable. Instead, section 959(a) should apply to prevent what constitutes a distribution of PTI -- i.e., earnings that have been previously taxed under section 951(a) -- from being included in income a second time when those earnings are distributed. The fact that the distribution is treated as a dividend does not prevent the application of section 959(a); indeed, every distribution of PTI is in the first instance a distribution of earnings, and thus a dividend, and section 959(a) is equally applicable in those instances as it should be to the present case[5]

This approach is consistent with how the statute always has operated, as demonstrated by Treasury regulation section 1.78-1(b) and 1.960-3(b), issued in 1965 and 1971, respectively, which provide that to the extent the grossed-up dividend under section 78 is from PTI, the amount in not included in taxable income.[6]

Treasury regulation section 1.960-3(b) specifically provides:

> [a]ny taxes deemed paid by a domestic corporation for the taxable year pursuant to [former] section 902(a) or [former] section 960(a)(1) shall not be included in the gross income of such corporation for such year as a dividend pursuant to section 78 and §1.78-1 . . . on or with respect to an amount which is excluded from

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[5] This is distinguishable from a credit under section 960(a) because the gross-up amount relating to the subpart F inclusion that is classified as a dividend under section 78 does not relate to taxes paid out of PTI and accordingly section 959 should not apply, and therefore the gross-up amount should be included in income.

[6] Treasury regulation section 1.78-1(b) was first included in T.D. 6805, 30 F.R. 3,208 (Mar. 9, 1965), and Treasury regulation section 1.960-3(b) was later introduced in T.D. 7120, 36 F.R. 10,856 (June 4, 1971).

> the gross income of such foreign corporation under section 959(b) and [Treasury regulation section] 1.959-2 as distributions from the earnings and profits of another controlled foreign corporation attributable to an amount which is, or has been, required to be included in the gross income of the domestic corporation under section 951.

Similarly, Treasury regulation section 1.78-1(b) provides a corollary rule stating, in relevant part, that:

> [f]oreign taxes deemed paid by a domestic corporation under section 902(a) . . . shall not, to the extent provided by [Treasury regulation section 1.960-3(b)] be treated as a section 78 dividend where such taxes are imposed on certain distributions from the earnings and profits of a controlled foreign corporation attributable to an amount which is, or has been, included in gross income of the domestic corporation under section 951.

Thus, even without examining the legislative history of sections 960 and 78, which, as discussed below, demonstrate that section 78 was not changed by the TCJA, a straightforward application of the relevant statutory provisions to the gross-up amount arising from to PTI credits leads to the appropriate answer.

III. The Historical Development of the Relevant Statutory Provisions Confirms that the Gross-Up Amount Related to PTI Credits Should Not be Taxable Income

A. Based Upon the Evolution of Former Sections 960 and 78, Reference to Section 960(a)(3) Was Unnecessary in the Former Section 78 Statute

[The straightforward application of the TCJA provisions should not be affected by the inclusion of a specific reference to section 960(b) in the revised version of section 78. Indeed, a conclusion that section 78 creates taxable income in this case would effectively read into this change that Congress decided to tax PTI *twice*, effectively overriding section 959(a) as well as Treasury regulation sections 1.960-3(b) and 1.78-1(b).] However, by reviewing the legislative development of sections 960 and 78, beginning with their enactment in 1962, it is clear that the amendment to section 78 by the TCJA does not suggest that the gross-up in the amount of the PTI credits should be taxable, and thus should not upset the operation of the various statutory provisions as described above. Specifically, this history demonstrates that former section 960(a)(3) was already included (indirectly) in the operation of former section 78, which relied on former section 902 for its "deemed paid" mechanism, and thus the inclusion of its successor, section 960(b), in the amended section 78 should have no effect on the treatment of PTI credits.

1. The Enactment of Sections 78 and 960 under the Revenue Act of 1962

The deemed paid credit under section 902 was first enacted in 1921. The version of section 902 in effect in 1962 when subpart F was enacted provided that a domestic corporation, which received a dividend from a foreign corporation in which it owned at least 10 percent of the voting stock, was deemed to have paid a portion of the foreign income taxes paid, or deemed paid, by the foreign corporation on, or with respect to, its accumulated profits.[7] The statute also extended the deemed paid credit to taxes paid by a second-tier foreign corporation, provided that the first-tier corporation owned at least 50 percent of the voting stock of the second-tier corporation.[8] Thus, from 1921 until 1962, the only circumstance in which a taxpayer could have received an indirect credit was in the case of an actual dividend distribution under section 902.

