employment, investment, productivity, innovation, or the ability of United States-based companies to compete with foreign-based companies in domestic and import markets.

Executive Order 12866

The Department of State has reviewed this proposed rule to ensure its consistency with the regulatory philosophy and principles set forth in Executive Order 12866 and has determined that the benefits of this final regulation justify its costs. The Department does not consider this final rule to be an economically significant action within the scope of section 3(f)(1) of the Executive Order since it is not likely to have an annual effect on the economy of $100 million or more or to adversely affect in a material way the economy, a sector of the economy, competition, jobs, the environment, public health or safety, or State, local or tribal governments or communities.

Executive Orders 12372 and 13132: Federalism

This regulation will not have substantial direct effects on the States, on the relationship between the national government and the States, or the distribution of power and responsibilities among the various levels of government. Nor will the rule have federalism implications warranting the application of Executive Orders No. 12372 and No. 13132.

Executive Order 12988: Civil Justice Reform

The Department has reviewed the regulations in light of sections 3(a) and 3(b)(2) of Executive Order No. 12988 to eliminate ambiguity, minimize litigation, establish clear legal standards, and reduce burden.

Executive Order 13563: Improving Regulation and Regulatory Review

The Department has considered this rule in light of Executive Order 13563, dated January 18, 2011, and affirms that this regulation is consistent with the guidance therein.

Paperwork Reduction Act

This rule does not impose information collection requirements under the provisions of the Paperwork Reduction Act, 44 U.S.C. Chapter 35.

List of Subjects in 22 CFR Part 41

Documentation of nonimmigrants.

For the reasons stated in the preamble, the Department of State amends 22 CFR part 41 to read as follows:

PART 41—[AMENDED]

■ 1. The authority citation for part 41 continues to read as follows:

Authority: 8 U.S.C. 1104; Pub. L. 105–277, 112 Stat. 2681–795 through 2681–801; 8 U.S.C. 1185 note (section 7209 of Pub. L. 108–458, as amended by section 546 of Pub. L. 109–295).

■ 2. Section 41.54 is revised to read as follows:

§ 41.54 Intracompany transferees (executives, managers, and specialized knowledge employees)

(a) *Requirements for L classification.* An alien shall be classifiable under the provisions of INA section 101(a)(15)(L) if:

(1) The consular officer is satisfied that the alien qualifies under that section; and either

(2) In the case of an individual petition, the consular officer has received official evidence of the approval by DHS of a petition to accord such classification or of the extension by DHS of the period of authorized stay in such classification; or

(3) In the case of a blanket petition,

(i) The alien has presented to the consular officer official evidence of the approval by DHS of a blanket petition listing only those intracompany relationships and positions found to qualify under INA section 101(a)(15)(L);

(ii) The alien is otherwise eligible for L–1 classification pursuant to the blanket petition; and,

(iii) The alien requests that he or she be accorded such classification for the purpose of being transferred to, or remaining in, qualifying positions identified in such blanket petition; or

(4) The consular officer is satisfied the alien is the spouse or child of an alien so classified and is accompanying or following to join the principal alien.

(b) *Petition approval.* The approval of a petition by DHS does not establish that the alien is eligible to receive a nonimmigrant visa.

(c) *Alien not entitled to L–1 classification under individual petition.* The consular officer must suspend action on the alien's application and submit a report to the approving DHS office if the consular officer knows or has reason to believe that an alien applying for a visa as the beneficiary of an approved individual petition under INA section 101(a)(15)(L) is not entitled to such classification as approved.

(d) *Labor disputes.* Citizens of Canada or Mexico shall not be entitled to classification under this section if the Secretary of Homeland Security and the Secretary of Labor have certified that:

(1) There is in progress a strike or lockout in the course of a labor dispute in the occupational classification at the place or intended place of employment; and,

(2) The alien has failed to establish that the alien's entry will not affect adversely the settlement of the strike or lockout or the employment of any person who is involved in the strike or lockout.

(e) *Alien not entitled to L–1 classification under blanket petition.* The consular officer shall deny L classification based on a blanket petition if the documentation presented by the alien claiming to be a beneficiary thereof does not establish to the satisfaction of the consular officer that

(1) The alien has been continuously employed by the same employer, an affiliate or a subsidiary thereof, for one year within the three years immediately preceding the application for the L visa;

(2) The alien was rendering services in a capacity that is managerial, executive, or involves specialized knowledge throughout that year; or

(3) The alien is destined to render services in such a capacity, as identified in the petition and in an organization listed in the petition.

(f) *Former exchange visitor.* Former exchange visitors who are subject to the two-year foreign residence requirement of INA section 212(e) are ineligible to apply for visas under INA section 101(a)(15)(L) until they have fulfilled the residence requirement or obtained a waiver of the requirement.

Dated: January 31, 2012.

Janice L. Jacobs,

Assistant Secretary for Consular Affairs, Department of State.

[FR Doc. 2012–3455 Filed 2–13–12; 8:45 am]

BILLING CODE 4710–06–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9576]

RIN 1545–BF73

Definition of a Taxpayer

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final Income Tax Regulations which provide guidance relating to the determination of who is considered to pay a foreign income tax for purposes of the foreign tax credit. These regulations provide rules for identifying the person with legal liability to pay the foreign income

tax in certain circumstances. These regulations affect taxpayers claiming foreign tax credits.

DATES: *Effective Date:* These regulations are effective on February 14, 2012.

Applicability Dates: For dates of applicability, see § 1.901–2(h)(4).

