

# Attorneys Take Aim at Nexus Rule in Proposed FTC Regs

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By Annagabriella Colón

Invoking the legislative reenactment doctrine, lawyers responding to a public consultation on proposed foreign tax credit regs say a jurisdictional nexus requirement in [section 901](#) should be removed.

On September 29, 2020, the IRS and Treasury released [two sets of FTC regs](#), including a new set of proposed regs ([REG-101657-20](#)).

Under reg. [section 1.901-2\(c\)\(1\)](#) and (2), the government has proposed adding a jurisdictional nexus requirement to the definition of foreign income tax under [section 901](#) in response to a growing trend in other countries of adopting extraterritorial taxes that deviate from the international taxing jurisdiction norms reflected in the Internal Revenue Code.

The jurisdictional nexus requirement would also be imposed on [section 903](#) in connection with the substitution requirement to ensure that a foreign tax cannot be creditable under the rule “by being imposed on a taxable base other than income.” [Section 903](#), which defines taxes paid in lieu of an income tax for FTC purposes, contains a substitution requirement that is satisfied when a foreign tax “operates as a tax imposed in substitution for, and not in addition to, an income tax or a series of income taxes.”

During the public consultation on the proposed regs, Leslie J. Schneider and Patrick J. Smith of Ivins, Phillips & Barker said in a [February 8 submission letter](#) that the nexus requirements should be eliminated from sections 901 and 903.

Citing the legislative reenactment doctrine, Schneider and Smith argued that Congress approved the current rules in 1983 without amending [section 901](#) or [903](#) and that those sections should remain unaltered.

A set of 1979 proposed regs was rejected because of a “mirror image” deduction rule in [section 901](#) that would have allowed FTCs for foreign taxes that suitably resembled U.S. taxes. The government took a second swing with 1980 temporary and proposed regs that eased up on the “mirror image” rules, and those regs were finalized in 1983.

“The final regulations . . . have been retained in essentially the same form since their issuance,” the letter says. However, the new proposed regulations “would deviate significantly from the provisions in the 1983 regulations that have now been in existence for almost 40 years,” it adds.

Taxpayers had a similar reaction to changes proposed for [section 903](#) in the 1979 proposed regs. However, their objection was to the government's jurisdictional nexus requirement. The government withdrew that proposal and it is not included in the finalized 1983 regulations.

Under the new [section 903](#), a foreign tax on a resident's income would not qualify for an FTC if the income is not sufficiently linked to the conduct of a trade or business in the other country, or a permanent establishment there. The current rules provide examples that "make it absolutely clear that no such nexus is a requirement for creditability under [section 903](#)," the letter says.

By deciding to neither modify nor question the 1983 FTC regulations, "Congress implicitly blessed the existing provisions in those regulations when [it] enacted the Tax Reform Act of 1986," the letter says.

Schneider and Smith said that, at the very minimum, the government should remove the nexus requirement in [section 903](#).

During a virtual tax conference held by the District of Columbia Bar January 13, Jason Yen, attorney-adviser, Treasury Office of International Tax Counsel, told attendees that the government was particularly interested in [comments regarding the sourcing element in the jurisdictional nexus rule](#). The consultation ended February 11.