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Relation-Back to the Future

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To limit double taxation from the relation-back doctrine due to the number of time-barred refund claims from slow-acting foreign tax authorities, amendments may need to be made to §905(c) and possibly §6511(d)(3)(A), but potential regulatory fixes should be considered as well, says Dirk Suringa of Covington & Burling.

The most recent changes to the "relation-back" doctrine in Treas. Reg. §1.905-1(d)(1)(ii) include changes that increase the practical risk of double taxation from administrative practices and time-barred refund claims. Under the doctrine, a contested foreign tax does not accrue until the contest is resolved and the liability becomes finally determined. For foreign tax credit purposes, however, the foreign tax, once finally determined, is considered to accrue in the taxable year "to which it relates," which is commonly understood to be the foreign tax year with respect to which the contested liability arose. Most of the timing rules for foreign tax redeterminations ("FTRs"), particularly in the context of contested foreign taxes, are premised on this version of the relation-back doctrine.

The IRS version of the relation-back doctrine has a long history, and in many cases its effects are benign. In the regulations mentioned above, however, the IRS tightened several of the rules surrounding the doctrine. Those changes meaningfully increase the practical risk of double taxation from administrative foot faults and time-barred refund claims. The regulations already are starting to impose significant compliance burdens on taxpayers, and eventually those burdens will fall on IRS Exam and the courts too. Many of the new restrictions appear to have been more or less spontaneous, and several reversed relatively lenient administrative practices that had been in place for decades. The new restrictions are inauspicious. The OECD Pillar 2 project seems likely to increase the volume of cross-border tax disputes in the coming years. With more disputes will come more instances of double taxation, which the regulations will make it more difficult to resolve.

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In those disputes, we can expect more pressure than ever before on the IRS relation-back doctrine. It is the core rubric for translating foreign audit outcomes and other FTRs into potential credit claims. Yet the doctrine itself is rarely, if ever, examined or questioned. This article asks what the IRS relation-back doctrine is, why we have it, and what measures, both legislative and regulatory, might improve upon it.

The first two sections of the article define relation-back as a concept and then describe the history leading up to the IRS version of the doctrine. First articulated in Rev. Rul. 58-55, the IRS version of relation-back differed from its antecedents in two key respects: its application of the contested tax doctrine and the "double accrual" of foreign taxes.

Those key features of Rev. Rul. 58-55 have given rise to significant interpretive questions, which took decades to resolve. Two examples of such questions are how to match FTRs to the particular prior year or years to which they relate, and whether to allow a credit for contested foreign taxes that are paid before the contest is resolved. The third section of the article follows the circuitous route taken by guidance on those subjects.

As that discussion illustrates, the IRS relation-back doctrine often fails to achieve the main policy justification typically offered for its existence, which is to match the timing of the foreign tax credit to the related U.S. income inclusion, in order to relieve double taxation. That was indeed the original justification of the doctrine, but its real driver now is instead a strict interpretation of the accrual method of accounting, which appears entirely indifferent to matching, or to the relief of double taxation. Indeed, the current version of the relation-back doctrine often seems designed to *cause* double taxation by delaying the accrual of foreign tax credits until they become time-barred.

The fourth section considers whether the IRS version of the relation-back doctrine finds support in the language of the Code. Are the hands of the regulator tied? The doctrine itself is not found in the language of the Code. The Code in places does appear to assume the existence of relation-back as a concept, but not necessarily the IRS version of it.

The fifth section considers how broad the doctrine is, and thus implicitly whether significant changes to the Code would be needed to change to a different approach. It turns out that the IRS version of the doctrine is narrow. It does not embody a universal tax principle that applies in adjacent areas, such as the foreign tax deduction or the computation of earnings and profits ("E&P").

The sixth section of the article discusses the recent changes to the regulations that are creating problems. Those changes materially increase the level of administrative burden, as well as the risk of double taxation through time-barred refund claims. In certain respects, the regulations reverse longstanding administrative practices, and this article argues for the reversal of those changes.

Finally, the article discusses potential alternatives to the relation-back doctrine for contested taxes, in particular alternatives implicated by the use of financial accounting standards for the corporate alternative minimum tax ("CAMT") and Pillar 2. While the details of the financial accounting rules are beyond the scope of this article, a cursory review suggests that contested foreign taxes generally are taken into account on an ongoing basis for financial accounting purposes, instead of on a retroactive basis.

A taxpayer election to replace the relation-back doctrine with some form of ongoing or prospective adjustment mechanism for contested foreign taxes, combined with expanding the availability of foreign tax credit carryovers for §951A taxes, would seem to be an alternative worth considering.

I. What Is the Relation-Back Doctrine?

A. Its Current Formulation

The most authoritative statement of the relation-back doctrine is now found in Treas.Reg. §1.905-1(d)(1)(ii), which Treasury and the IRS added to the regulations quite recently (*See* T.D. 9959, 87 Fed. Reg. 276, 364 (Jan. 4, 2022); T.D. 9882, 84 Fed. Reg. 69,022, 69,108 (Dec. 17, 2019)).

"Additional tax paid as a result of a change in the foreign tax liability, including additional tax paid when a contest with a foreign tax authority is resolved, relates back and is considered to accrue at the end of the foreign taxable year with respect to which the tax is imposed (the "relation-back year")."

Before being added to the regulations in 2022, the outlines of the doctrine could be found in former Temp. Treas. Reg. §1.905-3T(d)(1) ("If a foreign tax redetermination occurs with respect to foreign tax paid or accrued by or on behalf of a United States taxpayer, then a redetermination of the United States tax liability is required for the taxable year for which the foreign tax was claimed as a credit."); *see also* former Temp. Treas. Reg. §1.905-3T(d)(3)(ii), (iii) (Ex.) (illustrating the relation-back of adjustments to the tax and earnings pools of a controlled foreign corporation ("CFC")). Rev. Rul. 58-55 and Rev. Rul. 84-125, discussed below, contained the more detailed IRS version of the doctrine before it was added to the regulations)).

While the relation-back doctrine applies to FTRs more generally, the classic application of the relation-back doctrine involves a contested foreign tax, which will be the focus of this article. In that context, the IRS version of the doctrine (quoted above) provides that "a contested foreign tax does not accrue until the contest is resolved and the liability becomes finally determined, but for foreign tax credit purposes, the foreign tax, once finally determined, is considered to accrue in the taxable year to which it relates." (REG-101657-20, RIN 1545-BP70, 85 Fed. Reg. 72,078, 72,100 (Nov. 12, 2020)).

This formulation already requires clarification. The phrase "the taxable year to which it relates" is an often-used shorthand; it is now found in §905(c) (*See* §905(c)(1)(B) (requiring a redetermination if "accrued taxes are not paid before the date 2 years after the close of the taxable year to which such taxes relate"), (c)(2)(B)(i) (noting that certain late-paid taxes "shall be taken into account for the taxable year to which such taxes relate"). The statue thus implies that the relation-back year is the one in which the foreign taxes accrued, although as discussed below the year of accrual itself would seem to be debatable as a textual matter). The literal language, however, is unclear unless one already knows the year to which a tax "relates." The regulations define the "relation-back year" for foreign income taxes as "the foreign taxable year with respect to which the tax is imposed." (Treas. Reg. §1.905-1(d)(1)(ii)). This formulation is helpful, but there still remains the question of how to link the timing of the imposition of the foreign tax to the foreign tax year. Another provision of the regulations supplies that missing link: "[a] foreign income tax liability determined on the basis of a foreign taxable year becomes fixed and determinable at the close of the taxpayer's foreign taxable year." (Treas. Reg. §1.905-1(d)(1)(i)).

Thus, the regulatory formulation of the relation-back doctrine ties both the original imposition of a foreign income tax liability, and the imposition of additional tax from a contest of that liability, to the end of the foreign taxable year during which the foreign income tax liability *accrued* for foreign tax purposes. As discussed below, the IRS version of the relation-back doctrine is perhaps most accurately viewed as a compulsory method of accounting for foreign taxes to be claimed as credits.

B. The Subtext

The regulatory formulation of the doctrine glosses over a number of issues that have been debated over time. For example, the timing of the accrual of foreign taxes was not always so clear as the regulations and their preambles suggest. The new regulatory formulation of the doctrine does not mention its original and oft-cited policy rationale: *to match the foreign tax credit to the foreign income inclusion and thereby alleviate potential double taxation*. The omission is telling.

Before the IRS formulated its version of the relation-back doctrine in 1958, the more general concept of relation-back was used to match the foreign tax accrual for credit purposes to the accrual of the income taken into account for both U.S. and foreign tax purposes. That form of matching addressed a key problem in the early years of the foreign tax credit, the absence of a carryover for excess foreign tax credits. Relation-back was an attempt to solve the problem of a foreign tax liability accruing in a year different from the income that was supposed to supply the limitation necessary to credit the tax.

For routine tax filings, relation-back as a concept still achieves the goal. For accrual method taxpayers (that is, most taxpayers, given the ability of cash-method taxpayers to elect the accrual method for foreign tax credits), a foreign income tax paid in 2022 with respect to income generated in 2021 relates to 2021, so that the credit can be computed and claimed on the U.S. federal income tax return for 2021. As discussed below, however, the IRS version of relation-back prioritizes neither matching nor the relief of double taxation. To see what has become of the relation-back doctrine, the next section considers how it emerged.

II. Where Did the Doctrine Come From?

A. Matching Income and Credit to Prevent Double Taxation

Congress enacted the foreign tax credit in 1919 (Pub. L. No. 65-254, §238(a), 40 Stat. 1057, 1080-81 (1919)). The same legislation introduced the concept of FTRs, in the precursor to current §905(c):

"If accrued taxes when paid differ from the amounts claimed as credits by the corporation, or if any tax paid is refunded in whole or in part, the corporation shall at once notify the Commissioner, who shall redetermine the amount of the taxes due under this title and under Title III for the year or years affected, and the amount of taxes overpaid, if any, shall be credited or refunded to the corporation …."

(Id.). From the very beginning, Congress recognized the need for FTRs to reflect changes in foreign tax liability "for the year or years affected." (*Id.*; *see also* §905(c)(1) ("If … accrued taxes when paid differ from the amounts claimed as credits by the taxpayer … or … any tax paid is refunded in whole or in part, the taxpayer shall notify the Secretary, who shall redetermine the amount of the tax for the year or years

affected.")). The statute, however, did not address when taxes accrue, identify the relation-back year ("year or years affected"), or mention contested foreign taxes.

Congress enacted the foreign tax credit limitation in 1921 (Pub. L. No. 67-98, §222(a)(5), 42 Stat. 227, 249 (1921)), but Congress did not enact a carryover for excess foreign tax credits until 1958 (Pub. L. No. 85-866, §42, 72 Stat. 1606, 1639 (Sept. 2, 1958)). Therefore, from 1921 to 1958, timing differences in the imposition of taxes could relatively easily result in double taxation. If the taxpayer generated income for U.S. tax purposes in a year different from when the credit arose for that foreign tax, there might not have been sufficient limitation in the credit year to claim the full amount of the credit.

For example, in *United States v. Rogers* (122 F.2d 485 (9th Cir. 1941)), the taxpayer had sufficient limitation in 1926 to credit its foreign taxes, but it had insufficient limitation in 1930. The foreign government asserted additional taxes with respect to 1926, which the taxpayer paid in 1930. Neither the taxpayer nor the IRS argued for relation-back of the 1930 tax to 1926. Instead, the taxpayer argued that it should be allowed to claim a credit in 1930 based on the amount of limitation available from 1926. The court rejected this argument:

"The executors claim that the credit allowed the taxpayer ... must be determined both by amount of the United States tax and by the ratio of income in the year 1926 when the English tax accrued whether the credit is claimed in that year or in the year when the foreign tax was paid by the taxpayer (1930). That is, the claim of the executors is that the amount of credit is the same no matter when claimed by the taxpayer. The difficulty with this contention lies in the fact that the statute expressly provides that the credit shall be a portion, not of the foreign tax, but of the United States tax "against which such credit is taken," which in the case at bar is the United States tax for 1930.... [T]here is no allegation in the complaint that there was any income derived from foreign sources in the year 1930, hence, there was no basis for judgment in favor of the taxpayer."

(*Id.* at 486-87). As the dissent in *Rogers* pointed out, "[t]he construction placed on the credit provision by the majority clearly defeats its purpose, which was to prevent double taxation on foreign income. Under the majority's construction, the foreign income is taxed twice." (*Id.* at 491 (Haney, J., dissenting)).

The availability of the carryover of excess foreign tax credits rarely appears in the discussion of the relation-back doctrine and why we are supposed to need it. It deserves greater mention. Until 1958, the need was much more pressing to resolve timing mismatches potentially giving rise to double taxation. Taxpayers needed relation-back less once they could carry over excess credits—at least up until the enactment of §951A, which this article assumes one day will be addressed. Instead of dialing back the relation-back doctrine in 1958, however, the IRS gave the relation-back doctrine new life in a revenue ruling, less than a year before the enactment of §904(c).

Returning for the moment to 1924, Congress in that year enacted the precursor to §905(a), which allows a cash-method taxpayer to claim the foreign tax credit on an accrual basis (*See* Pub. L. No 68-176, §222(c), 43 Stat. 253, 279 (1924). Originally enacted as §222(c) for individuals and §238(c) for corporations, the two provisions were combined in §131(d) of the Internal Revenue Code of 1939, before eventually becoming §905(a)). The original purpose of §905(a) was simple. Most foreign countries, like the United

States, required the payment of taxes during the year following the year in which the taxpayer earned the income subject to tax. Cash method taxpayers thus were obliged to claim a foreign tax credit in the year *after* the year in which they earned (and paid U.S. tax) on the income that was subject to the foreign tax. Congress enacted the predecessor to §905(a) in order to correct this timing "defect" (*See* H. Rep. No. 68-179, at 60 (1924)).

"[S]ections 222 and 238 of the Revenue Act of 1921 ... provided for a credit for foreign taxes in the case of a citizen of the United States or a domestic corporation, but failed to recognize the inequity which might arise in the case where a taxpayer whose books of account were kept on the cash receipts and disbursements basis had a large income from a foreign country for one year but no income, or very little income, for the subsequent year. In such case the taxpayer would, for example, pay to a foreign government in 1922 taxes with respect to income for 1921 and such taxes would not be a credit against American income tax for the taxable year 1921, but would have to be claimed as a credit against income tax for the taxable year 1922, which is paid in 1923. Thus, the purpose for which a credit for foreign taxes was created, namely, the avoidance of double taxation, would not be accomplished in those cases where the taxpayer's books of account were kept on the cash receipts and disbursements basis. This inequity did not exist where the taxpayer's books of account were kept on the accrual basis, for accrued foreign taxes for 1921 could be claimed as a credit against accrued United States taxes for the same year, thus avoiding double taxation."

(G.C.M. 9459, X-1 C.B. 169 170 (1931); *see also Ferrer v. Commissioner*, 35 T.C. 617, 628 (1961) (noting that the purpose of the predecessor to §905(a) "was to permit as a credit against United States taxes, payable for a given year, the foreign taxes applicable to the same year, even though not yet paid, or possibly even due."), *rev'd in part on other grounds*, 304 F.2d 125 (2d Cir. 1962)).