FOR FURTHER INFORMATION CONTACT: Suzanne M. Walsh, (202) 622–3850 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Background

I. Section 901 Regulations

On August 4, 2006, the **Federal Register** published proposed regulations (71 FR 44240) under section 901 of the Internal Revenue Code concerning the determination of the person who paid a foreign income tax for foreign tax credit purposes (2006 proposed regulations). The 2006 proposed regulations would address the inappropriate separation of foreign income taxes from the income on which the tax was imposed in certain circumstances. In particular, the 2006 proposed regulations would provide guidance under § 1.901–2(f) relating to the person on whom foreign law imposes legal liability for tax, including in the case of taxes imposed on the income of foreign consolidated groups and entities that have different classifications for U.S. and foreign tax law purposes.

The Treasury Department and the IRS received written comments on the 2006 proposed regulations and held a public hearing on October 13, 2006. All comments are available at *www.regulations.gov* or upon request. In Notice 2007–95 (2007–2 CB 1091 (December 3, 2007)), the Treasury Department and the IRS announced that when issued, the final regulations will be effective for taxable years beginning after the final regulations are published in the **Federal Register**. This Treasury decision adopts, in part, the 2006 proposed regulations with the changes discussed in this preamble.

II. Section 909 and Notice 2010–92

Section 909 was enacted as part of legislation commonly referred to as the Education Jobs and Medicaid Assistance Act (EJMAA) on August 10, 2010 (Pub. L. 111–226, 124 Stat. 2389 (2010)). Section 909 was enacted to address concerns about the inappropriate separation of foreign income taxes and related income.

Section 909 provides that there is a foreign tax credit splitting event if a foreign income tax is paid or accrued by a taxpayer or section 902 corporation and the related income is, or will be, taken into account by a covered person with respect to such taxpayer or section 902 corporation. In such a case, the tax is suspended until the taxable year in which the related income is taken into account by the payor of the tax or, if the payor is a section 902 corporation, by a section 902 shareholder of the section 902 corporation.

On December 6, 2010, the Treasury Department and the IRS issued Notice 2010–92 (2010–2 CB 916 (December 6, 2010)), which primarily addresses the application of section 909 to foreign income taxes paid or accrued by a section 902 corporation in taxable years beginning on or before December 31, 2010 (pre-2011 taxable years). The notice provides rules for determining whether foreign income taxes paid or accrued by a section 902 corporation in pre-2011 taxable years (pre-2011 taxes) are suspended under section 909 in taxable years beginning after December 31, 2010 (post-2010 taxable years) of a section 902 corporation. It also identifies an exclusive list of arrangements that will be treated as giving rise to foreign tax credit splitting events in pre-2011 taxable years (pre-2011 splitter arrangements) and provides guidance on determining the amount of related income and pre-2011 taxes paid or accrued with respect to pre-2011 splitter arrangements. The pre-2011 splitter arrangements are reverse hybrid structures, certain foreign consolidated groups, disregarded debt structures in the context of group relief and other loss-sharing regimes, and two classes of hybrid instruments. The notice states that future guidance will provide that foreign tax credit splitting events in post-2010 taxable years will at least include all of the pre-2011 splitter arrangements. The notice also states that the Treasury Department and the IRS do not intend to finalize the portion of the 2006 proposed regulations relating to the determination of the person who paid a foreign income tax with respect to the income of a reverse hybrid. See Prop. § 1.901–2(f)(2)(iii). Temporary regulations under section 909 are published elsewhere in this issue of the **Federal Register**.

Summary of Comments and Explanation of Revisions

I. In General

In response to written comments on the 2006 proposed regulations and in light of the enactment of section 909, the Treasury Department and the IRS have determined that it is appropriate to finalize certain portions of the 2006 proposed regulations. These final regulations revise several of the proposed rules to take into account comments received. Other portions of those regulations are adopted without amendment. The Treasury Department and the IRS have also determined that the remaining portions of the 2006 proposed regulations should be withdrawn. The Treasury Department and the IRS, however, are continuing to consider whether and to what extent to revise or clarify the general rule that tax is considered paid by the person who has legal liability under foreign law for the tax. For example, the Treasury Department and the IRS are continuing to study whether it is appropriate to provide a special rule for determining who has legal liability in the case of a withholding tax imposed on an amount of income that is considered received by different persons for U.S. and foreign tax purposes, as in the case of certain sale-repurchase transactions.

II. Taxes Imposed on Combined Income

Section 1.901–2(f)(2) of the 2006 proposed regulations addresses the application of the legal liability rule to foreign consolidated groups and other combined income regimes, including those in which the regime imposes joint and several liability in the U.S. sense, those in which the regime treats subsidiaries as branches of the parent corporation (or otherwise attributes income of subsidiaries to the parent corporation), and those in which some of the group members have limited obligations, or even no obligation, to pay the consolidated tax. Section 1.901–2(f)(2)(i) of the 2006 proposed regulations provides that the foreign tax must be apportioned among the persons whose income is included in the combined base pro rata based on each person's portion of the combined income, as computed under foreign law. Because failure to allocate appropriately the consolidated tax among the members of the group may result in the separation of foreign income tax from the related income as described in section 909, comments recommended that the proposed rules be finalized in lieu of treating these arrangements as foreign tax credit splitting events under section 909, which would require suspension of split tax until the related income is taken into account. The Treasury Department and the IRS agree with the comments, and accordingly, § 1.901–2(f)(3)(i) of the final regulations adopts with minor modifications Prop. § 1.901–2(f)(2)(i). As these regulations are generally effective for foreign taxes paid or accrued during taxable years beginning after February 14, 2012, a foreign tax credit splitting event will not occur with respect to foreign taxes paid or accrued on combined income in such years. However, with respect to foreign income taxes paid or accrued on combined income during taxable years beginning after December 31, 2010, and on or before February 14, 2012, temporary regulations under section 909 provide that a foreign tax credit splitting event occurs to the extent that a taxpayer does not allocate the foreign consolidated tax liability among the members of the foreign consolidated group based on each member's share of the consolidated taxable income included in the foreign tax base under the principles of § 1.901–2(f)(3) prior to its amendment by this Treasury decision.