The enactment of the subpart F regime under the Revenue Act of 1962 was accompanied by the extension of the deemed paid credit to subpart F inclusions. The drafters of the original section 960(a)(1) did not reference former section 902 and its "deemed paid" mechanism (as did the pre-TCJA version of the provision), but rather included statutory language directly providing a deemed paid credit under former section 960(a)(1) by mirroring the language of former section 902 in the new provision. Specifically, former section 960(a)(1)(B)-(C), as drafted in 1962, provided in relevant part,

> the same proportion of the total . . . taxes paid (or deemed paid) by such foreign corporation to a foreign country . . . for the taxable year on or with respect to the earnings and profits of such foreign corporation which the amount of earnings and profits of such foreign corporation so included in gross income of the domestic corporation bears to . . . the entire amount of the earnings and profits of such foreign corporation for such taxable year.[9]

Accordingly, former section 960(a)(1)(C) directly provided the rules to qualify for, and compute, the deemed paid credit that a domestic corporation could claim with respect to a subpart F inclusion, and without reference to former section 902 (other than for purposes of defining the term "less developed country corporation").[10]

The original subpart F rules also recognized that in a case when PTI was distributed, additional foreign taxes could be incurred with regard to that income. Because the distributed PTI would not have been taxable under section 959(a) and (d), the additional foreign taxes would not have been deemed paid under former section 902. Accordingly, former section 960(a)(3) was included to provide taxpayers with a deemed paid credit in this circumstance.

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[7] Revenue Act of 1951, P.L. 82-183, § 332(a) and § 331(a).

[8] *Id.*

[9] The statute in its entirety is attached in Appendix A.

[10] Former section 960(a)(1)(D) provided rules to compute the indirect tax credit with respect to a foreign corporation that is a "less developed country corporation." In the case of corporations deriving most of their income from less developed countries, Congress concluded that a section 78 gross-up should not apply as it would be "inappropriate . . . to raise the effective rate of combined American-foreign tax since this would discourage new investments in such countries . . . [and] at this time would be contrary to our national policy." However, because the domestic corporation would not gross-up its income by the section 78 amount, in the case of dividends received from less developed country corporations, Congress also intended that "only the portion of the foreign income taxes attributable to the earnings after foreign taxes [ ] be allowed as a credit since only these earnings are taken into income by the domestic corporation." S. Rep. No. 1881 87th Cong., 2d Sess., 1962-3 C.B. 707 ("1962 Senate Report"), at 185-188 (1962).

Unlike former section 960(a)(1), however, former section 960(a)(3), did not directly provide a "deemed paid" mechanism. Rather, the statute provided that any portion of a distribution from a foreign corporation which was excluded from gross income under section 959(a) was treated as a dividend for the purpose of taking into account under former section 902 the previously uncredited foreign taxes paid on the profits distributed. Specifically, former section 960(a)(3) provided as follows:

> (3) Taxes paid by foreign corporation and not previously deemed paid by domestic corporation.— Any portion of a distribution from a foreign corporation received by a domestic corporation which is excluded from gross income under section 959(a) *shall be treated by the domestic corporation as a dividend, solely for purposes of taking into account under section 902* any income, war profits, or excess profits taxes paid to any foreign country or to any possession of the United States, on or with respect to the accumulated profits of such foreign corporation from which such distribution is made, which were not deemed paid by the domestic corporation under [former section 960(a)(1)] for any prior taxable year.[11]

Thus, following the enactment of subpart F in 1962, there were three situations in which a taxpayer received an indirect tax credit: first, under former section 902 in the case of an actual dividend distribution; second, under former section 960(a)(1) in the case of a subpart F inclusion; and third, under former section 902 as a result of the deemed dividend arising under former section 960(a)(3).