Section 905(a) was enacted to provide a special accrual method of accounting for taxpayers that claim foreign tax credits, *in order to match income and credit and to prevent double taxation*. In this, the first instance of relation-back, matching was essential.

B. The Accrual Method for Taxes

Soon after Congress authorized this special accrual method of accounting for foreign tax credits, the courts started to specify the contours of the accrual method of accounting for tax purposes. In 1926, the Supreme Court created the "all-events test" to determine when a federal munitions tax liability accrued for U.S. federal income tax purposes (*United States v. Anderson*, 269 U.S. 422 (1926); *see generally* Gertzman, Hani & Gadwood, *Federal Tax Accounting*, ¶4.02[2] n. 25 (WG&L, 2023 online edition) ("Although focusing on economic and bookkeeping concepts, the Supreme Court did refer to the fact that 'all the events may occur which fix the amount...and determine the liability....' Because of this language, *United States v. Anderson* is generally regarded as the source of the present all events test.").

"In a technical legal sense it may be argued that a tax does not accrue until it has been assessed and becomes due; but it is also true that in advance of the assessment of a tax *all the events may occur which fix the amount of the tax and determine the liability of the taxpayer to pay it*. In this respect, for purposes of accounting and of ascertaining true income for a given accounting period, the munitions tax here in question did not stand on any different footing than other accrued expenses appearing on appellee's

books. In the economic and bookkeeping sense with which the statute and Treasury decision were concerned, the taxes had accrued.... *We do not think that the Treasury Decision contemplated a return on any other basis when it used the terms "accrued" and "accrual" and provided for the deduction by the taxpayer of items "accrued on their books*."""

(*Id*. at 441 (emphasis added)). This case, *Anderson v. United States*, stood for the proposition that, unless it did not clearly reflect income, the accrual method of accounting used for financial accounting purposes also could be used for tax purposes (Gertzman, Hani & Gadwood, *Federal Tax Accounting*, ¶4.02[2] (WG&L, 2023 online edition)).

For a while, courts applied a version of relation-back based on *Anderson's* book-tax conformity. For example, in *Carter, Rice & Company Corporation v. Commissioner* (28 B.T.A. 687 (1933)), the taxpayer received in 1928 a notice of demand from Canada for additional taxes due with respect to 1925 through 1927. The taxpayer paid the tax in 1928 and claimed a credit for it in that year. The IRS argued (with emphasis added) "that the taxes accrued during the prior years and, despite the payment in 1928, are properly deductible from income, or to be credited against the domestic tax, only in the years when accrued, *since the company's accounts were kept on an accrual basis* ...." The Board agreed:

"We have previously held in cases wherein deductions were claimed that the construction of that term depends upon the basis on which the taxpayer keeps his accounts.... Here, the taxpayer kept its accounts on an accrual basis. Nothing has been suggested concerning the Canadian law or the nature of these tax claims indicating that the liability therefor was not fixed within or at the close of each of the taxable periods for which the demands were asserted, nor any other reason indicating that these taxes were not proper accruals for each of those years, beyond the fact that the taxpayer was not advised of [Canada's] claim against it until 1928."

(Id. at 679). Citing *Anderson*, the Board held in favor of the IRS. Lost in the later discussion of relation-back is this early reliance on financial accounting to determine when a foreign tax accrues.

C. The Contested Tax Doctrine

The IRS never seems to have agreed with book-tax conformity. As the IRS brought cases over time, moreover, the courts' reliance on financial accounting concepts to define the accrual method of accounting in tax cases began to give way to a variety of exceptions. The accrual method of accounting for tax purposes began to differ significantly from the accrual method of accounting for financial statement purposes. (*See, e.g*., *Thor Power Tool Co. v. Commissioner*, 439 U.S. 522 (1979) ("The primary goal of financial accounting is to provide useful information to management, shareholders, creditors, and others properly interested; the major responsibility of the accountant is to protect these parties from being misled. The primary goal of the income tax system, in contrast, is the equitable collection of revenue; the major responsibility of the Internal Revenue Service is to protect the public fisc.").

The Supreme Court created a key exception in 1944. The Court held, in *Dixie Pine Products Co. v. Commissioner* (320 U.S. 516 (1944)), that a contested tax did not meet the *Anderson* all events test until it was finally adjudicated.

The taxpayer in that case accrued a state tax liability for tax and financial accounting purposes but did not pay the tax, all the while contesting its imposition in state court. The state court eventually found in favor of the taxpayer, which thus never actually paid the tax. The taxpayer sought to deduct its tax in the year to which the tax related and then to reverse its deduction in the later year, in which the taxpayer received the favorable ruling. The Supreme Court analyzed the issue under *Anderson*'s all-events test—but then departed from it (*See Dravo Corp. v. United States*, 348 F.2d 542, 545 (Ct. Cl. 1965) ("The Supreme Court somewhat departed from this traditional concept of accrual accounting when it added a refinement to the 'all events test' by its holding in *Dixie Pine Products Co. v. Commissioner*.")).

"It has long been held that, in order truly to reflect the income of a given year, all the events must occur in that year which fix the amount and the fact of the taxpayer's liability for items of indebtedness deducted though not paid; and this cannot be the case where the liability is contingent and is contested by the taxpayer. Here the taxpayer was strenuously contesting liability in the courts and, at the same time, deducting the amount of the tax, on the theory that the state's exaction constituted a fixed and certain liability. This it could not do. It must, in the circumstances, await the event of the state court litigation and might claim a deduction only for the taxable year in which its liability for the tax was finally adjudicated."

(Dixie Pine Products Co., 320 U.S. at 519). Thus was borne the contested tax doctrine, which defers the accrual of a foreign tax for tax purposes without regard to whether the accrual is deferred for financial accounting purposes.

The IRS campaign to expand the contested tax doctrine started almost immediately, with the deferral of deductions for taxes challenged by the taxpayer in administrative proceedings as well as court proceedings (*See, e.g.*, G.C.M. 25298, 1947-2 C.B. 39, 43 ("The term 'contest' includes not only a contest in court … but a contest lodged with the tax authorities as well."); *Dravo Corp. v. United States*, 348 F.2d at 545 (1965) ("The concept of contest since *Dixie Pine* has been expanded not only to include litigation in the courts but also a dispute formally lodged with the tax authorities."). Nevertheless, there still are limits to what constitutes a "contest." For example, in *Dravo Corp.*, the IRS asserted that filing a state tax return gave rise to a contested foreign tax because the filing implicitly disputed the taxpayer's liability for a greater amount of tax. The court rejected this argument (*See* 348 F.2d at 546). The IRS conceded this particular issue in Rev. Rul. 68-631, 1968-2 C.B. 198, *modified by* Rev. Rul. 69-336, 1969-1 C.B. 142.

To summarize so far, by the early 1950s taxpayers could claim foreign tax credits, subject to potential redetermination for changes to the foreign tax liability "for the year or years affected." The foreign tax credit limitation applied without any carryover for excess foreign tax credits, creating a real risk of double taxation. Congress enacted the predecessor to §905(a) as a special rule allowing cash-method taxpayers to use the accrual method of accounting for foreign tax credit claims in order to avoid perpetually claiming credits one year too late. Based on the accrual method of accounting used for financial accounting purposes, the Supreme Court created the all-events test and used it to determine the year in which a tax can be deducted, including foreign taxes claimed as credits under the §905(a) precursor. Soon after, however, the Court departed from book-tax conformity for *contested* taxes, requiring the deduction of such taxes to be deferred until the year in which the tax liability is finally determined.

D. Cuba Railroad Company

That is the context in which the U.S. District Court for the Southern District of New York decided *Cuba Railroad Company v. United States* (124 F. Supp. 182 (S.D.N.Y. 1954)).

In that case, the court held that the Supreme Court's decision in *Dixie Pine Products* did not apply to the accrual of a foreign tax for purposes of the foreign tax credit. One might ask how a district court could overrule the Supreme Court's decision in *Dixie Pine Products.* It seems clear, however, that the district court did not consider itself to be overruling the Supreme Court, but rather to be applying a specific statutory exception that allowed it to distinguish *Dixie Pine Products*: the predecessor to current §905(a), former Code §131(d). Here is virtually the entire discussion of the issue in *Cuba Railroad*:

"Turning now to the second ground urged by the defendant [United States], we find the argument that the amount of the Cuban tax deficiency having been contested, the amount actually paid on settlement of the claim should not be considered as a credit for the year in which it accrued, but rather should only be asserted for the year in which it was paid. This theory is known as the 'contested tax' doctrine, and we do not believe that it should apply to this case. Section 131 of the Internal Revenue Code... is entitled 'Taxes of foreign countries and possessions of United States.' The plaintiff brings its claim under section 131(c) entitled 'Adjustments on payment of accrued taxes.' This subsection (c) is modified by the next subsection, (d), entitled 'Year in which credit taken,' which includes the following language: 'The credits provided for in this section may ... be taken in the year in which the taxes of the foreign country ... accrued....' That language is clear and unambiguous. Further, it is supported by case law. *Russell-Miller Milling Co. v. Helvering,* 63 App.D.C. 74, 69 F.2d 392; *Hygienic Products Co. v. Com'r,* 6 Cir., 111 F.2d 330, certiorari denied 311 U.S. 665, 61 S.Ct. 22, 85 L.Ed. 426; *Hecla Mining Co. v. Com'r,* 35 B.T.A. 454. We therefore conclude that this defense too must fail."

(*Id*. at 185).

This passage strongly suggests that the *Cuba Railroad* court treated the predecessor to §905(a) as a statutory override of the contested tax doctrine, or at least as a basis for distinguishing *Dixie Pine Products*. Congress had specifically allowed taxpayers to elect the accrual method in order to match a foreign tax liability paid after the end of the year back to the year for which the payment was made, and the IRS could not thwart that election by using the contested tax doctrine to put the taxpayer, in effect, onto the cash method.

The court's opinion also suggests a focus on matching. The cases cited by the court generally stood for the proposition that income taxes accrue when the underlying income is earned. For example, the court cited *Russell-Miller Milling Co. v. Helvering* (69 F.2d 392, 394 (D.C. Cir. 1934). In that case, the foreign tax was assessed against a U.S. company on profits earned in the year 1925-26. The tax was computed on an arbitrary basis because the taxpayer had failed to file the return necessary to compute it correctly. The taxpayer contested the tax initially but later settled it for a smaller amount than the taxing authority had asserted. The court held on those facts that "the amount paid accrued in the year the profits on which payment was based were made and not in the year of payment." (*Id.* at 394).

Cuba Railroad Company basically stood for the proposition that, by enacting what is now §905(a), Congress intended for the accrual method of accounting to apply to foreign tax credit claims without regard to the contested tax doctrine in order to match income and credit. The court issued its decision against a background in which there were no foreign tax credit carryovers, and not even an extended statute of limitations for claiming a refund based on foreign tax credits.

E. The 10-Year Statute

The latter issue, at least, was being addressed in the same year in which *Cuba Railroad* was decided, 1954. In that year, Congress enacted §6511(d)(3)(A), which provided a 10-year statute of limitations for overpayments arising from foreign tax credits:

"If the claim for credit or refund relates to an overpayment attributable to any taxes paid or accrued to any foreign country or to any possession of the United States for which credit is allowed against the tax imposed by subtitle A in accordance with the provisions of section 901 or the provisions of any treaty to which the United States is a party, in lieu of the 3-year period of limitation prescribed in subsection (a), the period shall be 10 years from the date prescribed by law for filing the return for the year which respect to which the claim is made."

As discussed below, Congress originally enacted §6511(d)(3)(A) to provide rough parity between the statute of limitations for refund claims, which otherwise would have been a mere three years, and the *apparently unlimited* statute of limitations for the assessment of additional taxes arising from foreign tax redeterminations, a position which to which the IRS has long adhered. (*See* §905(c), §6501(c)(5); *see, e.g.*, *Pacific Metals Corp. v. Commissioner*, 1 T.C. 1028, 1030 (1943) (holding that the period of limitations for assessment was postponed during the time that the taxpayer had not ascertained the correct amount of the foreign tax due and therefore had not informed the IRS of the correct amount); Rev. Rul. 83-80, 1983-1 C.B. 130 ("Section 905(c) of the Code provides in effect that there is no statute of limitations for the redetermination of the amount of Federal income taxes due upon adjustment of foreign income taxes by foreign tax authorities if the taxpayer overpaid the foreign tax and as a consequence received a refund." (quoting Rev. Rul. 71-454, 1971-2 C.B. 294 (internal quotations omitted), *obsoleted by* Rev. Rul. 2003-99, 2003-34 I.R.B. 388)); G.C.M. 18801, 1937-2 C.B. 302, 204; *but cf. The Texas Co. (Carribbean) Ltd. v. Commissioner*, 12 T.C. 925, 932 (1949), *acq.* 1949-2 C.B. 3, (holding that the IRS can assess U.S. tax after the expiration of the three-year statute for assessments with respect to substantive foreign tax adjustments, but not with respect to computational errors associated with the taxpayer's United States income tax return)). Later versions of the statute have become entangled with the IRS version of the relation-back doctrine, but that doctrine did not exist when §6511(d)(3)(A) was originally enacted.

F. The Doctrine Emerges: Rev. Rul. 58-55

One potential IRS response to *Cuba Railroad* could have been simply to apply relation-back without regard to the contested tax doctrine, based on the special method of accounting for foreign tax credits in §905(c). After all, the court in *Cuba Railroad literally* concluded that the contested tax doctrine in *Dixie Pine Products* did not apply: "This theory is known as the 'contested tax' doctrine, and we do not believe that it should apply to this case." Under this approach, the taxpayer at the very least would have been able to credit a contested foreign tax on an amended return for the relation-back year without waiting for the contest to resolve, with further adjustments to be made up to and including resolution of the contest (As

discussed below, this approach would not differ much from the rules permitting taxpayers to claim a credit currently for contested foreign taxes that are paid pending resolution of the foreign tax dispute). The IRS, moreover, had an unlimited statute of limitations to check the taxpayer's math.

Instead, the IRS issued Rev. Rul. 58-55 (1958-1 C.B. 266). That ruling created an IRS version of relation-back as an indifferent assortment of the ideas that came before it.

At first, all of the parts available for assembly seemed to be in order:

- The ruling started by citing *Dixie Pine Products*, noting that the accrual method taxpayer in that case "could not accrue and deduct the amount of gasoline tax assessed against it by the state taxing authorities, so long as such taxes were contested by the taxpayer." Instead, "the taxpayer may claim a deduction for such tax only for the taxable year in which the liability therefor is finally adjudicated."

- The IRS then cited *Cuba Railroad Company*, in which the court "rejected the contested tax doctrine in cases involving the accrual of a foreign tax under [what is] now section 905(a) of the Internal Revenue Code … for the purpose of the foreign tax credit."

- After some statutory citations, the ruling recalled that "[t]he basic purpose of the allowance of a foreign tax credit is to provide a credit against United States income tax on specific income from foreign sources for foreign taxes paid on such income and in this manner to substantially avoid double taxation on the income when earned." The ruling thus seemed to emphasize the goals of matching and the avoidance of double taxation.