One comment recommended that combined income subject to preferential tax rates should be allocated only to group members with that type of income, in order to more closely match the tax with the related income. The Treasury Department and the IRS agree with this comment, and § 1.901–2(f)(3)(i) of the final regulations provides that combined income with respect to each foreign tax that is imposed on a combined basis, and combined income subject to tax exemption or preferential tax rates, is computed separately, and the tax on that combined income base is allocated separately.

Section 1.901–2(f)(2)(ii) of the 2006 proposed regulations provides that for purposes of § 1.901–2(f)(2) of the 2006 proposed regulations, foreign tax is imposed on the combined income of two or more persons if such persons compute their taxable income on a combined basis under foreign law. Foreign tax is considered to be imposed on the combined income of two or more persons even if the combined income is computed under foreign law by attributing to one such person (for example, the foreign parent of a foreign consolidated group) the income of other such persons. However, foreign tax is not considered to be imposed on the combined income of two or more persons solely because foreign law: (1) Permits one person to surrender a net loss to another person pursuant to a group relief or similar regime; (2) requires a shareholder of a corporation to include in income amounts attributable to taxes imposed on the corporation with respect to distributed earnings, pursuant to an integrated tax system that allows the shareholder a credit for such taxes; or (3) requires a shareholder to include, pursuant to an anti-deferral regime (similar to subpart F of the Internal Revenue Code (sections 951 through 965)), income attributable to the shareholder's interest in the corporation.

The final regulations adopt § 1.901–2(f)(2)(ii) of the 2006 proposed regulations with several modifications in response to comments. Section 1.901–2(f)(3)(ii) of the final regulations provides that tax is considered to be computed on a combined basis if two or more persons that would otherwise be subject to foreign tax on their separate taxable incomes add their items of income, gain, deduction, and loss to compute a single consolidated taxable income amount for foreign tax purposes. In addition, foreign tax is not considered to be imposed on the combined income of two or more persons if, because one or more of such persons is a fiscally transparent entity under foreign law, only one of such persons is subject to tax under foreign law (even if two or more of such persons are corporations for U.S. tax purposes). The regulations include additional illustrations clarifying that foreign tax is not considered to be imposed on combined income solely because foreign law: (1) Reallocates income from one person to a related person under foreign transfer pricing provisions; (2) requires a person to take into account a distributive share of taxable income of an entity that is a partnership or other fiscally transparent entity for foreign tax law purposes; or (3) requires a person to take all or part of the income of an entity that is a corporation for U.S. tax purposes into account because foreign law treats the entity as a branch or fiscally transparent entity (a reverse hybrid). A reverse hybrid does not include an entity that is treated under foreign law as a branch or fiscally transparent entity solely for purposes of calculating combined income of a foreign consolidated group.

One comment requested clarification that the exclusions from the definition of a combined income base (for example, foreign integration and anti-deferral regimes) apply solely for purposes of determining whether a foreign income tax is imposed on combined income, and do not apply for purposes of determining each person's ratable share of the combined income base. The Treasury Department and the IRS agree that these exclusions from the definition of a combined income base do not exclude any amount of income otherwise subject to tax on a combined basis from the operation of the combined income rule. However, since nothing in the list of exclusions affects the amount of income in the combined income base, which is computed under foreign law, the Treasury Department and the IRS believe a change is unnecessary.

Section 1.901–2(f)(2)(iii) of the 2006 proposed regulations provides that a reverse hybrid is considered to have legal liability under foreign law for foreign taxes imposed on the owners of the reverse hybrid in respect of each owner's share of the reverse hybrid's income. As stated in Notice 2010–92, the Treasury Department and the IRS will not finalize the portion of the 2006 proposed regulations relating to the determination of the person who paid a foreign income tax with respect to the income of a reverse hybrid. Notice 2010–92 identifies reverse hybrids as pre-2011 splitter arrangements, and the temporary regulations under section 909 also identify reverse hybrids as splitter arrangements.

Section 1.901–2(f)(2)(iv) of the 2006 proposed regulations provides rules for determining each person's share of the combined income tax base, generally relying on foreign tax reporting of separate taxable income or books maintained for that purpose. The 2006 proposed regulations provide that payments between group members that result in a deduction under both U.S. and foreign tax law will be given effect in determining each person's share of the combined income. The 2006 proposed regulations, however, explicitly reserve with respect to the effect of hybrid instruments and disregarded payments between related parties, which the preamble to the proposed regulations describes as a matter to be addressed in subsequent published guidance. Section 1.901–2(f)(2)(iv) of the 2006 proposed regulations also provides special rules addressing the effect of dividends (and deemed dividends) and net losses of group members on the determination of separate taxable income.

Section 1.901–2(f)(3)(iii) of the final regulations adopts Prop. § 1.901–2(f)(2)(iv) with modifications reflecting that certain hybrid instruments and certain disregarded payments are treated as splitter arrangements subject to section 909. In particular, the final regulations provide that in determining separate taxable income of members of a combined income group, effect will be given to intercompany payments that are deductible under foreign law, even if such payments are not deductible (or are disregarded) for purposes of U.S. tax law. Thus, for example, interest accrued by one group member with respect to an instrument held by another member that is treated as debt for foreign tax purposes but as equity for U.S. tax purposes would be considered income of the holder and would reduce the taxable income of the issuer. The final regulations, however, include a crossreference to § 1.909–2T(b)(3)(i) for rules requiring suspension of foreign income taxes paid or accrued by the owner of a U.S. equity hybrid instrument.