Section 78 was also enacted under the Revenue Act of 1962 and provided, in relevant part, that "*an amount equal to* the taxes deemed to be paid by such corporation under section 902(a)(1) (relating to credit for corporate stockholder in foreign corporation) or under section 960(a)(1)(C) (relating to taxes paid by foreign corporation) for such taxable year shall be treated . . . as a dividend received by such domestic corporation from the foreign corporation." (emphases added). The section 78 gross-up amount only referenced the amounts calculated under former sections 902(a)(1) and 960(a)(1)(C), and not former section 960(a)(3), because former section 960(a)(3) did not directly provide for deemed paid credits, but rather referred the taxpayer to former section 902 to compute such amounts. Thus, a reference to section 960(a)(3) was unnecessary as this situation was already addressed by the inclusion of section 902. In fact, a reference to former section 960(a)(3) would not work as a technical matter, based upon the wording of the provision, since there is no "amount equal to the taxes deemed to be paid by such corporation" under former section 960(a)(3), apart from by reference to section 902.

This can be contrasted with section 78's inclusion of former section 960(a)(1)(C), which was necessary because former section 960(a)(1) did not use section 902 as a vehicle to calculate the indirect tax credit associated with the subpart F inclusion. Rather, former section

[11] Emphasis added.

960(a)(1)(C) included its own self-contained deemed paid credit computation — similar to the computation under section 902, but without referencing that section.[12]

2. The Modification of Former Section 960(a)(1) under the 1986 Act

The 1986 Act overhauled the operation of former section 902 in several ways. As part of these changes, the computation of the deemed paid credit under former section 960(a)(1) was conformed to computation under former section 902 by adopting the same approach taken under former section 960(a)(3) and referencing former section 902 in the case of a subpart F inclusion. Specifically, former section 960(a)(1), as revised by the 1986 Act, provided that:

> [f]or purposes of subpart A of this part, if there is included under section 951(a) in the gross income of a domestic corporation any amount attributable to earnings and profits of a foreign corporation which is a member of a qualified group (as defined in section 902(b)) with respect to the domestic corporation, then, except to the extent provided in regulations, *section 902 shall be applied as if the amount so included were a dividend paid by such foreign corporation (determined by applying section 902(c) in accordance with section 904(d)(3)(B))*.[13]

Because former section 960(a)(1) now referenced former section 902, and former section 902 was already included in former section 78, the separate reference to section 960(a)(1) was no longer needed. Indeed, to be consistent with the absence of a reference to former section 960(a)(3), that reference should have been deleted because former section 960(a)(1) was no longer providing the deemed paid mechanism with respect to a subpart F inclusion. However, section 78 was simply not amended in the 1986 Act. Indeed, prior to the TCJA, section 78 had not been amended since 1976.[14] Had this conforming change to section 78

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12 Section 902 (1962) provides that the deemed paid credit is calculated by taking the "proportion of any income, war profits, or excess profits taxes paid or deemed to be paid by such foreign corporation to any foreign country or to any possession of the United States, on or with respect to the *accumulated profits* of such foreign corporation from which such dividends were paid, which the amount of such dividends bears to the amount of such *accumulated profits*." (emphasis added).

13 Emphasis added.

14 Under the Revenue Act of 1971, Congress liberalized the qualification criteria for the indirect credit under former section 902 by reducing the ownership requirement of the first-tier corporation with respect to the second-tier corporation from 50 percent to 10 percent, and extending the scope of the indirect credit to dividends distributed from a third-tier foreign corporation in which the second-tier corporation owned 10 percent or more of the voting stock. Given the change in the qualification requirements under former section 902, there was a disconnect between former section 960(a)(3), which ran through section 902, and former section 960(a)(1) (1962), which supplied its own qualification requirements that once mirrored section 902.

Five years later, in the Tax Reform Act of 1976, former section 960(a)(1) was amended to reflect the changes to the qualification requirements under section 902. *See* Jt. Comm. on Tax'n, Summary of the Tax Reform Act of 1976, at 45 ("[u]nder the Act, the foreign tax credit under subpart F is made consistent with the credit for actual dividends from second and third-tier foreign subsidiaries."). And, former section 960(a)(1) continued to provide the rules to compute the indirect tax amount. Due to the change in section 960(a)(1), section 78 was also amended, occurred, the inference noted above, and the possibility of section 78 creating taxable income in the case of PTI credits, would never have arisen.