- The ruling highlighted §905(a), "allowing a credit for foreign taxes when the tax accrued, irrespective of the accounting method used," and thereby "demonstrat[ing] the special nature of such credit." The ruling dwelled on the differences between the statutory rules for the foreign tax credit and "usual accounting practice."

- The ruling called attention to the "separate and distinct method of correcting differences in taxes claimed as a credit and taxes finally paid" and the absence of a statute of limitations for assessment by the IRS. The IRS "may call for additional taxes due by notice and demand without facing the bar of the ordinary statute of limitations. Similarly, section 6511(d)(3) of the 1954 Code, which provides a 10-year statutory period of limitations, with respect to refunds relating to the credit for foreign taxes, evidences Congressional intent of separate treatment of the foreign tax credit."

So far, so good. All of the foregoing precedents are more or less accurate; the question is how to stitch them together. The result was surprising, but not in a good way:

> "The accrual of foreign taxes, for the purpose of the foreign tax credit under section 901 of the 1954 Code … must conform to the general rules laid down under section 461 …. Under such rules the

> accrual for the contested taxes cannot be made until the liability is finally determined, but, under the principles stated in *The Cuba Railroad Company* case, and in view of the special nature of the foreign tax credit as evidenced by its legislative history and concept, such accrual will relate back to the taxable year for which the foreign tax is in dispute."

The ruling tolls like the thirteenth chime of the clock. It purports to apply the accrual method of accounting and the "all events" test. It then departs from that method of accounting by applying the contested tax doctrine. The ruling next purports to follow *Cuba Railroad Company*, even though that case specifically rejected the contested tax doctrine that is applied by the ruling. Finally, the ruling departs from its departure by treating the foreign tax, once the contest has been resolved, as miraculously traveling back in time to have accrued already in "the taxable year for which the foreign tax is in dispute."

In addition to the physical and logical impossibility of a deduction accruing before it accrues, there is the internal inconsistency of double accrual with the very concept of accrual itself, which is to define the point in time when an expense becomes sufficiently fixed and determinable that it should be taken into account for tax purposes. Among the relation-back year, the year of the foreign audit adjustment, or the year in which the contest was resolved, the relation-back year is the least likely to be the one in which the additional foreign tax expense became fixed and determinable—it had not yet even been raised as an issue then.

Nothing in the language or history of §905(a), of course, supports this approach. Indeed, the ruling relegates §905(a) to a simpering platitude, "the special nature of the foreign tax credit as evidenced by its legislative history and concept." The avoidance of double taxation and the matching of credit and income do not make it into relation-back doctrine itself. The IRS later more or less admitted that Rev. Rul. 58-55 was not about matching credit to income (See G.C.M. 36085 (Nov. 18, 1974) ("In that ruling there was no dispute as to the proper year that foreign taxes were due, but only, whether such taxes were due at all.")). The relation-back year is the year for which the foreign tax is in dispute, not necessarily the year in which the related income accrued. After Rev. Rul. 58-55, the relation-back doctrine will continue to be invoked as a measure for the relief of double taxation through matching. (*See, e.g., American Air Filter Co., Inc. v. Commissioner*, 81 T.C. 709, 734 (1983) ("A special definition of 'accrual' is necessary so that payments of foreign taxes with respect to the income of a given year are offset against U.S. tax liability otherwise imposed on such income.")) The actual effect the doctrine, however, will be to defer the credit, often to a year that time-bars the refund claim and thus expressly leaves double taxation unresolved. (*See, e.g.*, 1993 F.S.A. LEXIS 354 (Nov. 30, 1993) (stating, in a case that denied credits because they related back to a closed year, that "[t]he rationale for the relation back of later accrued taxes is to ensure that the foreign tax credit prevents double tax on the same income, a function which would be defeated if the credit was allowed in the year the dispute was resolved rather than the year that the income upon which the tax was imposed was earned.")).

Rev. Rul. 58-55 limited its holding to the foreign tax credit and carved out the *deduction* for foreign taxes:

"The above-principles are not intended to affect the taxable year of the accrual of the deduction for foreign taxes under section 164 … as distinguished from the accrual of credits for such taxes under section

905(a) …. The principles enunciated in the *Dixie Pine Products Company* case, *supra*, will continue to be applicable to the accrual of foreign taxes for the purposes of the deduction[] under section 164 ….”

This language seems to indicate that relation-back does not apply to the foreign tax deduction. As discussed below, however, relation-back in fact does seem to apply the deduction for foreign taxes—just not *contested* foreign taxes.

The IRS followed up on Rev. Rul. 58-55 with a number of similar rulings (*See, e.g.*, Rev. Rul. 77-487, 1977-2 C.B. 479 (citing the relation-back doctrine from Rev. Rul. 58-55 as support for denying a foreign tax credit claim as time-barred), the most significant of which was Rev. Rul. 84-125 (1984-2 C.B. 125)). Issued in response to the *Ampex* decision, discussed below, the ruling formally linked the IRS version of relation-back to §6511(d)(3)(A): “The period of limitation prescribed in section 6511(d)(3)(A) of the Code for claiming a foreign tax credit is determined by reference to the year for which the taxes were paid or accrued and not to the carryover year.” Under the IRS relation-back doctrine, if the contested foreign tax relates back to a year for which the extended statute of limitations in §6511(d)(3)(A) has expired, the taxpayer cannot claim a refund to recover it.

In such a case, as noted, relation-back of the foreign tax is very likely to create unresolved double taxation. Unless the contested tax was imposed on a base difference, the taxpayer likely will have paid U.S. and foreign tax on the same income, yet the foreign tax credit will be time-barred, often because the foreign tax system simply took too long to resolve the dispute.

Did it have to be this way? The authorities in 1958 would seem to have supported an alternative approach. Contested foreign taxes that accrued for financial accounting purposes could have accrued for tax credit purposes as well. The objective of matching credit to income would have been addressed to the extent feasible by allowing excess credit carryovers under §904(c), enacted later in the same year. The IRS would have continued to have the authority to reverse the accrual of the contested taxes when the contest was resolved, given the unlimited statute of limitations for assessment. There would have been no need for the time warp of contested taxes accruing in the future and then being deemed to have accrued in the past. The need for the more or less arbitrary two-year cutoff later added to §905(c) (also discussed below) never would have arisen. The courts and the IRS would not have had to invent a standard for when foreign taxes accrue for tax purposes, independent from when they accrue for financial accounting purposes.

Instead, the ruling confronts us with problems such as determining which year is the true relation-back year, and what to do if the taxpayer pays a contested tax before resolution of the contest. Whatever answers we find for those questions, they might or might not be the same for foreign tax deductions, a distinction that rarely seems to be addressed (*Cf.* G.C.M. 9459, X-1 C.B. 169, 171-72 (“From a legal viewpoint as well as for administrative reasons it is certainly inadvisable to attempt to adopt one accrual date for that part of the foreign tax which is allowed as a deduction and another accrual date for that part of the foreign tax which is allowed as a credit.”). When considering below what challenges an alternative approach would crate, we should keep in mind for comparison purposes the issues created by Rev. Rul. 58-55, in particular its reliance on the contested tax doctrine and the supposedly tachyonic double accrual of the foreign tax.

III. When Did, or Will, the Contested Tax Accrue?

Double accrual is perhaps the most "unique" feature of the IRS relation-back doctrine. A few short years after Rev. Rul. 58-55, Elisabeth Owens put it as follows:

"In effect, the ruling holds that, when applying the tax credit provisions, contested taxes accrue at two different times for two different purposes. For the purpose of determining in what year the right to claim the credit arises, the "contested tax" doctrine is applied. For the purpose of determining against which United States tax the foreign tax is to be credited, the "contested tax" doctrine does not apply and the contested tax is held to have accrued in the taxable year "to which the tax relates.""

(Elisabeth A. Owens, *Foreign Tax Credit: A Study of the Credit for Foreign Taxes under United States Income Tax Law*, at 328 (1961) [hereinafter *Owens*]. To this one could add the further, potentially different accrual of the tax for financial accounting purposes, but that date has generally been ignored until very recently.).

Double accrual makes it necessary to determine when the foreign tax accrues in the future, under the contested tax doctrine, and when the foreign tax is deemed to have accrued in the past, in whatever year is the one "to which the tax relates."

The need for the IRS to create new, tax-only rules for the accrual of foreign taxes was apparent at the time of the ruling; again, Owens:

"although the reason for permitting a credit for a contested tax in the year to which it relates is to allow the tax to be offset against the United States tax on the same annual income, this may not be accomplished in all cases under the ruling. The taxable year to which the contested tax relates is referred to in the ruling "as the taxable year for which the foreign tax is in dispute." This definition is not precise. It probably means the taxable year in which the contested tax would have accrued, absent the tax contest. In a few cases, this may not be the year in which the income subject to the foreign tax was earned because accrual may be postponed beyond that year for other reasons."

(*Id.*). Taking up this thread, the section below discusses two interpretive issues with which the IRS has struggled over the years: how to identify the relation-back year, in which the tax is deemed to have accrued; and whether the payment of a contested tax allows it to accrue, even though the contest continues.

A. What Is the Year to Which the Tax Relates?

Soon after *Anderson* applied the "scientific accounting principles" of the accrual method of accounting to the accrual of a munitions tax, the IRS applied the same principles to income tax liability (S.M. 4499A, V-1 C.B. at 57 ("There is no reason stated or suggestion made in the court's opinion which would justify the making of a distinction between an income tax and an excise tax based on income..."). Matching and accrual accounting were said to be in harmony, and the IRS was supposed to apply accrual accounting in order to achieve matching (*See id.* ("[A] taxpayer is not properly reporting income on the accrual basis unless he deducts from gross income not only accruals of interest and expenses but also reserves made to meet liabilities for taxes incurred in the process of creating income; a liability for tax may be incurred prior

to the assessment or due date of a tax where prior thereto all the events 'occur which fix the amount of the tax and determine the liability of the taxpayer to pay it,' and in such cases both for purposes of accounting and of ascertaining true income tax has accrued and does 'not stand on any different footing than other accrued expenses.")). The reason why an income tax accrues at the end of the year is because that is when one could determine the amount of net income on which the tax has been imposed. The IRS therefore opined that "a taxpayer on the accrual basis should accrue the income taxes which he will be required to pay on the income accruing during the year, and in computing his net income for such year subject to tax he is entitled to deduct the state income tax which has accrued on such income." (*Id.* at 57-58).

This principle was soon tested, however, in the form of a British tax that not only was imposed for a year of assessment that ran from April of one year to April of the next, but that also was computed on the average profits of the three years ending on the day of the year immediately preceding the year of assessment. The IRS considered this tax in General Counsel Memorandum 5971 (VIII-1 C.B. 182 (1929)).

The taxpayer in that case opened a U.K. branch in 1922, which incurred losses in 1922 and 1923. The branch turned a profit in 1924 and 1925 and included those amounts in its U.S. tax return. A British tax was assessed for the period 1922 through 1924, based on the average profits for those years. The U.S. taxpayer paid the tax in 1925 and claimed it as a credit on its 1924 return. Similarly, a British tax was assessed for the average profits from 1923 through 1925. The taxpayer paid the tax in 1926 and claimed as a credit on its 1925 return.

Citing *Anderson*, the IRS agreed with the taxpayer's approach, finding that it produced matching between income and credit (*Id.* at 183). As support for its conclusion, the IRS pointed to language in the British statute that treated the average of the income from the three-year period as the taxpayer's income from the assessment year. It also noted an unusual feature of the British law:

"[T]he British income tax on the type of income involved in those cases is intended to be on the profits and gains forming income in the year of assessment, though not measured by the income of that year, and *if, therefore, a person has no income from a given source in the year of assessment or has ceased to own the source there is no income on which to base the tax, and no tax can be levied or collected in respect of a nonexisting income*."

(*Id.* at 183 (emphasis added)). Thus, under the British law, if the taxpayer ceased to exist before the start of the assessment year, then no tax was due, but this was said to support the accrual of the tax based on imputed income.

In *Columbian Carbon Company v. Commissioner* (25 B.T.A. 456 (1932)), the Board of Tax Appeals took a different view of the latter provision. If there would be no liability for tax for the year of assessment unless the corporation remained in existence on the first day of the year of assessment, the Board reasoned, the tax did not accrue until the assessment year. It thus rejected both parties' efforts to match the tax liability to the appropriate period during which the income accrued:

"Prior to the first day of the year of assessment, the liability to tax was not even conditional or contingent. No liability had been imposed. The liability was wholly *in futuro*, merely a prospective or anticipated liability. Whether any liability would in fact ever be incurred depended upon a future event which might or might not occur, namely, the continuance of the business until the first day of the year of assessment."

(Id. at 472). According to the Board, the tax did not accrue until the beginning of the assessment year, regardless of when the amount of the underlying income became fixed or determinable. Two judges dissented from the Board's opinion in *Columbian Carbon*, apparently on the ground that matching was not achieved: "I think the deduction for British income tax should be allowed in the amounts actually accrued in each calendar year .... In this way a proper portion of the tax for each British tax year is offset against the income of the company's income-computing year and the tax is not accrued before the liability is fixed." (Id. at 474).

The IRS responded to this decision by revoking its prior guidance and following *Columbian Carbon*: "British income taxes, regardless of whether such taxes are based on the average income of a 3-year period or on the income of the preceding year, will be held to have accrued on the first day of the British tax year of assessment, for it appears that liability for the payment of the British taxes is dependent upon whether the taxpayer continues in business during the year of assessment." (G.C.M. 106613, XI-1 C.B. 173 (1932)).

Where the foreign tax law did not condition the assessment of the tax on the taxpayer's continued existence in the assessment year, however, the IRS and the courts reverted to their prior approach of matching credit and income. I.T. 3309 (1939-2 C.B. 183), for example, considered a British tax that was assessed on the taxpayer's London branch for a period of eight months ending November 30, 1937, which was the end of the accounting year of the branch. This British tax did not require the taxpayer to continue in business during the year of the assessment, so the IRS distinguished *Colombian Carbon*: "Inasmuch as such tax is imposed on profits for the chargeable accounting period of the British taxpayer, the tax becomes a liability of the taxpayer on the last day of his accounting period when the question of profit or no profit is definitely determinable." (I.T. 3309, 1939-2 C.B. 183, 184).

Similarly, in *Universal Winding Company v. Commissioner* (39 B.T.A. 962 (1939)), the Board re-examined the British statute at issue in *Colombian Carbon Co.* and noted that certain amendments to it made the taxpayer subject to tax event if the taxpayer had no profit or gains in the year of assessment (*See id.* at 966). On that basis, the Board distinguished its prior opinion and allowed the credit during the taxable year in which the taxpayer's foreign fiscal year ended. Changing its position once again, the IRS limited its prior G.C.M. and its deference to *Columbian Carbon* (G.C.M. 21788, 1940 C.B. 158, 159 (1940) ("In view of the decision of the Board of Tax Appeals in *Universal Winding Co. v. Commissioner* (39 B. T. A., 962, acquiescence, page 5, this Bulletin), the principle enunciated in G.C.M. 10613, *supra*, should be applied only in cases where the British income taxes were imposed under the British law existing prior to the enactment of the British Finance Act of 1926."); *see also* Rev. Rul. 60-146, 1960-1 C.B. 276 (applying *Universal Winding Co.* to a Jamaican income tax with the same structure as the British income tax considered in that case)).