Section 1.901–2(f)(2)(v) of the 2006 proposed regulations provides that U.S. tax principles apply to determine the tax consequences if one person remits a tax that is the legal liability of another person. For example, a payment of tax for which a corporation has legal liability by a shareholder of that corporation (including an owner of a reverse hybrid), will ordinarily result in a deemed capital contribution and deemed payment of tax by the corporation. Prop. § 1.901–2(f)(2)(v) also provides that if the corporation reimburses the shareholder for the tax payment, such reimbursement would ordinarily be treated as a distribution for U.S. tax purposes. The Treasury Department and the IRS received several comments regarding Prop. § 1.901–2(f)(2)(v) noting that a shareholder's payment of a corporation's tax and a corporation's reimbursement of a shareholder for paying its tax liability will not result in deemed capital contribution and deemed dividend treatment if arrangements are in place that treat the shareholder's payment of the tax as pursuant to a lending or agency arrangement. In response to these comments, the second and third sentences of § 1.901–2(f)(2)(v) of the 2006 proposed regulations are not included in § 1.901–2(f)(3)(iv) of the final regulations, and the final regulations simply provide that U.S. tax principles apply to determine the tax consequences if one person remits a tax that is the legal liability of another person.

III. Taxes Imposed on Partnerships and Disregarded Entities

Section 1.901–2(f)(3) of the 2006 proposed regulations provides rules regarding the treatment of two types of hybrid entities. First, in the case of an entity that is treated as a partnership for U.S. income tax purposes but is taxable at the entity level under foreign law (which the 2006 proposed regulations define as a hybrid partnership), such entity is considered to have legal liability under foreign law for foreign income tax imposed on the income of the entity. The 2006 proposed regulations also provide rules for allocating foreign tax paid or accrued by a hybrid partnership if the partnership's U.S. taxable year closes with respect to one or more (or all) partners or if there is a change in ownership of the hybrid partnership. See Prop. § 1.901–2(f)(3)(i).

Second, in the case of an entity that is disregarded as separate from its owner for U.S. federal income tax purposes, the person that is treated as owning the assets of such entity for U.S. tax purposes is considered to have legal liability under foreign law for tax imposed on the income of the entity. The 2006 proposed regulations provide rules for allocating foreign tax between the old owner and the new owner of a disregarded entity if there is a change in the ownership of the disregarded entity during the entity's foreign taxable year and such change does not result in a closing of the entity's foreign taxable year. See Prop. § 1.901–2(f)(3)(ii). The 2006 proposed regulations generally provide that for hybrid partnerships and disregarded entities, allocations of tax will be made under the principles of § 1.1502–76(b) based on the respective portions of the taxable income of the hybrid entity (as determined under foreign law) for the foreign taxable year that are attributable to the period ending on the date of the ownership change (or the last day of the terminating partnership's U.S. taxable year) and the period ending after such date. This approach is consistent with the rule provided in § 1.338–9(d) for apportioning foreign tax paid by a target corporation that is acquired in a transaction that is treated as an asset acquisition pursuant to an election under section 338, if the foreign taxable year of the target does not close at the end of the acquisition date.

A change in the ownership of a hybrid partnership or disregarded entity during the entity's foreign taxable year that does not result in the closing of the hybrid entity's foreign taxable year may result in the separation of income from the associated foreign income taxes. A change in the ownership occurs if there is a disposition of all or a portion of the owner's interest. A separation of income from the associated foreign income taxes could occur if the foreign tax paid or accrued with respect to such foreign taxable year has not been allocated appropriately between the old owner and the new owner. Certain changes of ownership involving related parties could be treated as a foreign tax credit splitting event under section 909. Comments recommended that the proposed legal liability rules addressing the treatment of hybrid entities be finalized in lieu of treating the above-described case of a change in the ownership of a hybrid entity as a foreign tax credit splitting event under section 909. The Treasury Department and the IRS agree, and accordingly, the final regulations adopt the proposed rules with modifications in response to comments.

One comment recommended that, if a termination under section 708(b)(1)(B) requires a closing of the books to allocate U.S. taxable income between the old partnership and new partnership but the foreign taxable year does not close, or if a change in a partner's interest results in a closing of the partnership's taxable year with respect to the partner and an allocation of partnership items based on a closing of the books under section 706, foreign tax for the year of change should similarly be allocated under the principles of sections 706 and 708 and the regulations under those sections based on a closing of the books, rather than under the principles of § 1.1502–76(b), which permits ratable allocation of the foreign tax with an exception for extraordinary items. The comment noted that apportioning the foreign tax using the same methodology as is used to apportion U.S. taxable income between the terminating partnership and the new partnership, or between the partner whose interest changes and the other partners, would lead to better matching of foreign tax and the associated income. The Treasury Department and the IRS are concerned about the increased administrative and compliance burdens associated with requiring a closing of the foreign tax books in order to apportion foreign tax for the year of change. Accordingly, this comment was not adopted.

In response to a comment, the final regulations apply the same foreign tax allocation rules to section 708 terminations that arise under section 708(b)(1)(A) in the case of a partnership that has ceased its operations, including a change in ownership in which a partnership becomes a disregarded entity. The final regulations also apply the same allocation rules if there are multiple ownership changes within a single foreign taxable year.

Finally, § 1.901–2(f)(3)(i) of the 2006 proposed regulations defines a hybrid partnership as an entity that is treated as a partnership for U.S. income tax purposes but is taxable at the entity level under foreign law. Because the Treasury Department and the IRS believe that a special definition of the term hybrid partnership is unnecessary and could cause confusion, references to the term hybrid partnership are replaced in the final regulations with references to the term partnership. No substantive change is intended by this revision.

IV. Effective/Applicability Date

The 2006 proposed regulations would generally apply to foreign taxes paid or accrued during taxable years beginning on or after January 1, 2007. However, consistent with Notice 2007–95, § 1.901–2(h)(4) provides that these final regulations are generally effective for foreign taxes paid or accrued in taxable years beginning after February 14, 2012.