3. The Regulations Support the Argument that a Reference to Former Section 902 is an Implicit Reference to Former Section 960(a)(3)

The language of the section 960 regulations further supports the conclusions above, including that the reference to former section 902(a) in former section 78 included PTI credits. Treasury regulation section 1.960-3(b), issued in 1971, sets forth an exception to the general rule that income should be grossed-up by the amount relating to indirect credits claimed. In identifying the particular credits that are exempt from this general rule, the regulation states:

> [a]ny taxes deemed paid by a domestic corporation for the taxable year pursuant to *section 902(a) or section 960(a)(1)* . . . to the extent that such taxes are paid or accrued . . . on or with respect to an amount which is excluded from the gross income of such foreign corporation under section 959(b) and [Treasury regulation section] 1.959-2 as distributions from the earnings and profits of another [CFC] attributable to an amount which is, or has been, required to be included in the gross income of the domestic corporation under section 951.[15]

Of particular importance is that this regulation only references former section 902(a) and former section 960(a)(1), without mentioning former section 960(a)(3). However, this particular regulation is the basis for the exclusion of amounts in income relating to the credits under former section 960(a)(3), or PTI credits.[16] Thus, the reference to section 902(a) in this

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substituting the reference from "section 960(a)(1)(C)" to "section 960(a)(1)." The Tax Reform Act of 1976 eliminated the special treatment of a subpart F inclusion from a foreign corporation that was a "less developed country corporation" under former section 960(a)(1)(D), and therefore section 78's specific reference to section 960(a)(1)(C) with respect to a non-"less developed country corporation" was amended to former section 960(a)(1) more generally.

15 Treasury regulation section 1.960-3(b) (emphasis added).

16 *See* TAM 9817001 (Sept. 30, 1997) (describing the application of Treasury regulation section 1.960-3(b) by stating that:

> [t]he regulations under section 960 state that the taxes deemed paid by a domestic corporation under section 960(a)(3) shall not be included in gross income as a dividend under section 78. When the upper-tier distributes the PTI on to its domestic parent corporation, the parent will compute an amount of deemed paid taxes under section 960(a)(3) and section 902 with respect to the PTI distribution and the additional taxes imposed on the PTI. The additional taxes will not be included in gross income as an additional dividend under section 78");

See also CCA 200223022 (March 1, 2002) (stating that under Treasury regulation section 1.960-3(b), because "PTI on which the additional taxes are imposed and out of which they are paid was previously included in the U.S.

regulation, similar to the reference in former section 78, must encompass former section 960(a)(3). Further, because an actual dividend under section 902 is not PTI, the dividend amount cannot be "an amount which is excluded from the gross income of such foreign corporation under section 959(b)." Therefore, the section 902 language appears to be a reference to former section 960(a)(3).

Similarly, Treasury regulation section 1.78-1(b), the corollary rule to Treasury regulation section 1.960-3(b), references "[f]oreign income taxes deemed paid by a domestic corporation *under section 902(a)* in accordance with *§§ 1.902-1 and 1.902-2*[,]"[17] but applies to amounts relating to PTI credits. If former section 78 did not apply to former section 960(a)(3) in the first place, it would be unnecessary to draft a regulation stating that the PTI credits should *not* be included in gross income.

Therefore, these regulations confirm the reading that a reference to former section 902 is indeed a reference to former section 960(a)(3). More generally, the policy behind those regulations, ensuring that PTI is not taxed a second time, also supports the approach recommended herein.

IV. Conclusion

In conclusion, we understand that the inclusion of section 960(b) in amended section 78 may have raised a concern that Congress intended for the PTI credits to be treated differently, but as can be seen by the evolution of sections 960 and 78, the PTI credits have always been a included in section 78 — though indirectly through section 902. Because Congress indeed has not made any substantive changes to section 78 under the TCJA, no changes should be made to the treatment of the PTI credits, as well. Thus, we respectfully recommend that Treasury and the Service issue guidance confirming that although section 78 now specifically provides that an amount equal to the taxes deemed to be paid under section 960(b) should be treated as a dividend that dividend is excluded under section 959(a) because such taxes have been paid out of PTI.

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shareholder's income under section 951, the additional taxes [imposed on PTI] will not be included in gross income as an additional dividend").

[17] Emphasis added.