Still, the IRS continued to follow the no-matching approach of *Columbian Carbon* where the foreign tax assessment depended on the taxpayer remaining in existence. Rev. Rul. 76-39 considered a Swiss income

tax levied on the basis of the average of two years of income (*See* Rev. Rul. 76-39, 1976-1 C.B. 206). As an example, "if the assessment period consists of the calendar years 1967 and 1968, the net profits upon which the tax was computed for each of those years was the average of the net profits of 1965 and 1966." The IRS examined the following fact pattern:

"S commenced operation in Switzerland on January 1, 1965. However, assessment at the commencement of a corporation's existence is an exception to the above rule as no normal computation period exists. In this regard the tax levied for the first calendar year of S's existence, 1965, was computed on its net profits earned during that year. The tax levied for 1966 was computed on the average of S's net profits earned during 1965 and 1966. Since a normal two-year computational period now exists, the tax levied for the third and fourth calendar years of S's existence, 1967 and 1968, with respect to the profits earned during those years was computed on the average of S's net profits of 1965 and 1966. Since the computational period for the fifth year (1969) is the third and fourth years (1967 and 1968) the tax levied for 1969, with respect to the profits earned during that year was assessed on the average of the net profits of 1967 and 1968."

(*Id*.).

The IRS allowed the tax imposed for the first two years, 1965 and 1966, to accrue on the last day of each of those years, respectively, because the tax was computed based on the profits earned during those two years. For 1967 and 1968, however, the tax did not accrue until the year of assessment. Once again, the problem was a provision of foreign law that appeared to defeat assessment of the foreign tax if the taxpayer ceased to exist (*See* Rev. Rul. 83-85, 1983-1 C.B. 188 (applying Rev. Rul. 76-39 to a fact pattern in which the taxpayer had no earnings and profits in the assessment year).

In the memorandum accompanying this revenue ruling, G.C.M. 36085 (Nov. 18, 1974), the IRS admitted that its ruling did not follow the matching principle, but it basically concluded that matching must yield to the strictures of the accrual method applied for tax purposes.

"We believe the Swiss tax involved here is an unusual one and the answer we reach here results in an aberration from the general statutory objective of avoiding double taxation on the same income. The Swiss tax is unusual in that a corporation could have large profits for a year. However, if it went out of existence at the end of that year, it would not be liable for any tax for the next succeeding assessment period even though such tax would have been based in part on the profits of the above year if the corporation had been in existence during any year of such assessment period.... We are aware of the fact that our result does not achieve avoidance of double taxation, particularly if the income earned varies from year to year."

(*Id*.).

G.C.M. 36085 (Nov. 18, 1974) treated the failure to match as an aberration. If so, it has since become commonplace. The memorandum admits, "if the foreign taxable year or rules for determining when income is taxable differ from our own, distortions occur." G.C.M. 36085 already noted additional distortions in the accrual of foreign taxes (with emphasis added):

"In Rev. Rul. 74-310, I.R.B. 1974-26, 13, initialed by this office in I-5773, (Sept. 7, 1973) a foreign subsidiary used the completed contract method of accounting for United States income tax purposes but the percentage of completion method for foreign tax purposes. The amount of foreign tax paid, for purposes of Code § 902, is determined by foreign standards. A tracing of each dollar of foreign income tax to the specific foreign taxable income is not required. Similarly, G.C.M. 34109, *** I-3046 (April 25, 1969), concludes that under Code § 902, a foreign tax is creditable even though imposed on income which we do not regard as taxable. But see Rev. Rul. 288, 1953-2C.B. 27, concluding that the credit for foreign income taxes computed on a percentage of completion method should be deferred until the taxpayer reported that same income for United States tax purposes on the completed contract method. (This ruling and the blocked income rule cited therein are based on the premise that under Code § 461, the result reached more clearly reflects income.) *Thus, although our result does not necessarily achieve the goal of avoiding double taxation neither do many of the authorities cited above.*"

As a further example, in *Rowan v. Commissioner* (120 F.2d 515 (5th Cir. 1941)), the taxpayer had a fiscal year for foreign tax purposes and argued that it should be able to claim a credit for the foreign tax imposed on income for the first half of the year with the U.S. return covering that period. The court sided with the IRS on the ground that proration would require the taxpayer to show how much of its income accrued during each portion of the foreign fiscal year, which the taxpayer had not done. To the court in *Rowan*, the issue was a problem of proof.

That problem seems trivially easy to overcome. In various contexts, the IRS today simply takes the final tax that accrues at the end of the foreign tax year and pro-rates it between the two years on the basis of the number of days in each year. (*See, e.g.*, Treas. Reg. §1.901-2(f)(5)(1); Treas. Reg. §1.367(b)-7(f)(5); Treas. Reg. §1.1502-76(b)(2)(iv); Rev. Rul. 75-532, 1975-2 C.B. 295; PLR 7734080 (May 27, 1977)). In fact, the IRS did so for *computing the foreign tax credit* soon after *Rowan*. In 1950, the IRS considered a Hong Kong tax imposed on an assessment year that ran from April of one year to April of the next year. The IRS allowed a calendar-year taxpayer to pro-rate its tax liability between the two years, based on when the income subject to the foreign tax economically accrued (I.T. 4033, 1950-2 C.B. 52, 53).

Not one to let a litigation victory go to waste, the IRS subsequently abandoned pro-ration, in Rev. Rul. 61-93. Citing I.T. 3309 and Universal Winding Co., the IRS wrote, "it is apparent that, for the purpose of the foreign tax credit, foreign income taxes are considered as accrued in the taxable year in which the taxpayer's liability for such foreign taxes becomes fixed and determinable. Generally such accrual occurs in the United States taxable year within which the taxpayer's foreign taxable year ends." (Rev. Rul. 61-93, 1961-1 C.B. 390).

The best argument against pro-ration seems to be that the foreign tax liability does not become fixed during the foreign tax year at the point when the U.S. tax year ends, such that accrual as of that date would require some form of estimation. (*See, e.g.*, *Santa Fe Drilling Co. v. Riddell*, 217 F. Supp. 630 (D.C. Cal. 1963) (finding that for the Australian taxable year ending June 30, 1955, there was "no evidence that all events had occurred which fixed the amount of the total or of any part of such taxes, that the amount of the total or of any part thereof was readily ascertainable or ascertainable at all, even approximately, and that plaintiff's liability for all or any part thereof was determined at the end of the calendar year 1954. Therefore, it does not appear that any of such taxes had accrued at that time.")). As discussed, however, it

would not be difficult to wait for the end of the foreign taxable year, when the income for that year clearly can be ascertained and the amount of the foreign tax liability clearly can be determined, and then pro-rate the resulting liability based on the number of days during the foreign tax year that fell within each U.S. tax year. No estimation would be required. Pro-ration would have achieved better matching of credit and income.

Nevertheless, the government's rejection of that form of matching of income and credit is abundantly clear. (*See* T.D. 9959, 87 Fed. Reg. 276, 304 (Jan. 4, 2022)). According to the IRS, the entire foreign income tax accrual falls on the last day of the foreign taxable year, even if that creates a mismatch. In the preamble to the recent regulations, the IRS and Treasury rejected several comments proposing a variety of ways to match income and credit with respect to §951A taxes, for which there is no carryover of excess credits under § 904(c) and for which matching is therefore particularly important (T.D. 9882, 84 Fed. Reg. 69,022, 69,042 (Dec. 17, 2019)). The comments offered helpful alternatives: "[i]n addition, comments suggested a 'closing of the books' method for determining the foreign tax that is treated as either a current year tax or as accruing during the next U.S. taxable year, or other approaches such as a 'with-and-without' calculation to determine taxes attributable to extraordinary transactions." (*Id.*). All of the proposed alternatives were rejected. For example:

"Comments suggested that a portion of the foreign income taxes could be allocated between U.S. taxable years on the basis of a ratable allocation of the foreign taxable income on which the taxes are imposed to the portion of a foreign taxable year of the CFC that corresponds to the two U.S. taxable years."

(*Id.).*

In rejecting these comments, the government recognized the potential for mismatches but chose to downplay the problem.

"Differences in the timing of the accrual of foreign income taxes and the inclusion of income by a U.S. shareholder on which the taxes are imposed due to a CFC's differing U.S. and foreign taxable years will generally resolve over time because although the U.S. and foreign taxable years start and close on different dates, both taxable periods encompass profits earned over the same length of time."

(*Id.*).

This response is difficult to accept uncritically. Pro-ration limited to §951A taxes would have been well justified. The absence of excess credit carryforwards for §951A taxes means that timing mismatches are less likely to resolve over time for that limitation category than for any other limitation category, for which § 904(c) does allow excess credit carryforwards. Thus, for the one category of income for which timing mismatches would seem to present a real problem, the rules intentionally fail to match. Yet the same regulations insist on using the relation-back doctrine to "fix" potential timing mismatches, not only for the §951A category, but also for the limitation categories covered by §904(c), which largely resolves timing mismatches already. The relation-back fix, as noted, has the negative side effect of creating time-barred refund claims, leaving double taxation unresolved.

The preamble's argument that pro-ration would require estimates is incorrect because the type of pro-ration sought in the comments would have relied on the actual year-end foreign tax liability, not estimates. Similarly, the argument that pro-ration would be unprecedented also is incorrect because, as shown above, the IRS used to permit pro-ration in this very context and still does permit it in other contexts.

It is difficult to conclude from the foregoing history that the IRS relation-back doctrine is about matching income and credit to relieve double taxation. The governing principle instead is to defer the foreign tax credit claim to the greatest extent possible, even if that deferral results in economic double taxation (*See, e.g.*, *Chrysler Corp. v. Commissioner*, 436 F.3d 644 (6th Cir. 2006) (agreeing that the purpose of the foreign tax credit is to alleviate double taxation, but justifying is disallowance of the credit in part on the ground that the taxpayer still could deduct the foreign taxes). For example, note 1 of CCA 2008-005 explains (with emphasis added) that "*[b]y matching the U.S. and foreign tax on income accrued in a particular year*, the 'relation-back' doctrine promotes the purpose of the foreign tax credit to relieve double taxation of foreign-source income." The memorandum later concludes, however, that "[b]ecause the credit is allowed in the year the foreign taxes accrue, *and not in the year…. the related income is subject to U.S. tax*, there is no 'pro rata' division of the foreign tax liability over TP's two U.S. tax years." It is difficult to accept that the purpose of relation-back is to avoid double taxation by matching tax to income and that the doctrine achieves that result by *not* putting the tax in the year the income is subject to U.S. taxation.

B. Can You Pay to Make it Stop?

At the other end of the time horizon, the IRS relation-back doctrine also requires us to determine when contest resolves, which it must in order for the foreign tax to accrue. For example, it becomes necessary to determine whether payment of the tax allows its accrual, even if the taxpayer continues to fight its liability for the tax. Here too, IRS practices have varied, but they generally were taxpayer-favorable—until the last round of regulations.

From the earliest years of the foreign tax credit, the IRS allowed a credit for the payment of taxes still contested, on the ground that the redetermination provisions in what is now §905(c) adequately protected the government's interest.

"This office does not believe that it is the intention of the law to deprive a company of the right to obtain credit for foreign taxes because of the fact that the company contests the validity of the statutes under which the amount of taxes were paid or because it protests the assessment and has made application for a refund. While it may be contended that the amount of taxes is not definitely ascertainable for the period in question, it is evident that the tax when assessed constitutes at the time a liability against the corporation. Such liability was met by actual cash disbursements. If the protest of the corporation against such assessment prevails, any difference can readily be adjusted by additional assessments, as provided in the second paragraph of section 238(a) …."

(S.M. 2243, IV-1 C.B. 231, 232 (1925)).

The courts held, and the IRS accepted, that the payment of a contested tax liability rendered the tax deductible, even though the tax was still being contested. (*See Chestnut Securities Co. v. United States*, 62 F. Supp. 574, 576 (1945); G.C.M. 25298, 1947-2 C.B. 39, 43-44). In *United States v. Consolidated Edison*

Company (366 U.S. 380 (1961)), however, the Supreme Court held that a taxpayer could not deduct the payment of a contested tax assessment until the year in which the contest was resolved. The Court treated the remittance of the tax pending the outcome of the controversy to be a mere deposit against a liability that would mature only at the end of the proceeding (*See id.* at 391-92).

Four years later, Congress enacted § 461(f) to soften the Court's ruling in *Consolidated Edison*: "[I]t is unfortunate to deny taxpayers a deduction with respect to an item where the payment has actually been made, even though the liability is still being contested." (S. Rept. No 88-830 (1964), *reprinted in* 1964-1 C.B. (Part 2), at 604). Where the statutory conditions have been met, §461(f) permits taxpayers to deduct amounts actually paid despite the continuing contest over the amount or existence of liability. Section 461(f) has been found to apply to both accrual method and cash-method taxpayers (*Poirier & McLane Corporation v. Commissioner*, 547 F.2d 161, 164 (2nd Cir. 1976), *cert. denied*, 431 U.S. 967 (1977); *Weber v. Commissioner*, 70 T.C. 52, 55 (1978); *Barnette v. Commissioner*, T.C. Memo. 1992-371, 63 T.C.M. 3201, 3201-24).

Section 461(f), however, does not apply to foreign taxes. That limitation appears to have been added by the Conference Committee without explanation (*See* H.R. Conf. Rep. No. 88-1149 (1964), *reprinted in* 1964-1 C.B. (Part 2), at 814). Thus, the *deduction* of contested foreign taxes under § 164 still appears to require the resolution of the contest. In the case of the foreign tax *credit*, however, the IRS until very recently nevertheless maintained the position it took in 1925. In Rev. Rul. 70-290, the IRS essentially repeated its 1925 position almost verbatim, concluding that "[i]f the protest by the taxpayers against the original assessment prevails, any difference can readily be adjusted pursuant to the provisions of section 905(c) of the Code." (*See id.*; see, e.g., Rev. Rul. 84-125, 1984-2 C.B. 125 ("Accordingly, in 1973 X is allowed to claim a foreign tax credit of 5x dollars for the amount of the additional foreign tax assessment actually paid by X in 1973, which accrues for the taxable year 1971 pursuant to section 905(a) of the Code.").

When the IRS strayed from this position, the Court of Claims provided a reminder. In *International Business Machines Corp. v. United States* (38 Fed. Cl. 661 (1997)), for example, the IRS sought to deny a credit for an Italian tax on the ground that it was a noncompulsory payment. The Court of Claims noted that "Defendant's position controverts both Rev. Rul. 70-290 and Rev. Rul. 84-125. In both revenue rulings, the taxpayer was entitled to a foreign tax credit upon payment of the tax, notwithstanding the fact that the taxpayer was contesting liability." (*Id.* at 675 n. 11).