A comment raised several transition-related questions arising in situations where applying the final regulations changes the person who is considered the taxpayer with respect to a particular foreign income tax. First, the comment stated it is unclear what happens to the carryover under section 904(c) of foreign taxes paid or accrued in a taxable year beginning before the effective date of the final regulations (pre-effective date year) to a taxable year beginning on or after the effective date of the final regulations (post-effective date year). The comment recommended that the regulations clarify the treatment of foreign tax credit carryovers from pre-effective date years and foreign tax credit carrybacks from post-effective date years, and that the regulations provide that taxes paid or accrued in a pre-effective date year that are carried forward to a post-effective date year be assigned to the taxpayer that paid or accrued the foreign taxes in the pre-effective date year. Similarly, the comment recommended that taxes paid or accrued in a post-effective date year that are carried back to the last pre-effective date year should be treated in the carryback year as paid or accrued by the taxpayer that paid or accrued the taxes in the post-effective date year.

The Treasury Department and the IRS believe it is clear under current law that the person who paid or accrued foreign income taxes in a pre-effective date year is the person who is eligible under section 904(c) to carry forward such taxes to a post-effective date year, notwithstanding that such person may not be considered the taxpayer under these final regulations had the taxes been paid or accrued in the post-effective date carryover year. Similarly, the Treasury Department and the IRS believe it is clear that the person who paid or accrued foreign income taxes in a post-effective date year is the person who is eligible under section 904(c) to carry back such taxes to the last pre-effective date year. Therefore, the Treasury Department and the IRS believe that revision of the final regulations to reflect this comment is unnecessary.

The comment also recommended that taxpayers be permitted to apply the final regulations retroactively, but that taxpayers should not be permitted to take inconsistent positions with respect to the incidence of the foreign tax. The comment recommended that a duty of consistency be imposed on related parties, or parties that were related at the time the foreign tax was imposed. If parties that were related but are now unrelated do not agree on an election to apply the regulations retroactively, the comment stated no election should be permitted.

In response to the comment, the final regulations permit taxpayers to apply the combined income rules of § 1.901–2(f)(3) of the final regulations to taxable years beginning after December 31, 2010, and on or before February 14, 2012. This provision will permit taxpayers to avoid uncertainty regarding the application of section 909 to foreign taxes paid or accrued by foreign consolidated groups in pre-effective date taxable years beginning in 2011 and 2012. No inference is intended as to the determination of the person who paid the foreign tax under the rules in effect prior to the amendment of the regulations by this Treasury decision. To the extent that a taxpayer did not allocate foreign consolidated tax liability among the members of a foreign consolidated group based on each member's share of the consolidated taxable income included in the foreign tax base under the principles of § 1.901–2(f)(3), the foreign consolidated group is a foreign tax credit splitting event under section 909. See Section 4.03 of Notice 2010–92 and § 1.909–5T.

The Treasury Department and the IRS have concerns about the administrative complexity and burden on taxpayers associated with requirements to elect to apply § 1.901–2(f)(4) retroactively that would be necessary to prevent potential whipsaws from two unrelated persons claiming a foreign tax credit for a single payment of foreign income tax, in cases where different persons are considered to pay the tax under the final regulations and under prior law. Although taxpayers may not elect to apply § 1.901–2(f)(4) retroactively, certain portions of that provision, specifically with respect to the person that has legal liability for a foreign tax paid by a disregarded entity or a partnership in the absence of a change in ownership, were consistent with the rules in effect under the final regulations prior to amendment by this Treasury decision. In addition, to prevent treating more than one person as paying a single amount of tax, § 1.901–2(f)(4) of the final regulations will not apply to any amount of tax paid or accrued in a post-effective date year of any person, if such tax would be treated as paid or accrued by a different person in a pre-effective date year under the prior regulations.

Availability of IRS Documents

IRS notices cited in this preamble are made available by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

Effect on Other Documents

The following publication is obsolete in part as of February 14, 2012.

Notice 2007–95 (2007–2 CB 1091).

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to this regulation and because the regulation does not impose a collection of information requirement on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Suzanne M. Walsh of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

■ **Par. 2.** Section 1.706–1 is amended by adding paragraph (c)(6) to read as follows:

§ 1.706–1 Taxable years of partner and partnership.

* * * * *

(c) * * *

(6) *Foreign taxes.* For rules relating to the treatment of foreign taxes paid or

accrued by a partnership, see § 1.901–2(f)(4)(i) and (f)(4)(ii).

* * * * *

■ **Par. 3.** Section 1.901–2 is amended by revising paragraph (f)(3) and adding paragraphs (f)(4), (f)(5), and (h)(4) to read as follows:

§ 1.901–2 Income, war profits, or excess profits tax paid or accrued.

* * * * *

(f) * * *

(3) *Taxes imposed on combined income of two or more persons*—(i) *In general.* If foreign tax is imposed on the combined income of two or more persons (for example, a husband and wife or a corporation and one or more of its subsidiaries), foreign law is considered to impose legal liability on each such person for the amount of the tax that is attributable to such person's portion of the base of the tax. Therefore, if foreign tax is imposed on the combined income of two or more persons, such tax is allocated among, and considered paid by, such persons on a pro rata basis in proportion to each person's portion of the combined income, as determined under foreign law and paragraph (f)(3)(iii) of this section. Combined income with respect to each foreign tax that is imposed on a combined basis is computed separately, and the tax on that combined income is allocated separately under this paragraph (f)(3)(i). If foreign law exempts from tax, or provides for specific rates of tax with respect to, certain types of income, or if certain expenses, deductions or credits are taken into account only with respect to a particular type of income, combined income with respect to such portions of the combined income is also computed separately, and the tax on that combined income is allocated separately under this paragraph (f)(3)(i). The rules of this paragraph (f)(3) apply regardless of which person is obligated to remit the tax, which person actually remits the tax, or which person the foreign country could proceed against to collect the tax in the event all or a portion of the tax is not paid. For purposes of this paragraph (f)(3), the term *person* means an individual or an entity (including a disregarded entity described in § 301.7701–2(c)(2)(i) of this chapter) that is subject to tax in a foreign country as a corporation (or otherwise at the entity level). In determining the amount of tax paid by an owner of a partnership or a disregarded entity, this paragraph (f)(3) first applies to determine the amount of tax paid by the partnership or disregarded entity, and then paragraph (f)(4) of this section applies to allocate the amount of such tax to the owner.