Appendix A — Legislative Development of Section 960

§ 960(a)(1), (a)(3). Special rules for foreign tax credit - 1962

(a) Taxes paid by a foreign corporation

(1) General rule. — For purposes of subpart A of this part, if there is included, under section 951(a), in the gross income of a domestic corporation any amount attributable to earnings and profits —

(A) of a foreign corporation at least 10 percent of the voting stock of which is owned by such domestic corporation, or

(B) of a foreign corporation at least 50 percent of the voting stock of which is owned by a foreign corporation at least 10 percent of the voting stock of which is in turn owned by such domestic corporation, then, under regulations prescribed by the Secretary or his delegate, such domestic corporation shall be deemed to have paid the same proportion of the total income, war profits, and excess profits taxes paid (or deemed paid) by such foreign corporation to a foreign country or possession of the United States for the taxable year on or with respect to the earnings and profits of such foreign corporation which the amount of earnings and profits of such foreign corporation so included in gross income of the domestic corporation bears to —

(C) if the foreign corporation at least 10 percent of the voting stock of which is owned by such domestic corporation referred to in subparagraph (A) or (B) is not a less developed country corporation (as defined in section 902(d)) for such taxable year, the entire amount of the earnings and profits of such foreign corporation for such taxable year, or

(D) if the foreign corporation at least 10 percent of the voting stock of which is owned by such domestic corporation referred to in subparagraph (A) or (B) is a less developed country corporation (as defined in section 902(d)) for such taxable year, the sum of the entire amount of the earnings and profits of such foreign corporation for such taxable year and the total income, war profits, and excess profits taxes paid by such foreign corporation to foreign countries or possessions of the United States for such taxable year.

(3) Taxes paid by foreign corporation and not previously deemed paid by domestic corporation.—Any portion of a distribution from a foreign corporation received by a domestic corporation which is excluded from gross income under section 959(a) shall be treated by the domestic corporation as a dividend, solely for purposes of taking into account under section 902 any income, war profits, or excess profits taxes paid to any foreign country or to any possession of the United States, on or with respect to the accumulated profits of such foreign corporation from which such distribution is made, which were not deemed paid by the domestic corporation under paragraph (1) for any prior taxable year.

§ 960(a)(1), (a)(3). Special rules for foreign tax credit - 1976

(a) Taxes paid by a foreign corporation

(1) General rule. — For purposes of subpart A of this part, if there is included, under section 951(a), in the gross income of a domestic corporation any amount attributable to earnings and profits —

(A) of a foreign corporation (hereafter in this subsection referred to as the "first foreign corporation") at least 10 percent of the voting stock of which is owned by such domestic corporation, or

(B) of a second foreign corporation (hereinafter in this subsection referred to as the "second foreign corporation") at least ~~50~~10 percent of the voting stock of which is owned by the first foreign corporation, or

(C) of a third foreign corporation (hereinafter in this subsection referred to as the "third foreign corporation") at least 10 percent of the voting stock of which is ~~in turn~~ owned by ~~such domestic~~ the second foreign corporation,

then, under regulations prescribed by the Secretary ~~or his delegate~~, such domestic corporation shall be deemed to have paid the same proportion of the total income, war profits, and excess profits taxes paid (or deemed paid) by such foreign corporation to a foreign country or possession of the United States for the taxable year on or with respect to the earnings and profits of such foreign corporation which the amount of earnings and profits of such foreign corporation so included in gross income of the domestic corporation bears to ~~—~~the entire amount of the earnings and profits of such corporation for such taxable year. This paragraph shall not apply with respect to any amount included in the gross income of such domestic corporation attributable to earnings and profits of the second foreign corporation or of the third foreign corporation unless, in the case of the second foreign corporation, the percentage-of-voting-stock requirement of section 902(b)(3)(A) is satisfied, and in the case of the third foreign corporation, the percentage-of-voting-stock requirement of section 902(b)(3)(B) is satisfied.