Allowing the taxpayer to credit contested foreign taxes in the year of payment did not eliminate all controversy. The IRS and taxpayers have continued to dispute whether purported tax payments are instead mere deposits. In general, however, the IRS relied on its broad redetermination authority under §905(c) and allowed taxpayers to claim a credit for contested taxes in the year of payment.

In 2020, however, the IRS decided—after 95 years of contrary administrative practice—to impose new restrictions on the accrual of contested foreign taxes that are paid.

"The Treasury Department and IRS have determined that the administrative rulings that allow an accrual method taxpayer to claim a foreign tax credit for a contested tax that has been remitted to a foreign country, notwithstanding the fact that the contest is ongoing, are inconsistent with the all events test

(specifically, the test's requirement that all the events must have occurred that establish the fact and amount of the liability with reasonable accuracy). In addition, permitting taxpayers to claim a credit for contested taxes before the contest is resolved reduces the incentive for taxpayers to continue to pursue the contest and exhaust all effective and practical remedies, as required under §1.901-2(e)(5)(i), if the period of assessment for the year to which the taxes relate has closed and the IRS would be time-barred from disallowing the foreign tax credit claimed with respect to the contested tax paid on noncompulsory payment grounds. The Treasury Department and the IRS have determined that this is an inappropriate result that undermines the longstanding policy for requiring an amount of foreign income tax to be a compulsory payment in order to be creditable. Therefore, the proposed regulations provide new rules for when a credit for contested foreign income taxes can be claimed. Following the Supreme Court's holding in *Dixie Pine*, and consistent with the exception to section 461(f) and § 1.461–2(a)(2)(i) for foreign income taxes, §1.905-1(d)[(4)] provides that contested foreign income taxes do not accrue until the contest is resolved, because only then is the amount of the foreign income tax liability finally determined."

(REG–101657–20, RIN 1545–BP70, 85 Fed. Reg. 72,078, 72,103-04 (Nov. 12, 2020)).

This novel "determination" that a foreign tax does not, after all, accrue upon payment contradicted a nearly century-old administrative practice. No court case or amendment to the Code appears to have prompted the regulatory about-face. When the new restriction was proposed in 2020, it had been some 94 years since the Supreme Court created the all-events test, 59 years since the Court decided *Consolidated Edison*, 56 years since the enactment of § 461(f), and 50 years since the IRS reaffirmed its position allowing the accrual of contested taxes on the basis of payment. The "longstanding policy" on noncompulsory payments pales in comparison to the even more longstanding practice of allowing a credit upon payment of contested foreign taxes.

As for the argument that the IRS would have insufficient opportunity to audit whether the foreign tax payment is voluntary, that argument appears either incorrect or an admission against the government's interest, given the government's position that there is no statute of limitations for assessments attributable to FTRs. It appears that Treasury and the IRS do not consider the unlimited statute of limitations for assessment to apply to the issue of whether a contested foreign tax was compulsory. In any event, in light of its change in position, the IRS announced its intention to obsolete Rev. Rul. 70-290 and Rev. Rul. 84-125.

In place of the prior rule, the IRS now offers a "provisional credit for the portion of the taxes paid." (Treas. Reg. §1.905-1(d)(4)). The taxpayer still can credit the payment of the foreign tax, but there are now conditions, including annual certifications and an extension of the statute of limitations to examine whether the tax was a compulsory payment. To make matters worse for over-worked tax departments and IRS Exam, the regulations also appear for the first time to treat accrual of the foreign tax based upon payment, in the absence of this election, as an unauthorized change in method of accounting, which requires IRS permission (and a §481 adjustment) to correct. (*See* Treas. Reg. § 1.905-1(d)(5); *cf.* Treas. Reg. §1.905-1(d)(6)(v), Ex. 5 (illustrating an "improperly accelerated accrual" involving mismatched payments and accruals of foreign taxes that must be resolved through the filing of a method change).) These new foot-faults are discussed in further detail below.

To summarize this section, the IRS relation-back doctrine has given rise to interpretational problems over time regarding the year in which a contest is resolved and the year to which the taxes relate. On these and other issues, the IRS position has changed over the years. In the most recent regulations, the approach has been to impose new restrictions, relative to longstanding practices. The justifications offered for doing so appear unconvincing.

IV. Does the Code Require Relation-Back?

This section considers whether the language of the Code requires the IRS to apply the relation-back doctrine. The answer is probably yes, but the answer is not so clear as one might think. When the IRS first announced the doctrine, in Rev. Rul. 58-55, the answer might well have been no. Since 1958, however, the courts and Congress have treated the relation-back doctrine as a sort of background assumption, and today that assumption still lurks in the background.

A. Support from §6511(d)(3)(A)

There appear to be two primary sources of statutory support for the doctrine. We have already discussed one, § 6511(d)(3)(A). The 10-year statute has been said to be predicated on the IRS relation-back doctrine:

"It is highly unlikely that Congress intended to provide the prolonged 10-year limitations period simply to enable a taxpayer to complete the filing process following the resolution of its foreign tax liability. In light of the fact that a domestic taxpayer is given only three years to file a refund claim, it is evident that the much longer period for filing foreign tax claims was intended to take account of the time needed to resolve foreign tax liability.... We agree with the government that the limitations period should be measured with reference to the year of origin for such taxes."

(*Albemarle Corp. & Subs. v. United States*, 797 F.3d 1011, 1019-20 (Fed. Cir. 2015).).

Section 6511(d)(3)(A) does appear to support relation-back as a general concept, but it does not seem to cover all aspects of the IRS relation-back doctrine, most critically the double accrual of contested foreign taxes. The above explanation that the purpose of the 10-year statute was to give more time to resolve foreign tax disputes is unconvincing. If that were true, then why is there only a three-year statute for the deduction of foreign taxes? Do foreign tax disputes take less time to resolve when the U.S. taxpayer deducts the foreign tax?

The legislative history of the original enactment of § 6511(d)(3)(A) provides no support for the double accrual of contested foreign taxes. As the National Office once wrote, "[t]he House and Senate Reports on the 1954 Code do not give any reasons for the special limitations period for refund claims attributable to the foreign tax credit, nor do they explain how Congress intended them to work." (T.A.M. 8727006 (Mar. 25, 1987)). When it enacted § 6511(d)(3)(A) in 1954, Congress obviously did not have in mind Rev. Rul. 58-55, which was published four years later.

Instead, as noted above, the purpose of the 10-year statute was to provide rough parity between the limitations periods for refund versus assessment with respect to the foreign tax credit, and *not* to specify the timing of accrual for contested foreign taxes. (*See Hart v. United States*, 585 F.2d 1025, 1029 (Ct. Cl.

1978); *Bank of America v. United States*, 377 F.2d 575, 579 (Ct. Cl. 1967); *see also Albemarle Corp. & Subs.*, 797 at 1018 (citing and quoting *Hart*).). When Mitchell B. Carroll testified before the Ways & Means Committee in 1953, he focused on the more basic case in which the foreign taxing authority just assessed additional taxes for the year in question. Contested taxes *per se* apparently were not the subject of his testimony.

"Often in foreign countries you will be subjected to additional taxes, 4, 5, 6, and even 10 more years after the year to which the tax relates. Thus in Cuba the statute of limitation is 15 years. In the case of Mexico the period is 5 years. It may be extended for an additional 5-year period. But as you know, under our law, we try to settle things up rapidly, and if a company is going to take a credit for foreign taxes it has to do it when it is subjected to additional taxes abroad, so it is entitled to a refund, it has to file a claim for refund within 3 years from the time the return for the year involved was filed, or within 2 years from the time that the tax was paid. It seems that the statute should be a little bit more realistic about this and allow a much longer period for filing refund claims in those cases.

It seems if a domestic company gets a foreign tax refund there is no limit to the time when it must report that refund and pay a tax on it, but on the other hand, if it is subjected to an additional tax the statute runs in 2 or 3 years. *Therefore, we suggest that the committee give consideration to allowing the taxpayer to file a claim for a refund because of additional foreign tax assessed without limitation to time*."

(Statement of Mitchell B. Carroll, Special Counsel, NFTC Tax Committee, *General Revenue Revision, Hearings Before the Committee on Ways & Means*, 83d Cong., 1st Session, Pt. 2, at 1432-33 (1953) (emphasis added)).

Carroll asked for an unlimited refund statute to match the unlimited assessment statute, but Congress instead granted taxpayers a 10-year statute.

Based on this legislative history, §6511(d)(3)(A) as originally enacted is perhaps best viewed as a provision that roughly matches the refund statute to the unlimited statute of limitations for assessment, and the purpose of the 10-year refund statute was simply to allow a claim for credits attributable to the assessment of foreign taxes on top of those already assessed. Such adjustments could be effectuated through an amended return for the year in question, although neither the language nor the original history of §6511(d)(3)(A) requires that they be. Nor does that language, or the legislative history, speak to *the timing of accrual of contested foreign taxes*.

Later amendments to §6511(d)(3)(A) support the IRS relation-back doctrine insofar as they appear to assume its existence. In 1980, the Court of Federal Claims held, in *Ampex Corporation v. United States* (620 F.2d 853 (Ct. Cl. 1980)), that the 10-year statute should be calculated based on the year to which excess foreign tax credits are carried (*See id.* at 862). As noted, IRS opposition to *Ampex* appears to have been the driving force behind Rev. Rul. 84-125, which held that the 10-year statute "is determined by reference to the year for which the taxes were paid or accrued and not to the carryover year." In 1997, Congress amended § 6511(d)(3)(A) to provide that the 10-year period runs "from the date prescribed by law for filing the return for the year in which such taxes were actually … accrued." The committee reports indicate that the change was intended to overrule *Ampex*. The limitations period of §6511(d)(3)(A) was to be

determined by reference to the year "in which the foreign taxes were paid or accrued (and not the year to which the foreign tax credits are carried)." (H.R. Conf. Rep. No. 105-220, at 576-77 (1997)).

None of these changes imported the relation-back doctrine into the language of §6511(d)(3)(A), and the legislative history of the 1997 amendments to that section do not mention the doctrine. Nevertheless, the IRS has been able to persuade at least a few courts that §6511(d)(3)(A) is all about relation-back for contested foreign taxes. The Federal Circuit, for example, wrote that "[t]he 10-year limitations period for a contested foreign tax had been determined with reference to the year of origin since long before the 1997 amendment, because the year of origin is 'the year with respect to which the [refund] claim is made,' 26 U.S.C. §6511(d)(3)(A) (1994), including in the case of contested taxes." (*Albemarle Corp. & Subs. v. United States*, 797 F.3d 1011 (Fed. Cir. 2015)). As support for this view, the Federal Circuit cited Rev. Rul. 84-125 and Rev. Rul. 58-55. In other words, the 10-year statute has been determined with reference to the year of origin since long before the 1997 amendment because the IRS said it was.

IRS pronouncements are hardly infallible or immutable. Courts other than the *Ampex* court have forced the IRS to change its reading of §6511(d)(3)(A) before, and, in the recent regulations, the IRS itself decided to change its own reading of the statute—once again narrowing it relative to longstanding practice.

In Rev. Rul. 63-248, the IRS considered whether a taxpayer had the right to make or change the election to claim foreign taxes as a deduction or as a credit at any time within the 10-year statute. The ruling answered "no." The 10-year statute "is available only for the purposes of determining the size of the credit and not for purposes of making a choice between deduction or credit."

The courts then ruled against the IRS on this point (*See Bank of America v. United States*, 377 F.2d 575, 580 (Ct. Cl. 1967); *Hart v. United States*, 585 F.2d 1025 (Ct. Cl. 1978); *Allott v. United States*, 42 AFTR 2d 78-6077 (Ct. Cl. 1978)),and the IRS eventually amended the regulations to provide a 10-year period during which to switch between a deduction and a credit (*See* former Treas. Reg. §1.901-1(d)(1)). In the recent regulations, the IRS narrowed the rules on this issue as well. The IRS amended its prior regulations to make the 10-year statute available only for electing to change from a deduction to a credit (*See* Treas. Reg. § 1.901-1(d)(1)). Even though broader rules were on the books for decades, without apparent ill effect, now just a three-year statute is available to change from a credit to a deduction.

Another example is Rev. Rul. 68-150 (1968-1 C.B. 564), in which the IRS held that the 10-year statute applied to claims for credit or refund based on the correction of mathematical errors, the discovery of creditable taxes which were not reported on the income tax return when filed, or other adjustments to the size of the foreign tax credit. According to the National Office, "[t]he basic Service position that can be distilled from these rulings is that section 6511(d)(3)(A) only applies to adjustments in the size of the FTC which results directly in a credit or refund." (T.A.M. 8727006 (Mar. 25, 1987); *see also, e.g.*, Rev. Rul. 71-533, 1971-2 C.B. 413 (concluding that where a carryback of foreign taxes arises as a result of a net operating loss carryback from a subsequent taxable year, a claim for credit or refund on a resulting overpayment of tax attributable to the foreign tax credit is governed by the 10-year statute), *suspended by* Rev. Rul. 2020-8, 2020-19 I.R.B. 775.) By contrast, under the recent regulations, the IRS now treats almost any change relating to foreign income as an FTR subject to the 10-year statute.

In sum, the Federal Circuit's reliance on IRS pronouncements regarding the purpose and scope of the 10-year statute would seem to have been misplaced.

B. Support from §905(c)

The most direct support for a statutory relation-back doctrine is found in current §905(c), but even there the literal language is not so clear as one might assume.

As noted above, the original foreign tax credit statute in 1918 required a redetermination of U.S. taxes due if accrued taxes when paid differed from the amounts claimed as credits or if any foreign tax paid was refunded in whole or in part. Today, §905(c) similarly requires a redetermination of the foreign tax credit if the amount of the accrued tax when paid differs from the amount claimed as a foreign tax credit, or if an amount of tax paid is subsequently refunded. Section 905(c) also requires a redetermination of the foreign tax credit if "accrued taxes are not paid before the date 2 years after the close of the taxable year to which such taxes relate." Section 905(c)(2)(A) is a companion provision that generally requires the IRS redetermination to zero out the credit for any taxes that are not paid before the two-year deadline. Section 905(c)(2)(B)(i) further provides that if any such taxes are paid after the deadline, then they "shall be taken into account for the taxable year to which such taxes relate," which is presumably the same year as the one to which the taxes relate for purposes of the two-year rule. (Similar language is found in §986, but this paper is already long enough without a detour into matters of foreign currency gain or loss.)

The language of §905(c) clearly shows some kind of temporal relationship between the payment of foreign taxes and a particular taxable year — "the taxable year to which such taxes relate" — but the statute does not quite name the relation-back year, nor does it actually require a redetermination with respect to the relation-back year. The statute literally says that the IRS "shall redetermine the amount of the tax for the year or years affected," not "the year to which such taxes relate."

The most natural reading of §905(c) is that it requires the taxpayer to correct any errors in the original accrual of the foreign tax credit claimed for a given year, and in that sense § 905(c) does require a type of relation-back. If the taxpayer accrues a foreign tax but does not actually pay the tax within two years, or the taxpayer actually pays an amount different from the amount accrued, or instead of paying the accrued amount of tax the taxpayer receives a refund, then the taxpayer has to correct its original accrual, and § 905(c) empowers the IRS to require a redetermination (See *Owens*, at 345 ("When a refund of a foreign tax is received, regardless of the reason, it is necessary to look to foreign law to determine what year's tax is being refunded. Having determined what year's foreign tax has been reduced by reason of the refund, the refund is applied under section 905 (c) to reduce the tax credit previously taken for that year's tax.")).