(ii) *Combined income.* For purposes of this paragraph (f)(3), foreign tax is imposed on the combined income of two or more persons if such persons compute their taxable income on a combined basis under foreign law and foreign tax would otherwise be imposed on each such person on its separate taxable income. For example, income is computed on a combined basis if two or more persons add their items of income, gain, deduction, and loss to compute a single consolidated taxable income amount for foreign tax purposes. Foreign tax is considered to be imposed on the combined income of two or more persons even if the combined income is computed under foreign law by attributing to one such person (for example, the foreign parent of a foreign consolidated group) the income of other such persons or by treating persons that would otherwise be subject to tax as separate entities as unincorporated branches of a single corporation for purposes of computing the foreign tax on the combined income of the group. However, foreign tax is not considered to be imposed on the combined income of two or more persons if, because one or more persons is a fiscally transparent entity (under the principles of § 1.894–1(d)(3)) under foreign law, only one of such persons is subject to tax under foreign law (even if two or more of such persons are corporations for U.S. Federal income tax purposes). Therefore, foreign tax is not considered to be imposed on the combined income of two or more persons solely because foreign law:

(A) Permits one person to surrender a loss to another person pursuant to a group relief or other loss-sharing regime described in § 1.909–2T(b)(2)(vi);

(B) Requires a shareholder of a corporation to include in income amounts attributable to taxes imposed on the corporation with respect to distributed earnings, pursuant to an integrated tax system that allows the shareholder a credit for such taxes;

(C) Requires a shareholder to include, pursuant to an anti-deferral regime (similar to subpart F of the Internal Revenue Code (sections 951 through 965)), income attributable to the shareholder's interest in the corporation;

(D) Reallocates income from one person to a related person under foreign transfer pricing rules;

(E) Requires a person to take into account a distributive share of income of an entity that is a partnership or other fiscally transparent entity for foreign tax law purposes; or

(F) Requires a person to take all or part of the income of an entity that is a corporation for U.S. Federal income tax purposes into account because foreign law treats the entity as a branch or fiscally transparent entity (a reverse hybrid). A reverse hybrid does not include an entity that is treated under foreign law as a branch or fiscally transparent entity solely for purposes of calculating combined income of a foreign consolidated group.

(iii) *Portion of combined income*—(A) *In general.* Each person's portion of the combined income is determined by reference to any return, schedule or other document that must be filed or maintained with respect to a person showing such person's income for foreign tax purposes, as properly amended or adjusted for foreign tax purposes. If no such return, schedule or other document must be filed or maintained with respect to a person for foreign tax purposes, then, for purposes of this paragraph (f)(3), such person's income is determined from the books of account regularly maintained by or on behalf of the person for purposes of computing its income for foreign tax purposes. Each person's portion of the combined income is determined by adjusting such person's income determined under this paragraph (f)(3)(iii)(A) as provided in paragraph (f)(3)(iii)(B) and (f)(3)(iii)(C) of this section.

(B) *Effect of certain payments*—(*1*) Each person's portion of the combined income is determined by giving effect to payments and accrued amounts of interest, rents, royalties, and other amounts between persons whose income is included in the combined base to the extent such amounts would be taken into account in computing the separate taxable incomes of such persons under foreign law if they did not compute their income on a combined basis. Each person's portion of the combined income is determined without taking into account any payments from other persons whose income is included in the combined base that are treated as dividends or other non-deductible distributions with respect to equity under foreign law, and without taking into account deemed dividends or any similar attribution of income made for purposes of computing the combined income under foreign law, regardless of whether any such deemed dividend or attribution of income results in a deduction or inclusion under foreign law.

(*2*) For purposes of determining each person's portion of the combined income, the treatment of a payment is determined under foreign law. Thus, for example, interest accrued by one group member with respect to an instrument held by another member that is treated as debt for foreign tax purposes but as equity for U.S. Federal income tax purposes would be considered income of the holder and would reduce the income of the issuer. See also § 1.909–2T(b)(3)(i) for rules requiring suspension of foreign income taxes paid or accrued by the owner of a U.S. equity hybrid instrument.

(C) *Net losses.* If tax is considered to be imposed on the combined income of three or more persons and one or more of such persons has a net loss for the taxable year for foreign tax purposes, the following rules apply. If foreign law provides mandatory rules for allocating the net loss among the other persons, then the rules that apply for foreign tax purposes apply for purposes of this paragraph (f)(3). If foreign law does not provide mandatory rules for allocating the net loss, the net loss is allocated among all other such persons on a pro rata basis in proportion to the amount of each person's income, as determined under paragraphs (f)(3)(iii)(A) and (f)(3)(iii)(B) of this section. For purposes of this paragraph (f)(3)(iii)(C), foreign law is not considered to provide mandatory rules for allocating a net loss solely because such loss is attributed from one person to a second person for purposes of computing combined income, as described in paragraph (f)(3)(ii) of this section.

(iv) *Collateral consequences.* U.S. tax principles apply to determine the tax consequences if one person remits a tax that is the legal liability of, and thus is considered paid by, another person.

