



Internal Revenue Service

DEPARTMENT OF THE TREASURY

LB&I International Practice Service Transaction Unit

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Unit Name	Dual Consolidated Losses - Overview
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Volume	Part	Chapter	Sub-Chapter
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Issue and Transaction Overview

Dual Consolidated Losses - Overview

The United States taxes worldwide income of domestic corporations. A domestic corporation is a corporation incorporated or organized in the United States or under the laws of the United States or of any State. When two or more domestic corporations file a U.S. consolidated return, the losses that one corporation incurs generally may be used to offset income that another corporation of the affiliated group earns. Some countries use criteria other than place of incorporation or organization to determine whether corporations are residents for tax purposes. For example, some countries treat corporations as residents for tax purposes if they are managed or controlled in that country. Consequently, a domestic corporation that is managed or controlled in such a country is subject to the income tax of both the foreign country and the United States on a residence basis. If the foreign country permits the losses of such a “dual resident” corporation to offset income of another person (e.g. as a result of consolidation or other loss transfer techniques under the foreign country’s tax laws) then the dual resident corporation could use a single economic loss twice- once to offset income subject to U.S. tax and a second time to offset income that is subject to foreign tax, but not U.S. tax. In other words, the dual resident corporation could “double-dip” the loss. Likewise, certain types of foreign corporations may be treated as domestic corporations under certain provisions of the Code (e.g., IRC §§ 953(d) and 1504(d)).

IRC § 1503(d) was enacted to address the problem and generally provides that a dual consolidated loss may be not used to offset income of another member of the corporation’s affiliated group. The same “double-dip” problem is also possible when a domestic corporation operates in a foreign country directly or indirectly through separate units, such as a branch or hybrid entity. As a result, notably the dual consolidated loss (DCL) rules under IRC § 1503(d) were expanded to apply to losses incurred by separate units of a domestic corporation. Thus, the DCL rules may apply to U.S. corporations that do not file a U.S. consolidated tax return if they own foreign separate units. The operative rules governing dual consolidated losses are set forth in regulations issued under IRC § 1503(d).

This Practice Unit provides a general overview of the dual consolidated loss rules by addressing the following basic questions: (1) which entities are subject to the DCL rules, (2) what is a DCL, (3) what is the general rule for a DCL and (4) what exceptions exist to the general rule for a DCL. This Unit will be supplemented with a number of other Practice Units to be developed focusing on particular aspects of the DCL rules. Other Practice Units will address specific DCL issues in greater detail.

Volume	Part	Chapter	Sub-Chapter
Outbound Income Shifting	Limitations on Cross Border Losses	Dual Consolidated Losses (DCL)	N/A

Transaction and Fact Pattern

Dual Consolidated Losses - Overview	
Diagram of Transaction	Facts
<pre> graph TD USC[USC (U.S.)] --- USC_FBR([USC's FBR (Country X)]) USC --- DE[DE (Country X)] DE --- CFC[CFC (Country X)] DE --- DE_FBR([DE's FBR (Country X)]) </pre>	<ul style="list-style-type: none"> ▪ USC is classified as a domestic corporation under IRC § 7701(a)(3) and (4). ▪ USC operates a foreign branch (USC's FBR) in Country X. ▪ USC owns DE, a foreign hybrid disregarded entity (DE) (elected to be disregarded from USC for U.S. federal tax purposes, but subject to Country X tax as a corporation on its worldwide income or residence basis). ▪ USC files a U.S. income tax return (USC's FBR's and DE's items are included on the U.S. return). ▪ DE operates a foreign branch (DE's FBR) in Country X. The operations of DE's FBR are separate from the operations of USC's FBR. ▪ In addition, DE owns 100% of CFC, a controlled foreign corporation (CFC), subject to Country X tax as a corporation on its worldwide income or residence basis. ▪ In Country X, DE may elect to file a consolidated foreign tax return with CFC. ▪ The U.S. does not have an income tax treaty with Country X.