The two-year rule in the statute would seem to make it difficult to credit the accrual of a contested tax, without payment, in the year in which the foreign taxing authority asserts it. Such an accrual, based only on the assertion by the foreign tax authority, is likely to occur more than two years after the foreign audit year, which thus would seem a likely candidate for "the year to which such taxes relate." The foreign audit year is not the only candidate, however. If one does treat the contested foreign tax as accruing in the year the foreign taxing authority asserts its claim (and the taxpayer then reflects the additional tax on its books), the year to which such taxes relate arguably could be the year in which the claim is asserted, giving the

taxpayer two years from *that* year to pay the tax. Nothing in the language of the statute seems to prevent such an interpretation.

If that interpretation of the statutory seems a stretch, however, consider how little direct support the statutory language offers for the Rev. Rul. 58-55 approach to contested foreign taxes. The statute fails to say that contested foreign taxes do not accrue until the contest is resolved, nor does the statute say that once the contest is resolved the taxes accrue and then are treated as accruing in the relation-back year. Indeed, §905(c) does not address at all *when* a foreign tax accrues.

Moreover, the IRS itself has not always read §905(c) to require relation-back: for many years the IRS allowed *prospective* adjustments to be made to the post-1986 taxes and earnings pools used to compute deemed paid credits under §902 and §960 (*See* former Temp. Treas. Reg. §1.905-3T(d)(3) (requiring an FTR with respect to a pooling corporation only if (1) the foreign tax liability is in a hyperinflationary currency; (2) pooling adjustments would have had the effect of reducing by 10% or more the U.S. shareholder's foreign taxes deemed paid under section 902 or 960 in any year; (3) pooling adjustments would have had the effect of reducing below zero the foreign corporation's pool of foreign taxes in any separate category; or (4) a U.S. shareholder of a CFC receives a distribution out of PTEP and a foreign country has imposed tax on the income of the CFC, which tax is reduced on the distribution of the corporation's E&P)).

By way of background, §905(c) previously was interpreted by both the IRS and the Courts to require a redetermination of U.S. tax liability when the only difference between the foreign tax paid and the foreign tax accrued was a difference caused by an exchange rate fluctuation (*See* Rev. Rul. 73-506, 1973-2 C.B. 268, *superseding* S.M. 4081, IV-2 C.B. 201 (1925); *First National City Bank v. The United States*, 557 F.2d 1379, 1386 (Ct.Cl. 1977); Comprehensive Designers International, Ltd., 66 T.C. 348, 356 (1976)). In fact, much of the history of § 905(c) has been focused on efforts to rationalize the exchange rates used to translate the accrual and payment of foreign taxes over time (*See generally* Neal M. Kochman & H. David Rosenbloom, *Deconstructing Section 905(c): An Examination of the Redetermination Rules After TRA 1997*, 26 Tax Notes Int'l 333, at*5-6 (Apr. 22, 2002)). That problem was particularly acute with respect to deemed paid credits, which typically accrued and were deemed paid using different exchange rates.

When Congress in 1986 revised §902 to require the computation of deemed-paid credits on the basis of multi-year pools, Congress also enacted §989(c)(4). That provision authorizes Treasury and the IRS to issue regulations "providing for alternative adjustments to the application of section 905(c)."

The IRS exercised that authority in 1988 (former Treas. Reg. §1.905-3T(d); *see generally* F.S.A. 200035019 (May 31, 2000) (explaining that the result was the same under the regulations before and after the codification of prospective pooling adjustments)). Under temporary regulations, an FTR that impacted foreign taxes deemed paid by a U.S. taxpayer under § 902 and § 960 was accounted for through an adjustment, on a prospective basis, to the affected pools of post-1986 earnings and taxes. The adoption of prospective pooling adjustments in 1988, and their subsequent revision in 1990, show that the IRS has not always felt compelled by the language of §905(c) to require relation-back to the foreign audit year.

In 1997, Congress ratified the temporary regulations by adding to §905(c) language specifically authorizing prospective pooling adjustments: "The Secretary may prescribe adjustments to the pools of post-1986 foreign income taxes and the pools of post-1986 undistributed earnings under sections 902 and 960 in lieu of the redetermination under the preceding sentence." (Former § 905(c)(1), added by Taxpayer Relief Act of 1997, Pub. L. No. 105-34, §1102(a)(2), 111 Stat. 788, 964-5 (1997)) Congress repealed that language in 2017, when it repealed § 902 (*See* Pub. L. No. 115-97, §14301(c)(20) 131 Stat. 2054, 2223 (2017)).

Treasury and the IRS appear to have fastened on the repeal of this language as a mandate to abandon any and all types of prospective adjustments:

"The TCJA repealed section 902 and the regulatory authority at the end of section 905(c)(1) to prescribe alternative adjustments to multi-year pools of earnings and taxes of foreign corporations in lieu of the required adjustments to U.S. tax liability for the affected years. Recharacterizing prior year taxes as current year taxes would have substantive effects on the amounts of a taxpayer's GILTI and subpart F inclusions, the applicable carryover periods for excess credits, the applicable currency translation conventions, the amounts of interest owed by or due to the taxpayer, and the applicable statutes of limitation for refund or assessment."

(T.D. 9922, 85 Fed. Reg. 71,998, 72016 (Nov. 12, 2020); *see also* T.D. 9882, 84 Fed. Reg. 69,022, 69023 (Dec. 17, 2019) ("As part of the TCJA, section 905(c) was amended to reflect the repeal of section 902, by eliminating the provisions allowing for adjustments to pools of post-1986 undistributed earnings and foreign income taxes…. Portions of the 2007 temporary regulations relating to prospective pooling adjustments are not included in the final regulations in light of the TCJA's repeal of section 902 and related amendments to section 905(c).")).

While it is true that recharacterizing prior year taxes as current year taxes would have substantive effects, relation-back also has substantive effects—just different ones. The question is which approach provides the better tax-policy answer within the four corners of the statutory language. In any case, it is not entirely accurate to say that the TCJA repealed the regulatory authority to prescribe alternative adjustments. In 1988, Treasury and the IRS adopted prospective adjustments based on § 989(c)(4), well before Congress added to §905(c) the now-repealed language authorizing prospective adjustments. Section 989(c)(4) was not repealed in 2017. It remains in the Code.

In sum, there is certainly support for the concept of relation-back in the Code. Section 905(c) and its predecessor have long required true-up adjustments to the original foreign tax accrual, and §6511(d)(3)(A) provides a 10-year statute for such adjustments when they result in a refund. What the statutory language does not speak to is the broader IRS relation-back doctrine set forth in Rev. Rul. 58-55, in which contested foreign taxes do not accrue until the contest is resolved and then are deemed to accrue back at the end of the foreign audit year. The statutory language seems flexible enough to allow an alternative approach.

V. How Broad Is the Doctrine?

The IRS version of relation-back is not as broad as one might think. This section discusses two related contexts where it does not apply: foreign tax deductions, and the computation of E&P. From this one could conclude that the IRS relation-back doctrine does not reflect a fundamental tax principle so much as a narrow compromise that could have gone another way.

A. Foreign Tax Deductions

Rev. Rul. 58-55 itself announced that the relation-back doctrine does not apply to the deduction of contested foreign taxes, and the IRS today generally continues to apply relation-back to contested taxes resulting in credits but not deductions (*See generally* REG–101657–20, RIN 1545–BP70, 85 Fed. Reg. 72,078, 72,101 (Nov. 12, 2020) ("The special period of limitations is not needed when a taxpayer instead claims a deduction, because accrued foreign income taxes do not relate back for deduction purposes, and the additional tax paid as a result of the foreign assessment can be claimed as a deduction in the year the contest is resolved.")).

For example, the final regulations provide a special exception that allows taxpayers to deduct, in a year in which they claim foreign tax credits, additional foreign taxes that they pay upon the resolution of a contest, where the taxes otherwise would have related back to a prior year in which the taxpayer deducted foreign taxes (*See* Treas. Reg. §1.901-1(c)(3), (4) (Ex.); *cf.* G.C.M. 36722, (May 7, 1976) ("The tax accounting principle that a subsequent redetermination of a deductible tax does not relate back to the year of deduction has no application in the case of foreign tax credit.")). That special rule would not be necessary if the relation-back doctrine applied to the deduction of contested foreign taxes. The deducted foreign taxes simply would have related back to the prior year.

The reasons offered for applying relation-back to contested foreign taxes that are credited but not those that are deducted do not seem wholly convincing. For example, Elisabeth Owens recognized that "[p]ostponement of the time of accrual of taxes and other expenses as deductions raise problems parallel to those which occur when a tax credit is postponed, that is, an expense may not be deductible until after the taxable year in which the income to which it relates accrues for tax purposes." (*Owens*, at 327 n. 35) She argued, however, that "unless there is a change in the United States tax rate, it is not too important whether an expense is deducted in one year or another by a corporation. Postponement of the time for taking a tax credit on the other hand, may often result in a loss of credit and a consequent increase in taxes." (*Id.)*. While taxpayers certainly would have reason to oppose the inappropriate loss of credits, many tax disputes still have arisen from the inappropriate deferral of deductions. Taxpayers litigate both issues and presumably regard both as "important." Other than for section 951A category taxes, section 904(c) reduces the risk of losing credits due to timing mismatches, but there is no such protection for foreign tax deductions. As Owens admitted with respect to the deferral of foreign tax deductions, "[t]his does not mean, of course, that it cannot or should not be solved separately."

The IRS relation-back doctrine does not attempt to solve this problem. Both the foreign tax credit and the foreign tax deduction are measures to address double taxation, and the matching rationale sometimes offered as a justification for the relation-back doctrine would seem to apply with equal force to the foreign tax deduction. To the extent that *Cuba Railroad* relied on matching concepts from prior case law, in

addition to the special accounting method for credits implied by §905(a), *Cuba Railroad* would seem to support the application relation-back to the deduction of contested foreign taxes (*See generally Cuba Railroad Co. v. United States*, 124 F. Supp. 182, 185 (S.D.N.Y. 1955)).

The absence of relation-back for the deduction of contested foreign taxes is all the more surprising because there exists support for applying relation-back to such taxes when they are *not* contested. According to one court, "[a]bsent a contest, a subsequent adjustment by tax authorities to a deduction accrued in an earlier year must be accrued to that earlier year in which the events occurred to fix the fact and amount of the liability." (*Consolidated Industries, Inc. v. Commissioner*, 82 T.C. 477, 480 (1984)). In the context of a contested foreign tax deduction, the IRS does not apply the relation-back doctrine, even though relation-back appears to apply to foreign tax deductions that are not contested.

B. Computation of Earnings and Profits

A further permutation is found in the computation of E&P, where relation-back applies to contested foreign taxes even though they are still being contested.

An example of this line of authority is *Stern Brothers & Company v. Commissioner* (16 T.C. 295 (1951), *acq.* 1951-2 C.B. 4), which considered the deductibility of excess profits taxes from E&P. According to the court:

"[t]he accrual of these taxes results in no deductible expense in computing taxable income. The sole reason for the accrual of such taxes is to properly reflect the amount of a corporation's accumulated earnings and profits at the beginning of a taxable year for invested capital credit purposes. If accumulated earnings and profits at the start of any taxable year are to show the true financial status of an accrual basis taxpayer, an adjustment must be made for income and excess profits taxes arising in the preceding year."

(*Id*. at 322-23).

Under this line of authority, even if a tax adjustment is not made until a later year, it relates back to the earlier year for the purpose of computing E&P, including the determination of whether a distribution in that year was a taxable dividend (*See Stein*, at 965-66 (holding that the retroactive change to E&P is necessary "in order that distributions which actually impair capital will not be taxed as dividends")). In reaching this conclusion, moreover, courts have rejected the contested tax doctrine (*See, e.g.*, *Drybrough v. Commissioner*, 238 F.2d 735, 739 (6th Cir. 1956); *Russell Mfg. Co. v. United States*, 146 Ct. Cl. 833 (1959)). Contesting a tax does not prevent its accrual for E&P purposes. The E&P cases suggest that the failure of the IRS to follow *Cuba Railroad* in Rev. Rul. 58-55 — that is, its failure to deactivate the contested tax doctrine with respect to foreign tax credits—did not save us from some unmanageable problem.

In short, the IRS relation-back doctrine does not seem to embody some fundamental principle of international tax law. The doctrine does not apply to the deduction of contested foreign taxes, even though both foreign tax credits and deductions are measures for the relief of double taxation, and even though relation-back apparently does apply to the deduction of foreign taxes that are not contested. The relation-back doctrine also does not apply to contested foreign taxes for the purpose of computing E&P.

The relation-back part of the doctrine applies, but the computation of E&P is not subject to the contested tax doctrine or to "double accrual."

VI. What is Wrong with the Doctrine?

We have seen that the relation-back doctrine, now enshrined in regulations, was not inevitable; that its double-accrual concept is problematic; that the matching principle which is offered as its primary justification yields whenever necessary to the accrual method of accounting for tax purposes; that until recently it lacked a strong statutory foundation (and arguably still does); and that it does not embody some universal principle that invariably applies.

This section turns to the question of whether the IRS relation-back doctrine is nonetheless useful. Unfortunately, the doctrine's real-life shortcomings are obvious, due to the pressures imposed by recent changes to the regulations. The most serious problems are the increases to the number of time-barred refund claims that the doctrine causes, where double taxation arises solely because foreign taxing authorities are slow to act; the considerable filing burden that the new regulations inevitably will impose; and the draconian consequences for relatively minor failures to comply with rules without historical precedent.

A. Time-Barred Refund Claims and Foot-Faults

To illustrate the first shortcoming, imagine a domestic partnership with say 50 partners, some of whom are individuals. In 2016, the partnership generates net income in a foreign country, which income appears to be subject to a preferential rate of tax under foreign law, and the partnership files a local tax return claiming that lower rate.

In 2021, the foreign taxing authority's exam team asserts that the partnership's income was not entitled to the preferential rate. In 2024, the foreign audit team finalizes its determination and issues a notice of adjustment. The partnership challenges the notice of adjustment, but under foreign law the taxpayer must pay the tax in order to challenge it, which the taxpayer does in early 2026. The partnership decides to fight the foreign tax assessment, but it now must confront the IRS relation-back doctrine.

Under the regulations, the partnership and its partners generally cannot claim a foreign credit for the 2016 tax, despite the fact that they have paid it, until the contest is resolved, for example in 2029 (Treas. Reg. § 1.905-1(d)(1)(ii)). Upon resolution in 2029, the relation-back doctrine would treat the tax as accruing in 2029, and then deem it to accrue in 2016 (*See id.*; *see also* REG–101657–20, RIN 1545-BP70, 85 Fed. Reg. 72,078, 72,100 (Nov. 12, 2020) (quoting the double-accrual concept from Rev. Rul. 58-55)). By 2029, the 10-year statute will have expired. Thus, absent further action by the taxpayer, actual double-taxation will occur, solely as a result of the length of time it takes to resolve the foreign tax dispute, over which the taxpayer is likely to have little practical control.