(4) *Taxes imposed on partnerships and disregarded entities*—(i) *Partnerships.* If foreign law imposes tax at the entity level on the income of a partnership, the partnership is considered to be legally liable for such tax under foreign law and therefore is considered to pay the tax for U.S. Federal income tax purposes. The rules of this paragraph (f)(4)(i) apply regardless of which person is obligated to remit the tax, which person actually remits the tax, or which person the foreign country could proceed against to collect the tax in the event all or a portion of the tax is not paid. See §§ 1.702–1(a)(6) and 1.704–1(b)(4)(viii) for rules relating to the determination of a partner's distributive share of such tax. If the U.S. taxable year of a partnership closes for all partners due to a termination of the partnership under section 708(b)(1)(A) and the regulations under that section and the foreign taxable year of the partnership does not close, then foreign tax paid or accrued with respect to the foreign taxable year in which the termination occurs is allocated between the terminating partnership and its successors or assigns. For example, if, as a result of a change in ownership during a partnership's foreign taxable year, the partnership becomes a disregarded entity and the entity's foreign taxable year does not close, foreign tax paid or accrued by the owner of the disregarded entity with respect to the foreign taxable year is allocated between the partnership and the owner of the disregarded entity. If the U.S. taxable year of a partnership closes for all partners due to a termination of the partnership under section 708(b)(1)(B) and the regulations under that section and the foreign taxable year of the partnership does not close, then foreign tax paid or accrued by the new partnership with respect to the foreign taxable year in which the termination occurs is allocated between the terminating partnership and the new partnership. If multiple terminations under section 708(b)(1)(B) occur within the foreign taxable year, foreign tax paid or accrued with respect to that foreign taxable year by a new partnership is allocated among all terminating and new partnerships. In the case of any termination under section 708(b)(1), the allocation of foreign tax is made based on the respective portions of the taxable income (as determined under foreign law) for the foreign taxable year that are attributable under the principles of § 1.1502–76(b) to the period of existence of each terminating and new partnership, or successor or assign of a terminating partnership, during the foreign taxable year. Foreign tax allocated to a terminating partnership under this paragraph (f)(4)(i) is treated as paid or accrued by such partnership as of the close of the last day of its final U.S. taxable year. In the case of a change in any partner's interest in the partnership (a variance), except as otherwise provided in section 706(d)(2) (relating to certain cash basis items) or 706(d)(3) (relating to tiered partnerships), foreign tax paid or accrued by the partnership during its U.S. taxable year in which the variance occurs is allocated between the portion of the U.S. taxable year ending on, and the portion of the U.S. taxable year beginning on the day after, the day of the variance. The allocation is made under the principles of this paragraph (f)(4)(i) as if the variance were a termination under section 708(b)(1).

(ii) *Disregarded entities.* If foreign law imposes tax at the entity level on the income of an entity described in § 301.7701–2(c)(2)(i) of this chapter (a *disregarded entity*), the person (as defined in section 7701(a)(1)) who is treated as owning the assets of the disregarded entity for U.S. Federal income tax purposes is considered to be legally liable for such tax under foreign law. Such person is considered to pay the tax for U.S. Federal income tax purposes. The rules of this paragraph (f)(4)(ii) apply regardless of which person is obligated to remit the tax, which person actually remits the tax, or which person the foreign country could proceed against to collect the tax in the event all or a portion of the tax is not paid. If there is a change in the ownership of such disregarded entity during the entity's foreign taxable year and such change does not result in a closing of the disregarded entity's foreign taxable year, foreign tax paid or accrued with respect to such foreign taxable year is allocated between the transferor and the transferee. If there is more than one change in the ownership of a disregarded entity during the entity's foreign taxable year, foreign tax paid or accrued with respect to that foreign taxable year is allocated among all transferors and transferees. The allocation is made based on the respective portions of the taxable income of the disregarded entity (as determined under foreign law) for the foreign taxable year that are attributable under the principles of § 1.1502–76(b) to the period of ownership of each transferor and transferee during the foreign taxable year. If, as a result of a change in ownership, the disregarded entity becomes a partnership and the entity's foreign taxable year does not close, foreign tax paid or accrued by the partnership with respect to the foreign taxable year is allocated between the owner of the disregarded entity and the partnership under the principles of this paragraph (f)(4)(ii). If the person who owns a disregarded entity is a partnership for U.S. Federal income tax purposes, see § 1.704–1(b)(4)(viii) for rules relating to the allocation of such tax among the partners of the partnership.

(5) *Examples.* The following examples illustrate the rules of paragraphs (f)(3) and (f)(4) of this section:

Example 1. (i) *Facts.* A, a United States person, owns 100 percent of B, an entity organized in country X. B owns 100 percent of C, also an entity organized in country X. B and C are corporations for U.S. and foreign tax purposes that use the "u" as their functional currency. Pursuant to a consolidation regime, country X imposes an income tax described in (a)(1) of this section on the combined income of B and C within the meaning of paragraph (f)(3)(ii) of this section. In year 1, C pays 25u of interest to B. If B and C did not report their income on a combined basis for country X tax purposes, the interest paid from C to B would result in 25u of interest income to B and 25u of deductible interest expense to C. For purposes of reporting the combined income of B and C, country X first requires B and C to determine their own income (or loss) on a separate schedule. For this purpose, however, neither B nor C takes into account the 25u of interest paid from C to B because the income of B and C is included in the same combined base. The separate income of B and C reported on their country X schedules for year 1, which do not reflect the 25u intercompany payment, is 100u and 200u, respectively. The combined income reported for country X purposes is 300u (the sum of the 100u separate income of B and 200u separate income of C).

(ii) *Result.* On the separate schedules described in paragraph (f)(3)(iii)(A) of this section, B's separate income is 100u and C's separate income is 200u. Under paragraph (f)(3)(iii)(B)(*1*) of this section, the 25u interest payment from C to B is taken into account for purposes of determining B's and C's portions of the combined income under paragraph (f)(3)(iii) of this section, because B and C would have taken the items into account if they did not compute their income on a combined basis. Thus, B's portion of the combined income is 125u (100u plus 25u) and C's portion of the combined income is 175u (200u less 25u). The result is the same regardless of whether the 25u interest payment from C to B is deductible for U.S. Federal income tax purposes. See paragraph (f)(3)(iii)(B)(*2*) of this section.