~~(C) if the foreign corporation at least 10 percent of the voting stock of which is owned by such domestic corporation referred to in subparagraph (A) or (B) is not a less developed country corporation (as defined in section 902(d)) for such taxable year, the entire amount of the earnings and profits of such foreign corporation for such taxable year, or~~

~~(D) if the foreign corporation at least 10 percent of the voting stock of which is owned by such domestic corporation referred to in subparagraph (A) or (B) is a less developed country corporation (as defined in section 902(d)) for such taxable year, the sum of the entire amount of the earnings and profits of such foreign corporation for such taxable year and the total income, war profits, and excess profits taxes paid by such foreign corporation to foreign countries or possessions of the United States for such taxable year.~~

(3) Taxes paid by foreign corporation and not previously deemed paid by domestic corporation.— Any portion of a distribution from a foreign corporation received by a domestic corporation which is excluded from gross income under section 959(a) shall be treated by the domestic corporation as a dividend, solely for purposes of taking into account under section 902 any income, war profits, or excess profits taxes paid to any foreign country or to any possession of the United States, on or with respect to the accumulated profits of such foreign corporation from which such distribution is made, which were not deemed paid by the domestic corporation under paragraph (1) for any prior taxable year.

§ 960(a)(1), (a)(3). Special rules for foreign tax credit - 1986

(a) Taxes paid by a foreign corporation

(1) ~~General rule.~~ Deemed paid credit —For purposes of subpart A of this part, if there is included~~,~~ under section 951(a)~~,~~ in the gross income of a domestic corporation any amount attributable to earnings and profits ~~—~~of a foreign corporation which is a member of a qualified group (as defined in section 902(b)) with respect to the domestic corporation, then, except to the extent provided in regulations, section 902 shall be applied as if the amount so included were a dividend paid by such foreign corporation (determined by applying section 902(c) in accordance with section 904(d)(3)(B)).

~~(A) of a foreign corporation (hereafter in this subsection referred to as the "first foreign corporation") at least 10 percent of the voting stock of which is owned by such domestic corporation, or~~

~~(B) of a second foreign corporation (hereinafter in this subsection referred to as the "second foreign corporation") at least 10 percent of the voting stock of which is owned by the first foreign corporation, or~~

~~(C) of a third foreign corporation (hereinafter in this subsection referred to as the "third foreign corporation") at least 10 percent of the voting stock of which is owned by the second foreign corporation,~~

~~then, under regulations prescribed by the Secretary, such domestic corporation shall be deemed to have paid the same proportion of the total income, war profits, and excess profits taxes paid (or deemed paid) by such foreign corporation to a foreign country or possession of the United States for the taxable year on or with respect to the earnings and profits of such foreign corporation which the amount of earnings and profits of such foreign corporation so included in gross income of the domestic corporation bears to the entire amount of the earnings and profits of such corporation for such taxable year. This paragraph shall not apply with respect to any amount included in the gross income of such domestic corporation attributable to earnings and profits of the second foreign corporation or of the third foreign corporation unless, in the case of the second foreign corporation, the percentage-of-voting-stock requirement of section 902(b)(3)(A) is satisfied, and in the case of the third foreign corporation, the percentage-of-voting-stock requirement of section 902(b)(3)(B) is satisfied.~~

(3) Taxes paid by foreign corporation and not previously deemed paid by domestic corporation.— Any portion of a distribution from a foreign corporation received by a domestic corporation which is excluded from gross income under section 959(a) shall be treated by the domestic corporation as a dividend, solely for purposes of taking into account under section 902 any income, war profits, or excess profits taxes paid to any foreign country or to any possession of the United States, on or with respect to the accumulated profits of such foreign corporation from which such distribution is made, which were not deemed paid by the domestic corporation under paragraph (1) for any prior taxable year.

§ 960(a)(1), (a)(3). Special rules for foreign tax credit - 2018

(a) ~~Taxes paid by a foreign corporation(1) Deemed paid credit —~~In General. For purposes of subpart A of this part, if there is included ~~under section 951(a)~~ in the gross income of a domestic corporation any ~~amount attributable to earnings and profits of a foreign corporation which is a member of a qualified group (as defined in section 902(b)) with respect to the domestic corporation, then, except to the extent provided in regulations, section 902 shall be applied as if the amount so included were a dividend paid by such foreign corporation (determined by applying section 902(c) in accordance with section 904(d)(3)(B))~~item of income under section 951(a)(1) with respect to any controlled foreign corporation with respect to which such domestic corporation is a United States shareholder, such domestic corporation shall be deemed to have paid so much of such foreign corporation's foreign income taxes as are properly attributable to such item of income.