Until the final regulations (that is, from 1925 until 2022), the partnership's actual payment of the contested tax would have enabled the taxpayer to claim a foreign tax credit, even under the IRS relation-back doctrine, on an amended return for 2016, reducing the risk of an unintentional failure to file the paperwork necessary to prevent double taxation (*See* Rev. Rul. 84-125, 1984-2 C.B. 125; Rev. Rul. 70-290,

1970-1 C.B. 168). The regulations took away that longstanding practice and replaced it with a provisional credit (*See* Treas. Reg. § 1.905-1(d)(4)). The taxpayer can claim a credit for 2016 upon payment of the contested tax in 2026, but only if the taxpayer agrees to a number of conditions, including annual reports to the IRS and an extension of the statute of limitations for three years past the resolution of the contest (*See* Treas. Reg. § 1.905-1(d)(4)(i), (ii)(D)). The preamble to the proposed regulations more or less promises the taxpayer an audit on the issue of whether the tax payment was compulsory (85 Fed. Reg. at 72,111), presumably including, in the case of a treaty jurisdiction, whether the partnership and all its partners could have invoked competent authority, and in fact did so. If the partners claim a credit for the 2026 tax payment without the provisional-credit election, then they apparently will have adopted an unauthorized method of accounting (*See generally* Treas. Reg. § 1.905-1(d)(5)(i), (6)(iii) (Example) (providing that the time when a taxpayer accrues a foreign income tax expense is a method of accounting)). The partners then would have to apply to the IRS for a method change to put themselves back onto a proper method of accounting (Treas. Reg. § 1.905-1(d)(5)(i)).

The foregoing assumes that all of the partners are crediting foreign taxes, and that they are on accrual method of accounting, including the individual partners, who might otherwise be on the cash method. For partners who are deducting foreign taxes, for example, the 2026 payment of the foreign tax would not seem to allow for a current deduction, but at least the IRS relation-back doctrine should not apply to time-bar their claim of a deduction in 2029. They generally should have a three-year statute from that year to claim the payment (*See generally* §6511(a)). Still other rules would apply to cash-method taxpayers claiming credits (See Treas. Reg. § 1.905-1(c)).

The likelihood of missing the statute of limitations increases materially under the IRS relation-back doctrine. As Owens put it 60 years ago with characteristic understatement, "Revenue Ruling 58-55 makes the timely settlement of tax contests significant in a way in which it was not significant under the law prior to the promulgation of the ruling." (*Owens*, at 331).

B. Expansion of the Definition of "Foreign Tax Redetermination"

The problems created by the new regulatory restrictions were compounded by the simultaneous broadening of the definition of an FTR that triggers the relation-back doctrine.

Contested foreign taxes almost invariably give rise to FTRs because they almost invariably fall into one of the categories listed in §905(c) (*e.g.*, accrued taxes not paid within two years) (*See, e.g.*, Treas. Reg. §1.905-3(b)(1)(ii)(A) (Example 1) ("Under paragraph (b)(1)(i) of this section, the additional tax is taken into account in Year 1, the year to which the redetermined tax relates, irrespective of when the tax is paid.")). The IRS, however, generally applies the relation-back doctrine to all FTRs (*See* Treas. Reg. §1.905-1(d)(1)(ii)). Not long ago, the regulations defined FTRs relatively narrowly. In addition to the three events listed in section 905(c), the regulations defined an FTR as "a change in the foreign tax liability that may affect a taxpayer's foreign tax credit." (former Temp. Treas. Reg. §1.905-3T(c))

The 1988 version of the Treasury regulations added the following list:

"[a] difference between the dollar value of the accrued foreign tax and the dollar value of the foreign tax actually paid attributable to differences in the units of foreign currency paid and the units of foreign

currency accrued; or … [a] difference between the dollar value of the accrued foreign tax and the dollar value of the foreign tax actually paid attributable to fluctuations in the value of the foreign currency relative to the dollar between the date of accrual and the date of payment."

(*Id.*). The 2007 version of the regulations revised this list to account for changes to the currency translation rules and added the following: "accrued taxes that when paid differ from the amounts added to post-1986 foreign income taxes or claimed as credits by the taxpayer (such as corrections to overaccruals and additional payments)." (former Treas. Reg. §1.905-3T(c) (2007)).

This relatively narrow list limited the number of FTRs, and thus the number of instances in which the relation-back doctrine required an amended return. As discussed above, the availability of prospective pooling adjustments at the CFC level considerably reduced the number of amended returns required to be filed.

In 2017, however, Congress repealed §902, and with it the rules in §905 that referred to §902 and §960 (Pub. L. No. 115-97, §14301(c)(20) 131 Stat. 2054, 2223 (2017)). As discussed above, the IRS interpreted that repeal as a bar to all forms of prospective adjustments (REG–105495–19, 84 Fed. Reg. 69,124, 69,135 (Dec. 17, 2019)). Treasury and the IRS admitted the significant burden that would arise from the elimination of such adjustments: "the Treasury Department and the IRS anticipate that there will be significantly more instances in which taxpayers must redetermine their U.S. tax liability with respect to a prior taxable year by reason of a foreign tax redetermination with respect to a controlled foreign corporation …," (T.D. 9882, 84 Fed. Reg. 69,022, 69,023 (Dec. 17, 2019)). Nevertheless, Treasury and the IRS rejected essentially all comments proposing a solution to the problem (*See* T.D. 9922, 85 Fed. Reg. 71,998, 72,015-16 (Nov. 12, 2020) (rejecting requests for alternative reporting mechanisms on the ground that, "based on existing processes," the only way that taxpayers can notify the IRS of a change in U.S. tax liability that results from an FTR is by filing an amended return), and at the same time materially expanded the scope of what constitutes an FTR.

Treas. Reg. §1.905-3(a) now treats the following as FTRs:

1. A change in the liability for foreign income taxes … or certain other changes … that may affect a taxpayer's U.S. tax liability, including by reason of:

a. A change in the amount of its foreign tax credit,

b. A change to claim a foreign tax credit for foreign income taxes that it previously deducted,

c. A change to claim a deduction for foreign income taxes that it previously credited,

d. A change in the amount of its distributions or inclusions under §951, §951A, or §1293,

e. A change in the application of the high-tax exception described in §954(b)(4), or

f. A change in the amount of tax determined under §1291(c)(2) and §1291(g)(1)(C)(ii).

2. In the case of a taxpayer that claims the credit in the year the taxes are paid, an FTR occurs if any portion of the tax paid is subsequently refunded, or if the taxpayer's liability is subsequently determined to be less than the amount paid and claimed as a credit.

3. In the case of a taxpayer that claims the credit in the year the taxes accrue, an FTR occurs if taxes that when paid or later adjusted differ from amounts accrued by the taxpayer and claimed as a credit or added to PTEP group taxes.

4. An FTR includes corrections and other adjustments to accrued amounts to reflect the final foreign tax liability, such as

a. additional payments of tax that accrue after the close of the taxable year to which the tax relates, and

b. for foreign income taxes taken into account when accrued but translated into dollars on the date of payment, a payment of accrued tax if the value of the foreign currency relative to the dollar has changed between the date or taxable year of accrual and the date of payment.

5. An FTR occurs if any tax claimed as a credit or added to PTEP group taxes is refunded in whole or in part, regardless of whether such tax was paid within the meaning of Treas. Reg. §1.901-2(e) at the time the tax was claimed as a credit or added to PTEP group taxes.

Thus, going forward, it does not appear to be much of an exaggeration to think that most U.S.-parented multinationals will be required to file amended returns for every year, year after year, not only when they contest the amount of their foreign tax liability, but also when other items only indirectly related to their foreign tax liability change, such as their §951A inclusion for a given year.

It also may come as something of a surprise that the failure to notify the IRS of an FTR on this list triggers a penalty of *up to 25% of the deficiency attributable to the FTR*, unless the taxpayer can show reasonable cause, and that the penalty according to the IRS *cannot be challenged before payment* (*See* §6689; Treas. Reg. §301.6689-1(a) & (b); *see also* T.D. 9362, 62,771, 62,777 (Nov. 7, 2007)). This penalty appears to have been enacted to police the timing of deductions associated with foreign deferred compensation plans (*See generally* S. Rep. No. 96-1039, at 16 (1980)), but it now comes into play for a very broad category of foreign tax and income adjustments.

Some increase in burden likely was inevitable in light of the legislative amendments in 2017. Treasury and IRS were confronted with the unenviable task of making sense of the new rules. Nevertheless, the government arguably had the interpretive authority to alleviate the problems caused by relation-back, even if it chose not to revisit the doctrine itself. The government could have left the definition of FTRs unchanged from the 2007 temporary regulations or provided some type of materiality threshold in order to limit the number of amended returns. The government could have left intact the ability of taxpayers to claim a foreign tax credit for the payment of contested taxes, which reduces the risk of missing a statute and which had survived for nearly a century without concern. The government could have allowed the pro-ration of income between foreign taxable years that straddle the end of a U.S. tax year, at least for §951A taxes, using the foreign tax liability determined for the two- year period. The government did

not need to take the position that claiming a credit in the wrong year is a change in method of accounting requiring a full-blown method-change request. The government did not have to specify that the election to change from a credit to a deduction is limited to the three-year statute and not the 10-year statute.

On the latter, the regulatory preamble claims that this discrepancy is required because the 10-year statute applies only to refund claims attributable to foreign income taxes claimed as a credit. (*See* REG–101657–20, RIN 1545-BP70, 85 Fed. Reg. at 72,101). The preamble also cites *Trusted Media Brands, Inc. v. United States* (899 F.3d 175 (2d Cir. 2018)), which declined to apply the 10-year statute to a refund claim based on a foreign tax deduction. (*See id.* at 179). As the court in that case noted, however, the 10-year period during which to decide whether to credit or deduct taxes stems from §901, while the 10-year statute to claim a refund attributable to foreign tax credits is in a different statute, §6511(d)(3)(A). (*See id.* at 181-82). More generally, the regulation appears to contradict the plain language of §901: "Such choice for any taxable year may be made or changed at any time before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by this chapter for such taxable year." (§ 901(a))

Note: The preamble claims that this discrepancy is required because the 10-year statute applies only to refund claims attributable to foreign income taxes claimed as a credit (*See* REG–101657–20, RIN 1545-BP70, 85 Fed. Reg. at 72,101 (Nov. 12, 2020)). The preamble also cites *Trusted Media Brands, Inc. v. United States*, 899 F.3d 175 (2d Cir. 2018), which declined to apply the 10-year statute to a refund claim based on a foreign tax deduction (*See id.* at 179). As the court in that case noted, however, the 10-year period during which to decide whether to credit or deduct taxes stems from §901, while the 10-year statute to claim a refund attributable to foreign tax credits is in a different statute, §6511(d)(3)(A). *See id.* at 181-82. More generally, the regulation appears to contradict the plain language of §901: "Such choice for any taxable year may be made or changed at any time before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by this chapter for such taxable year." (§901(a)).

In any case, these were interpretive choices Treasury and the IRS made, in many cases contrary to longstanding practice, that limit the availability of the foreign tax credit—at a time when the threat of double taxation has never been greater.

This article would not be complete, however, without mentioning the problem caused by the relation-back doctrine that the regulations had to adopt a special, taxpayer-favorable rule to resolve. It has long been recognized that relation-back for foreign tax credits, in combination with the rule requiring a taxpayer either to deduct or to credit all foreign taxes for a given year, s*ee* §275(a)(4) *and* Treas. Reg. §1.901-1(c)(1), creates the potential for double taxation (*see Owens* at 328-30). The two rules in combination would prevent a taxpayer from claiming either a deduction or a credit with respect to additional taxes that are paid in a year in which the taxpayer claims a credit if those additional taxes would relate back to an earlier in which the taxpayer claimed a deduction. The final regulations include a rule that allows the taxpayer to deduct additional foreign taxes paid in a year in which the taxpayer otherwise claims foreign tax credits if the additional taxes would have related back to a year in which the taxpayer claimed a foreign tax deduction. (Treas. Reg. §1.901-1(c)(3)). This special rule would not have been necessary if the relation-back doctrine did not apply to foreign tax credits.

VII. What Might an Alternative Look Like?

A. Book-Tax Conformity

What if Rev. Rul. 58-55 had simply chosen to follow the accrual method of accounting for financial accounting purposes, without regard to the contested tax doctrine? What if the special method of accounting for foreign tax credits under §905(a) simply meant book-tax conformity for credits? This final section speculates about potential alternatives to the relation-back doctrine.

A detailed discussion of the financial accounting treatment of adjustments to a U.S. multinational's foreign tax expense and associated foreign tax credits exceeds the scope of this article. The author is not an accountant, and this article provides no accounting advice. Still, one does not frequently hear news about multinationals restating their published financial statements to account for contested foreign taxes or FTRs more generally, while those same multinationals are almost certainly filing amended U.S. federal income tax returns to restate prior-year foreign tax credit claims in order to comply with the IRS relation-back doctrine. It seems logical to suppose that for financial accounting purposes, at least, the vicissitudes of foreign tax adjustments and other FTRs generally are addressed through prospective adjustments to the income tax provision, and not by repeatedly restating prior-year financials.

ASC 250, entitled "Accounting Changes and Error Corrections," appears to apply to an FTR if it would impact the overall tax amount reported in the income statement or the income tax provision footnote in the financial statements, for example as a change to an allowance, deferred tax asset, or deferred tax liability. Assuming that ASC 250 does apply in this context, then the financial accounting treatment of a given FTR would depend on the facts and circumstances, both in terms of the reasons for the FTR and its materiality.

An adjustment to the tax provision based on differing viewpoints regarding the application of foreign law appears to be a change in estimate as opposed to an error, and changes in estimates are reflected prospectively, on the financial statements for the year in which they arise (ASC 250-10-45-17. A change in estimate is defined in the ASC Master Glossary as referring to changes resulting from "new information."). For example, an adjustment of a prior-period tax accrual that results either from new information or later identification of information that was not reasonably knowable at the original balance sheet date and that results in improved judgment typically would lead to a change in estimate that can be addressed prospectively. That description would seem to fit at least certain FTRs.

By contrast, the correction of an error is generally accounted for by restating prior-period financial statements in subsequent financials which include the prior years (ASC 250-10-45-23. The ASC Master Glossary defines an error in previously issued financial statements as resulting from "mathematical mistakes, mistakes in the application of accounting principles, or oversight or misuse of facts that existed at the time the financial statements were prepared."). If the error is material, a restatement of the prior-period financials themselves may be required. If the error is not material and a correction as an out-of-period adjustment does not materially misstate that year, then that error also could be corrected prospectively, similar to a change in estimate.

