Treasury Urged To Rethink Proposed Nexus Requirement, 2021 Law360 40-182

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Summary

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The U.S. Department of the ***Treasury***'s ***proposed*** foreign tax credit regulations conflict with congressional intent, several groups said this week.There's no legislative backing to justify the regulations, which say foreign taxes are creditable only if they're based on sufficient ***nexus*** to the country, according to a letter Monday to ***Treasury*** and the Internal Revenue Service from attorneys at Ivins Phillips & Barker Chtd. Similar comments were raised in letters submitted by practitioners at Fenwick & West LLP and the U.S. Council for International Business, among others.

Under the ***proposed*** regulations (*2020 Law360 273-62*), issued in September, offshore corporate income taxes aren't creditable back home unless they have the character of "an income tax in the U.S. sense." A foreign tax imposed on a U.S. company's income that lacks sufficient ***nexus*** to the country — such operations or employees — isn't an income tax in the U.S. sense and therefore not eligible for a foreign tax credit, according to the ***proposed*** rules.

In the preamble, ***Treasury*** said it revisited the definition of foreign income tax because in recent years, several countries have adopted or are considering "novel extraterritorial taxes that diverge in significant respects from traditional norms."

In asking ***Treasury*** to eliminate the jurisdictional ***nexus requirement***, two Ivins Phillips partners noted in their letter Monday that regulations ***proposed*** in 1980 similarly said foreign taxes weren't creditable unless they were a "mirror image" of the U.S. income tax. Those regulations didn't make it into a final guidance package issued in 1983, and Congress subsequently took no action to modify or question those rules, the attorneys said.

"Congress had a chance to review the rules in that area and didn't do anything about it, and basically blessed the existing rules," Ivins Phillips partner Les Schneider told Law360 on Tuesday. "So it does not seem appropriate for the ***Treasury*** to be going back to the rules before 1983 in light of what's happened."

Schneider, who coauthored the letter with Ivins Phillips partner Patrick J. Smith, said the legislative reenactment doctrine would seem to prevent what ***Treasury*** has ***proposed***. In their letter, Schneider and Smith said the doctrine derives most prominently from a 1938 U.S. Supreme Court decision.

In that case, Helvering v. *Winmill (Helvering v. Winmill, 305 U.S. 79)*, the court ruled that ***Treasury*** regulations "long continued without substantial change, applying to unamended or substantially reenacted statutes, are deemed to have received congressional approval, and have the effect of law."

According to the letter, Congress was aware of the 1983 regulations when it overhauled the tax code in 1986 and made no additional changes to the definition of an income tax. The same review of rules took place again in 2017 when Congress enacted the Tax Cuts and Jobs Act (115 P.L. 97) and adopted no "wholesale changes" to the definition of creditable foreign tax, Schneider and Smith said.

Accordingly, the subsequent ***proposed*** rule "so soon after the enactment of the TCJA strongly calls for the invocation of the legislative reenactment doctrine," according to the letter.

A group of tax partners at Fenwick raised similar concerns about the jurisdictional ***nexus requirement***. In a letter submitted Monday, they wrote that the ***proposal*** and others "would fundamentally change existing U.S. tax laws and policies to such a degree that they should be implemented, if at all, only by Congress."

Treasury regulations issued under Section 901 (*26 USCS § 901*) of the Internal Revenue Code, which covers foreign taxes, have generally provided technical guidance — such as the boundary between income taxes and other taxes, according to the four partners.

"Absent a statutory exception, however, taxes that are plainly foreign income taxes paid by the taxpayer are creditable under the plain, simple and longstanding language of Section 901 of the code," they said.

The U.S. Council for International Business also highlighted what it saw as a contradiction with congressional intent. In a letter submitted on Monday, the chair of the organization's tax committee noted that Congress repealed a jurisdictional ***nexus requirement*** in 1921.

"The imposition of a new rigid ***requirement*** for another country's ***nexus*** rules to closely align with U.S. rules would be inconsistent with this history and the plain meaning of the text of Section 901," according to the letter, which said such text has been "virtually unchanged since 1921."

Shortly after ***Treasury*** ***proposed*** the jurisdictional ***nexus requirement***, government officials have commented on the rules' connection to offshore measures (*2020 Law360 276-167*). The ***requirement*** is "something that we have been thinking about for a long time," said Jason Yen, associate international tax counsel at ***Treasury***, speaking in early October during the American Bar Association Section of Taxation's fall meeting.

John Merrick, senior-level counsel to the IRS' associate chief counsel, international, cited offshore digital taxes (*2020 Law360 316-18*) in November during the American Bar Association's Philadelphia Tax Conference. He noted that "we had to act to protect the [U.S.] fisc" because some countries had already enacted unilateral digital services taxes that would be subject to the ***proposed*** rule.

In the preamble to the ***proposed*** rules, ***Treasury*** said it has been "actively engaged in negotiations with other countries" as part of the Organization for Economic Cooperation and Development's ***proposed*** overhaul (*2019 Law360 282-1*) to international corporate taxation.

"If an agreement is reached that includes the United States, the ***Treasury*** Department recognizes that changes to the foreign tax credit system may be required at that time," according to the preamble.

Meanwhile, the New York State Bar Association Tax Section on Tuesday said in a report that the ***proposed*** jurisdictional ***nexus requirement*** should be separated from the other ***proposed*** foreign tax credit rules. This ***requirement*** should be "considered subject to an extended comment period and in light of further international developments, particularly the ongoing work at the OECD," according to the report.

A representative for the IRS declined to comment on the letters on Tuesday.

A representative for ***Treasury*** couldn't be reached for comment.

--Editing by Neil Cohen.

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