(b) Special Rules for Distributions from Previously Taxed Earnings and Profits. For purposes of subpart A of this part—

(~~3) Taxes paid by foreign corporation and not previously deemed paid by domestic corporation — Any~~ 1) *In General.* If any portion of a distribution from a controlled foreign corporation ~~received by~~ to a domestic corporation which is a United States shareholder with respect to such controlled foreign corporation is excluded from gross income under section 959(a) ~~shall be treated by the domestic corporation as a dividend, solely for purposes of taking into account under section 902 any income, war profits, or excess profits taxes paid to any foreign country or to any possession of the United States, on or with respect to the accumulated profits of such foreign corporation from which such distribution is made, which were~~, such domestic corporation shall be deemed to have paid so much of such foreign corporation's foreign income taxes as—

(A) are properly attributable to such portion, and

(B) have not been deemed to have to been paid by such domestic corporation under this section for the taxable year or any prior taxable year.

(2) Tiered controlled foreign corporations. If section 959(b) applies to any portion of a distribution from a controlled foreign corporation to another controlled foreign corporation, such controlled foreign corporation shall be deemed to have paid so much of such other controlled foreign corporation's foreign income taxes as—

(A) are properly attributable to such portion, and

(B) have not been deemed to have been paid by ~~the~~ a domestic corporation under ~~paragraph (1)~~this section for the taxable year or any prior taxable year.

§ 78. Dividends received from certain foreign corporations by domestic corporations choosing foreign tax credit

1962

If a domestic corporation chooses to have the benefits of subpart A of part III of subchapter N (relating to foreign tax credit) for any taxable year, an amount equal to the taxes deemed to be paid by such corporation under section 902(a)(1) (relating to credit for corporate stockholder in foreign corporation) or under section 960(a)(1)(C) (relating to taxes paid by foreign corporation) for such taxable year shall be treated for purposes of this title (other than section 245) as a dividend received by such domestic corporation from the foreign corporation.

1976

If a domestic corporation chooses to have the benefits of subpart A of part III of subchapter N (relating to foreign tax credit) for any taxable year, an amount equal to the taxes deemed to be paid by such corporation under section 902(a)~~(1)~~ (relating to credit for corporate stockholder in foreign corporation) or under section 960(a)(1)~~(C)~~ (relating to taxes paid by foreign corporation) for such taxable year shall be treated for purposes of this title (other than section 245) as a dividend received by such domestic corporation from the foreign corporation.

1986

No amendment.

2018

If a domestic corporation chooses to have the benefits of subpart A of part III of subchapter N (relating to foreign tax credit) for any taxable year, an amount equal to the taxes deemed to be paid by such corporation under ~~section 902(a)(1) (relating to credit for corporate stockholder in foreign corporation) or under section 960(a)(1)(C) (relating to taxes paid by foreign corporation~~ subsections (a), (b), and (d) of section 960 (determined without regard to the phrase "80 percent of" in subsection (d)(1) thereof) for such taxable year shall be treated for purposes of this title (other than ~~section~~ sections 245 and 245A) as a dividend received by such domestic corporation from the foreign corporation.

Treas. Reg. § 1.960-3 - Gross-up of amounts included in income under section 951

(b) Certain taxes not included in income. Any taxes deemed paid by a domestic corporation for the taxable year pursuant to section 902(a) or section 960(a)(1) shall not be included in the gross income of such corporation for such year as a dividend pursuant to section 78 and § 1.78-1 to the extent that such taxes are paid or accrued by the first-, second-, or third-tier corporation, as the case may be, on or with respect to an amount which is excluded from the gross income of such foreign corporation under section 959(b) and § 1.959-2 as distributions from the earnings and profits of another controlled foreign corporation attributable to an amount which is, or has been, required to be included in the gross income of the domestic corporation under section 951.

Treas. Reg. § 1.78-1 - Dividends received from certain foreign corporations by certain domestic corporations choosing the foreign tax credit

(b) ***Certain taxes not treated as a section 78 dividend***. Foreign income taxes deemed paid by a domestic corporation under section 902(a) in accordance with §§ 1.902-1 and 1.902-2 or section 960(c)(1) in accordance with § 1.960-7, shall not, to the extent provided by paragraph (b) of § 1.960-3, be treated as a section 78 dividend where such taxes are imposed on certain distributions from the earnings and profits of a controlled foreign corporation attributable to an amount which is, or has been, included in gross income of the domestic corporation under section 951.