The events giving rise to FTRs, particularly under the newly broadened definition of FTR in the regulations, would not seem typically to rise to the level an error. Errors appear to include things like the intentional misstatement of a tax accrual, mathematical errors such as double counting or omission of items, or the failure to record a tax benefit or a contingent tax liability that was reasonably knowable when the financials were issued. At the risk of oversimplifying, it appears that *routine* FTRs, including changes resulting from foreign tax contests, are generally taken into account prospectively, in the year they occur. They would seem to be viewed as a change in estimate.

Maybe it is too late now, but if Rev. Rul. 58-55 had gone back to *Anderson* and applied financial accounting principles to the foreign tax credit, the analogous regime today might look something like the rules ultimately adopted for prospective pooling adjustments at the CFC level. FTRs generally would have been taken into account prospectively, and amended returns for prior years only would have been required for FTRs above a certain threshold amount, for those involving a hyperinflationary currency, etc. Taxpayers could have relied on § 904(c) to address the mismatching of income and credit. The 10-year statute could have been read, as it was likely intended, to provide rough parity between the statute of limitations for refund and the unlimited statute of limitations for assessment with respect to foreign taxes originally accrued in a year, without any gloss regarding the year in which *contested* foreign taxes accrue (or, as it now happens, double-accrue).

Book-tax conformity for contested taxes would seem to be an idea worth considering, particularly given how fashionable it has once again become in the last few years. Recent proposals, such as Pillar 2 and the CAMT, use financial accounting as the starting point for the computation of the minimum tax liability of a multinational group. That use of financial accounting would seem to open the door to a re-examination of the relation-back doctrine.

B. The CAMT Variant

The 2022 Act revived an idea that was first enacted in 1986 and repealed three years later: a CAMT based on a company's financial statements (*See* Pub. L. No. 117-169, § 10101 136 Stat. 1818, 1818 (2022); *cf.* Tax Reform Act of 1986, Pub. L. No. 99-514, §§ 701-702, 100 Stat. 2085, 2336 (1986); *repealed by* Omnibus Budget Reconciliation Act of 1990, §11801(a)(3), 104 Stat. 1388, 1388-520 (1989). The current incarnation of the CAMT is based on adjusted "financial statement income," which generally is the net income set forth on the taxpayer's applicable financial statement, with certain adjustments (§ 56A(a)).

The CAMT provides its own version of the foreign tax credit if the taxpayer elects to credit foreign income taxes for the year (§59(l)). Among other requirements, the taxes generally must be "taken into account on the applicable financial statement" of the applicable corporation or CFC (as applicable), *and* "paid or accrued (for Federal income tax purposes)" by the applicable corporation or CFC (§59(l)(1)(A)(i)(I) & (B)(i)).

The first test is the more interesting one. The statute does not define when taxes are "taken into account." According to one helpful group of commentators, the first test potentially could be satisfied in the year in which the taxpayer makes a journal entry to reflect the foreign income tax liability (*i.e.*, any debit or credit to any tax account on the balance sheet or income statement); or, alternatively, in the tax year in which the foreign income tax results in a net financial statement tax expense (David M. Abrahams, Jeff Michalak,

Colleen O'Neill, and Saurav Agarwala, *The Next Chapter in the Book Minimum Tax Saga: Understanding the CAMT Foreign Tax Credit*, Tax Mgmt. Int'l J., at 11 (Nov. 4, 2022)).

The former interpretation likely would allow the foreign tax expense to be reflected the soonest because it apparently does not take much for a journal entry to occur with respect to a foreign tax liability. Under the latter interpretation, the foreign income tax "taken into account" in a particular tax year would be the net financial statement tax expense (broadly, the sum of deferred tax expense or benefit and current tax expense) in that year resulting from that foreign income tax. A current income tax expense that results in a deferred tax asset would be considered "taken into account" once the deferred tax asset reverses, resulting in a deferred tax expense. Where a temporary difference instead gives rise to a deferred tax liability with respect to a foreign income tax, the foreign income tax corresponding to the deferred tax expense would be considered to be "taken into account" in that tax year (*Id.* at 11-12). Neither would seem to require a restatement of prior-period results in a manner similar to how the relation-back doctrine requires amended returns.

In recent guidance, Treasury and IRS indicated their intention to follow the first interpretation: a foreign income tax is taken into account on an AFS "if any journal entry has been recorded in the journal used to determine the amounts on the AFS of the Taxpayer for any year, or another AFS that includes the Taxpayer, to reflect the income tax, even if the income tax does not increase or decrease the Taxpayer's FSI at the time of the journal entry." (Notice 2023-64, § 8.02(2), 2023-40 I.R.B 974).

The second test in the statute requires that the foreign tax also be "paid or accrued (for Federal income tax purposes)," and that language could be read to summon the relation-back doctrine. A foreign tax accrues in two different years under the doctrine, and only coincidence would seem to make either of those years the same year in which the first test would be met. Application of the relation-back doctrine under the second test would seem likely to result in the deferral of the CAMT foreign tax credit, relative to the first test, and the filing of yet another series of amended returns to re-compute the CAMT foreign tax credit for the relation-back year. Given the number of moving parts, the prospects for double taxation appear high.

Nevertheless, Treasury and IRS have somewhat unsurprisingly chosen to follow the relation-back doctrine:

"A Foreign Income Tax paid or accrued as a result of a foreign tax redetermination (as defined in §1.905-3(a)) is an Eligible Tax only if the Taxpayer is an Applicable Corporation in the taxable year to which the foreign tax redetermination related (Relation-Back Year). An Eligible Tax in this instance may be claimed as a CAMT FTC only in the Relation-Back Year, even if the tax is reflected in a journal entry on an AFS within a taxable year that is later than the Relation-Back Year."

(Notice 2023-56, §14.02(3), 2023-40 I.R.B 974).

An alternative reading would have been better. Ideally, the relation-back doctrine would be reconsidered for both CAMT purposes and regular tax purposes. If the relation-back doctrine were turned off for CAMT purposes but not for regular tax purposes, then a different set of timing mismatches likely would arise between the two systems, only some of which would be resolved by the carryover of CAMT credits against regular tax liability. As noted below, a one-time taxpayer election to turn off relation-back for

CAMT purposes potentially could serve as a test case for broader reconsideration of the relation-back doctrine.

AICPA submitted a comment letter on the CAMT asking that guidance allow "for all accrued foreign taxes 'taken into account' on the AFS as a credit so long as the foreign taxes are eligible credits under section 901 either in a current, prior or future tax year." (*See* Letter from AICPA to Lily Batchelder and Brett York, U.S. Treasury Department, and William Paul, Internal Revenue Service, "Re: Corporate Alternative Minimum Tax Immediate Guidance Needed," at 8 (Oct. 14, 2022)). According to the above group of commentators, this approach would interpret "taken into account" to mean recording a deferred tax expense, such that taxes could be claimed as a CAMT foreign tax credit in which the deferred tax expense is recorded even though the taxes are "paid or accrued" for U.S. federal income tax purposes in a different year (David M. Abrahams, Jeff Michalak, Colleen O'Neill, and Saurav Agarwala, The Next Chapter in the Book Minimum Tax Saga: Understanding the CAMT Foreign Tax Credit, Tax Mgmt. Int'l J., at 11 n.51 (Nov. 4, 2022)). In other words, the second test would simply require the taxes to be paid or accrued for tax purposes *at some point in time*.

That interpretation might seem strange at first, but the relation-back doctrine is hardly less strange. Interpreting the first test to be the operative one and the second test simply to confirm that accrual does occur for tax purposes would spare the government from having to tell us the year in which the foreign tax *really* accrues for purposes of the CAMT.

As illustrated by an example from the commentators, several alternatives appear available to Treasury and the IRS as they consider regulations under the CAMT (*Id.* at *22). Assume that based on a foreign audit an applicable corporation in Year 1 records an uncertain tax position in a foreign country and records a liability and corresponding income tax expense for the associated unrecognized tax benefit under ASC 740. In Year 4, the foreign taxing authority prevails in an amount equal to the liability originally recorded.

The foreign tax satisfies the first test in Year 1 because it is taken into account as an expense in the financial statements in that year. Under the original interpretation of the second test that applies the relation-back doctrine, the foreign tax does not meet that second test until Year 4 because it is a contested tax until that year, but then the tax is treated as accruing in Year 1. Because the tax also met the first test in Year 1, the taxpayer would be entitled to a CAMT foreign tax credit in that year, but it would be required to claim the credit on an amended return. The IRS in theory could interpret the second test not to incorporate the relation-back doctrine but still to incorporate the contested tax doctrine. *See id.* ("Under that argument, the additional tax liability would not be included in the CAMT FTC (i.e., the [second test] would not be met) before the taxable year in which the all events test is met. (Thus, in the [above] example, the CAMT FTC for the Country A tax expense would not apply until Year 4."). This alternative seems difficult to envision in light of Cuba Railroad Co. and the special method of accounting implied by §905(a), but in this area any outcome seems possible.

If the second test applies without the relation-back doctrine, for example by applying the AICPA interpretation, then the applicable corporation would claim the CAMT foreign tax credit on its tax return for Year 1, when it records an income tax expense for the foreign tax. So long as the tax accrues for U.S. federal income tax purposes in some year, which it does in Year 4, no change to the applicable

corporation's entitlement to a CAMT foreign tax credit would occur, including in Year 4 when the contest is resolved. Under this approach, if the contest were instead resolved instead in favor of the taxpayer in Year 4, then presumably the tax expense and associated unrecognized tax benefit would reverse in Year 4 for financial statement purposes. The taxpayer then would incur in Year 4 an associated CAMT liability from the reduction of the credit claimed in Year 1, but still no amended return would be filed for Year 1.

Some might perceive this third approach to favor the taxpayer, which would have the time value of money for the amount of CAMT offset by the credit between the time the foreign taxing authority asserts a deficiency and the conclusion of the dispute. There are a few potential responses to this potential concern.

First, the AICPA interpretation matches the tax benefit of the credit to the book detriment of the foreign tax expense when it is reflected in the financial statements, achieving the book-tax conformity intended by the CAMT. Second, the approach still incentivizes the taxpayer to fight the foreign audit adjustment, both to secure the book benefit of reversing the tax expense incurred and to avoid having to regurgitate the foreign tax credit claimed in the prior year. Third, the taxpayer would bear the risk of a mismatch arising over time between the timing of the foreign tax liability and the availability of the CAMT foreign tax credit limitation to credit the tax. Fourth, taxpayers do not typically control when foreign taxing authorities make their audit adjustments, nor do they have an incentive to seek them out or to record a UTP for foreign tax expense on their financials, just to claim the associated foreign tax credit.

Regulatory under the CAMT presents an opportunity for the IRS to reintroduce financial accounting principles into the timing of foreign tax credit claims. The context would seem ideal: after all, the whole point of a book-minimum tax like the CAMT is supposed to be to conform tax accounting to financial accounting. A one-time taxpayer election to apply the CAMT foreign tax credit on the basis of financial accounts could serve as a test case for reconsidering the relation-back doctrine more broadly. So far, however, Treasury and IRS do not seem inclined to deviate from the relation-back doctrine, despite the mismatches that such an approach potentially can create.

C. The Pillar 2 Variant

The value of efforts spent rethinking this issue would not be limited to the CAMT. The value would extend to the Pillar 2 project, which like CAMT starts with a group's financial statements.

The 2022 Pillar 2 Commentary recognizes the problem created by FTRs: the MNE Group's Covered Tax computation may increase or decrease based on a foreign tax audit, or for other reasons. "These changes to accrued tax expense may have impacted the MNE Group's Top-up Tax liability with respect to a preceding Fiscal Year." (OECD, Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two), Art. 4.6, ¶ 119 (2022)). The GloBE Information Return for the preceding year would not have taken these changes into account, and the Top-up Tax liability for the preceding year may have been overstated or understated. To address the issue, the Commentary goes on to provide a Pillar 2 version of relation-back, but with some interesting differences.

First, relation-back is explicitly turned off when it would benefit the taxpayer. The guidance directs the MNE group to accrue in the current year an increase in Covered Taxes attributable to previous years.

"While treating such post-filing adjustments to a tax liability in the current year is not as accurate as recalculating the GloBE tax liability or potential GloBE tax liability with respect to the relevant Fiscal Years, it significantly simplifies the computation of Top-up Tax under the GloBE Rules" (Id., Art. 4.6.1, ¶ 120). In fact, the guidance favors simplification to such a degree that it does not permit taxpayers to claim refunds of Top-up Tax based on an increase to prior-year taxes (*See* id.).

Under the commentary, relation-back is instead reserved for adjustments that benefit governments. The guidance "generally requires a re-computation of the ETR and Top-up Tax for the Fiscal Year to which the tax adjustment relates in the case of a decrease in Covered Taxes," except that an MNE Group "may elect to include an immaterial decrease in the current Fiscal Year" (*Id*., ¶¶ 121-22) The explicit purpose of the rule is to raise revenue:

"Adjustments for material decreases must be made in respect of the relevant previous Fiscal Year to which the tax adjustment relates because the over-statement of Covered Taxes may have avoided Top-up Tax in that year and simply reducing Covered Taxes in the current year may not effectively recapture the avoided Top-up Tax….These rules ensure that the GloBE Income or Loss and the Covered Taxes associated with such amount are taken into account in the ETR and Top-up Tax computations for the same Fiscal Year to avoid a distorted result."

(*Id*., ¶¶ 121-22.).

While refreshingly direct, this one-way matching rule in favor of governments seems unfair. A "distorted result" is not something that we should try to avoid only when doing so benefits the fisc. The rules should apply more neutrally.

In addition to making the Pillar 2 version of relation-back into a one-way rule for the protection of the fisc, the Commentary limits that doctrine in other respects. Relation-back under Pillar 2 does not apply unless the adjustment would be material. Although computed using the information for the relation-back year, moreover, any increase to the Top-up Tax resulting from the redetermination is paid in the current year. The MNE Group does not amend its GloBE Information Return or any related tax returns filed for the relation-back year.

Adoption in the United States of this OECD's more limited version of relation-back, while still unfair and burdensome, would seem to improve on the final regulations. It would conform more closely to financial accounting and would require fewer adjustments and amended returns. If all resulting adjustments could be made in the current year, perhaps time-barred claims could be reduced.

VIII. A New Beginning?

A missed opportunity in 1958 has since taken on a life of its own and blocked out potentially more administrable and less controversial alternatives for relieving double taxation. The recent final regulations place even greater weight on a flawed doctrine and make matters still worse by spontaneously outlawing useful and longstanding administrative practices. The final regulations merit reconsideration.

To limit the IRS relation-back doctrine more broadly might require changes to §905(c) and possibly §6511(d)(3)(A). The two-year rule in §905(c), which seems to be the closest statutory reference to relation-back, should not really be necessary at all in light of the unlimited statute of limitations for assessment available to the IRS, and should be repealed. The need to amend § 6511(d)(3)(A) only would seem to exist because of court cases interpreting that provision to incorporate Rev. Rul. 58-55, instead of simply providing rough parity between the statutes of limitation for assessment and refund. The statutory language itself does not incorporate the IRS relation-back doctrine.

In light of the more sweeping changes necessary to implement Pillar 2, a taxpayer election to apply book-tax conformity for foreign tax credits, combined with expanded carryover rules for excess credits, would seem to be an approach worth considering.

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