Example 2. (i) *Facts.* A, a United States person, owns 100 percent of B, an entity organized in country X. B is a corporation for country X tax purposes, and a disregarded entity for U.S. income tax purposes. B owns 100 percent of C and D, entities organized in country X that are corporations for both U.S. and country X tax purposes. B, C, and D use the ''u'' as their functional currency and file on a combined basis for country X income tax purposes. Country X imposes an income tax described in paragraph (a)(1) of this section at the rate of 30 percent on the taxable income of corporations organized in country X. Under the country X combined reporting regime, income (or loss) of C and D is attributed to, and treated as income (or loss) of, B. B has the sole obligation to pay country X income tax imposed with respect to income of B and income of C and D that is attributed to, and treated as income of, B. Under the law of country X, country X may proceed against B, but not C or D, if B fails to pay over to country X all or any portion of the country X income tax imposed with respect to such income. In year 1, B has income of 100u, C has income of 200u, and D has a net loss of (60u). Under the law of country X, B is considered to have 240u of taxable income with respect to which 72u of country X income tax is imposed. Country X does not provide mandatory rules for allocating D's loss.

(ii) *Result.* Under paragraph (f)(3)(ii) of this section, the 72u of country X tax is considered to be imposed on the combined income of B, C, and D. Because country X law does not provide mandatory rules for allocating D's loss between B and C, under paragraph (f)(3)(iii)(C) of this section D's (60u) loss is allocated pro rata: 20u to B ((100u/300u) × 60u) and 40u to C ((200u/300u) × 60u). Under paragraph (f)(3)(i) of this section, the 72u of country X tax must be allocated pro rata among B, C, and D. Because D has no income for country X tax purposes, no country X tax is allocated to D. Accordingly, 24u (72u × (80u/240u)) of the country X tax is allocated to B, and 48u (72u × (160u/240u)) of such tax is allocated to C. Under paragraph (f)(4)(ii) of this section, A is considered to have legal liability for the 24u of country X tax allocated to B under paragraph (f)(3) of this section.

Example 3. (i) *Facts.* A, B, and C are U.S. persons that each use the calendar year as their taxable year. A and B each own 50 percent of the capital and profits of D, an entity organized in country M. D is a partnership for U.S. tax purposes, but is a corporation for country M tax purposes. D uses the ''u'' as its functional currency and the calendar year as its taxable year for both U.S. tax purposes and country M tax purposes. Country M imposes an income tax described in paragraph (a)(1) of this section at a rate of 30 percent at the entity level on the taxable income of D. On September 30 of Year 1, A sells its 50 percent interest in D to C. A's sale of its partnership interest results in a termination of the partnership under section 708(b)(1)(B) for U.S. tax purposes. As a result of the termination, ''old'' D's taxable year closes on September 30 of Year 1 for U.S. tax purposes. New D also has a short U.S. taxable year, beginning on October 1 and ending on December 31 of Year 1. The sale of A's interest does not close D's taxable year for country M tax purposes. D has 400u of taxable income for its foreign taxable year ending December 31, Year 1 with respect to which country M imposes 120u of income tax, equal to $120 as translated in accordance with section 986(a).

(ii) *Result.* Under paragraph (f)(4)(i) of this section, partnership D is legally liable for the $120 of country M income tax imposed on its foreign taxable income. Because D's taxable year closes on September 30, Year 1, for U.S. tax purposes, but does not close for country M tax purposes, under paragraph (f)(4)(i) of this section the $120 of country M tax must be allocated under the principles of § 1.1502–76(b) between terminating D and new D. See § 1.704–1(b)(4)(viii) for rules relating to the allocation of terminating D's country M taxes between A and B and the allocation of new D's country M taxes between B and C.

* * * * *

(h) * * *

(4) Paragraphs (f)(3), (f)(4), and (f)(5) of this section apply to foreign taxes paid or accrued in taxable years beginning after February 14, 2012. However, if an amount of tax is paid or accrued in a taxable year of any person beginning on or before February 14, 2012, and the tax is treated as paid or accrued by such person under 26 CFR 1.901–2(f) (revised as of April 1, 2011), then paragraph (f)(4) of this section will not apply, and 26 CFR 1.901–2(f) (revised as of April 1, 2011) will apply, to determine the person with legal liability for that tax. No other person will be treated as legally liable for such tax, even if the tax is paid or accrued on a date that falls within a taxable year of such other person beginning after February 14, 2012. Taxpayers may choose to apply paragraph (f)(3) of this section to foreign taxes paid or accrued in taxable years beginning after December 31, 2010, and on or before February 14, 2012.

Steven T. Miller,

Deputy Commissioner for Services and Enforcement.

Approved: February 8, 2012.

Emily S. McMahon,

Acting Assistant Secretary of the Treasury (Tax Policy).

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9577]

RIN 1545–BK50

Foreign Tax Credit Splitting Events

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary Income Tax Regulations with respect to a new provision of the Internal Revenue Code (Code) that addresses situations in which foreign income taxes have been separated from the related income. These regulations are necessary to provide guidance on applying the new statutory provision, which was enacted as part of legislation commonly referred to as the Education Jobs and Medicaid Assistance Act (EJMAA) on August 10, 2010. These regulations affect taxpayers claiming foreign tax credits. The text of the temporary regulations also serves as the text of the proposed regulations (REG–132736–11) published in the Proposed Rules section of this issue of the **Federal Register**.

DATES: *Effective Date:* These regulations are effective on February 14, 2012.

Applicability Dates: For dates of applicability, see §§ 1.704–1T(b)(1)(ii)(*b*)(*3*), 1.909–1T(e), 1.909–2T(c), 1.909–3T(c), 1.909–4T(b), 1.909–5T(c), and 1.909–6T(h).

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