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Outbound Income Shifting	Limitations on Cross Border Losses	Dual Consolidated Losses (DCL)	N/A

Transaction and Fact Pattern (cont'd)

Dual Consolidated Losses - Overview	
Facts	
<pre> graph TD USC["USC (U.S.) \$1,000 Income"] --- USC_FBR(["USC's FBR (Country X)"]) USC --- DE["DE (Country X) \$100 Income"] DE --- CFC["CFC (Country X) \$300 Income"] DE --- DE_FBR(["DE's FBR (Country X) (\$300) Loss"]) </pre> <p>The diagram illustrates the corporate structure for Dual Consolidated Losses. At the top is USC (U.S.) with \$1,000 Income. USC owns two entities: USC's FBR (Country X) and DE (Country X). DE (Country X) has \$100 Income and owns two entities: CFC (Country X) with \$300 Income and DE's FBR (Country X) with a (\$300) Loss.</p>	<ul style="list-style-type: none"> ▪ On its year 3 U.S. tax return, USC claims the following: <ul style="list-style-type: none"> – USC, without regard to USC's FBR or DE, has \$1,000 of taxable income; – USC's FBR has a net loss of (\$100). – DE has a net income of \$100 without regard to DE's FBR. – DE has a net loss of (\$300) attributable to DE's FBR activities. – As a result DE has a combined net loss of (\$200) (\$100 + (\$300)) for its income and DE's FBR loss. – CFC has net profit of \$300.

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Effective Tax Rate Overview

Dual Consolidated Losses - Overview

ETR of Company

- Losses generated by any affiliate (domestic or foreign) will result in a reduction of the affiliated group's overall effective tax rate (ETR). In order to minimize its U.S. tax exposure and lower its worldwide ETR, U.S. corporations may structure their foreign affiliates in a manner to generate DCLs and use such foreign losses to offset domestic affiliate income. A double dip of the DCL, which is generally disallowed under the DCL rules, would further reduce worldwide ETR by using a single economic loss to offset two separate streams of income in the U.S. and the foreign jurisdiction.

ETR Impact of Adjustment

- Use of a DCL in contravention of the U.S. DCL rules may result in a double-dip of the DCL thereby causing a correlative reduction to the corporation's ETR. An adjustment under IRC § 1503(d) disallowing the use of a DCL to offset domestic affiliate income on the U.S. return will increase U.S. taxable income thereby causing a correlative increase in ETR.

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Summary of Potential Issues

Dual Consolidated Losses - Overview	
Issue 1	Which entities and business operations are subject to the dual consolidated loss rules?
Issue 2	What is a dual consolidated loss?
Issue 3	What is the general rule for a dual consolidated loss?
Issue 4	Does an exception to the general rule for a dual consolidated loss apply?

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All Issues, Step 1: Initial Factual Development

Dual Consolidated Losses - Overview

IRC § 1503(d) generally provides that a dual consolidated loss (DCL) incurred by either a dual resident corporation or a separate unit owned directly or indirectly by a domestic corporation may not be used to offset income of any domestic affiliate on the U.S. return. Exceptions apply to this general rule including an election by the taxpayer to use the loss to offset domestic affiliate income on the U.S. return (“domestic use election and agreement” or “DUE”) subject to certain conditions and reporting requirements.

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ An analysis of the worldwide tax organizational chart will assist you in determining whether you have any DCL issue. ▪ Placing a dividing line on the organizational chart to isolate the entities and operations the items of which are included on the U.S. tax return is helpful in determining entities subject to the DCL rules. ▪ Beginning with the first day of the first year under examination, secure a worldwide organizational chart with the following information for each entity: <ul style="list-style-type: none"> – classification of each entity for U.S. tax purposes and foreign purposes (e.g. corporation, disregarded entity (DE), non-hybrid partnership, hybrid partnership, reverse hybrid entity) – ownership interest(s) in each entity – whether entity is considered domestic or foreign for U.S. tax purposes – any changes to any of the above occurring during years under examination. 	<ul style="list-style-type: none"> ▪ IRM 4.61.13.2.1.1 ▪ Organizational Charts ▪ Form 1120, Sch N – Lines 1 and 2 	

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Issue 1, Step 2: Review Potential Issues

Dual Consolidated Losses - Overview

Issue 1

Which entities and business operations are subject to the DCL rules?

Explanation of Issue	Resources	6103 Protected Resources
<p>To determine whether the DCL rules apply at all, you must determine if there are any entities and operations subject to the DCL rules.</p> <p>In our example, you must first determine if USC is the type of entity, or directly or indirectly owns any type of entity or carries on operations, the losses from which would be subject to the DCL rules.</p>	<ul style="list-style-type: none"> ▪ IRC § 1503(d) – General DCL rule ▪ Treas. Reg. § 1.1503(d)-1(b) – DCL Definitions ▪ Treas. Reg. § 1.1503(d)-4 – Domestic Use Limitation Rule – General DCL rule 	

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Issue 1, Step 2: Review Potential Issues (cont'd)

Dual Consolidated Losses - Overview

Issue 1

Which entities and business operations are subject to the DCL rules?

