



Reform of Foreign Tax Credit Carryover Rules to Prevent Double Taxation

Issue

Reform of the foreign tax credit ("FTC") carryover rules is needed to provide for an effective operation of U.S. tax laws intended to protect against double taxation. The current rules are no longer consistent with ongoing changes in international tax administration of transfer pricing rules and other U.S. and foreign tax laws.

Background

U.S. taxpayers may claim foreign tax credits against U.S. tax in order to avoid double taxation of income. The amount of foreign tax credits that may be claimed in a year is subject to a limitation, so that the credit is allowed only to offset U.S. tax on foreign source income. To the extent the amount of creditable taxes of a given taxable year exceeds the limitation, the excess may be carried back two (2) years and forward five (5) years.

Policy Considerations

Problems of double taxation often arise because the foreign tax treatment of items of income and expense may differ from the U.S. tax treatment. For example, the same income may arise in different taxable years for foreign and U.S. tax purposes. As a result, the foreign taxes may be imposed in a year during which little or no foreign income may arise under U.S. tax principles. The rules for FTC carryovers seek to address this problem by allowing the foreign tax credits to be carried over from years in which foreign taxes are imposed to years in which the foreign source income arises under U.S. tax principles.

Extending the period of the FTC carryforwards and amending the ordering rules would allow companies to offset their U.S. tax liabilities in later years when they are profitable without facing the pressure of expiring FTC carryovers. This modification would allow U.S. taxpayers that had accrued or paid foreign taxes additional time to utilize their foreign tax credit carryovers. In addition, with the enactment of transfer pricing legislation in many foreign jurisdictions, U.S. multinational corporations are required to recognize income and pay foreign taxes in foreign jurisdictions even when they have losses on a consolidated basis.

Earlier this year, Rep. Amo Houghton (R-NY) introduced an international tax reform bill (H.R. 285) with a provision to extend the FTC carryforward period to 10 years. House Ways and Means Committee Chairman Bill Thomas (R-CA) is expected to reintroduce his international tax reform bill (H.R. 5095,) from the 107th Congress. H.R. 5095 included a provision to extend the FTC carryforward period to 10 years.

Published December 8, 2004

Visit the Silicon Valley Tax Directors Group Web site at www.svtdg.org



Reform of Foreign Tax Credit Carryover Rules to Prevent Double Taxation

Recommendation

The SVTDG recommends that legislation be enacted in the 108th Congress to extend the FTC carryforward period to ten (10) years. The SVTDG further recommends that the ordering rules be amended such that credits would be used first from carryforwards to such taxable year, second from the current year, and third from carrybacks.