Explanation of Issue	Resources	6103 Protected Resources
<p>The DCL rules are applicable only to the losses attributed to (1) dual resident corporations and (2) separate units.</p> <p><u>Dual resident corporation</u></p> <p>A dual resident corporation (DRC) is a domestic corporation, including any entity treated as a domestic corporations (e.g. pursuant to IRC §§ 953(d) or 1504(d) election), that is subject to foreign income tax on its worldwide income or on a residence basis.</p> <p>Note that a foreign insurance company that makes an election to be treated as a domestic corporation pursuant to IRC § 953(d) is treated as a DRC even if not subject to foreign income tax on its worldwide income or on a residence basis.</p>	<ul style="list-style-type: none"> ▪ IRC § 1503(d) – General DCL rule ▪ Treas. Reg. § 1.1503(d)-1(b)(1) – Definition of domestic corporation ▪ Treas. Reg. § 1.1503(d)-1(b)(2)(i) and (ii) – Definition of DRC ▪ IRC § 953(d) – Election by foreign insurance company to be treated as domestic corporation ▪ IRC § 1504(d) – Contiguous Country Election ▪ IRM 4.61.13.2.2 – Determining the Existence of DRCs and Separate Units 	

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Issue 1, Step 2: Review Potential Issues (cont'd)

Dual Consolidated Losses - Overview

Issue 1

Which entities and business operations are subject to the DCL rules?

Explanation of Issue	Resources	6103 Protected Resources
<p>In addition, the DCL rules are applicable to losses attributed to separate units.</p> <p><u>Separate Unit</u></p> <p>A separate unit (SU) is either of the following that is carried on or owned, as applicable, directly or indirectly (through a partnership (P/S), a DE or a grantor trust), by a domestic corporation (including a DRC):</p> <ul style="list-style-type: none"> • <u>A foreign branch SU</u> – a business operation outside the U.S. that would constitute a foreign branch under Treas. Reg. § 1.367(a)-6T(g)(1). • <u>Hybrid entity SU</u> – an interest in a hybrid entity, i.e. flow-through for U.S. tax purposes but regarded as a separate entity subject to income tax of a foreign country (e.g. foreign DE, foreign hybrid P/S). <p>The DCL regulations make a distinction between a foreign branch SU and a hybrid entity SU, so a hybrid entity that carries on branch operations may be considered two different SUs (although they may be combined as discussed below) and a DCL may be attributable to either the hybrid entity SU or the foreign branch SU, or both.</p>	<ul style="list-style-type: none"> ▪ IRC § 1503(d)– General DCL rule ▪ Treas. Reg. § 1.1503(d)-1(b)(3) – Definition of hybrid entity ▪ Treas. Reg. § 1.1503(d)-1(b)(4)(i)(A) and (B) – Definition of Separate Unit ▪ Treas. Reg. § 1.1503(d)-1(b)(9) – Definition of domestic owner ▪ Treas. Reg. § 1.1503(d)-1(b)(4)(ii) – SU combination rule ▪ Treas. Reg. § 1.367(a)-6T(g)(1) – Definition of Foreign Branch ▪ IRM 4.61.13.2.2 – Determining the Existence of DRCs and Separate Units 	

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Issue 1, Step 2: Review Potential Issues (cont'd)

Dual Consolidated Losses - Overview

Issue 1

Which entities and business operations are subject to the DCL rules?

Explanation of Issue	Resources	6103 Protected Resources
<p>A domestic corporation that owns an interest in a SU is referred to as a “domestic owner.”</p> <p>Note that if two or more SU’s are located in the same country and are owned by a domestic owner, or two or more domestic owners that are members of the same consolidated group, the SU’s are treated as a single “combined” SU (“CSU”).</p>	<ul style="list-style-type: none"> ▪ IRC § 1503(d)– General DCL rule ▪ Treas. Reg. § 1.1503(d)-1(b)(3) – Definition of hybrid entity ▪ Treas. Reg. § 1.1503(d)-1(b)(4)(i)(A) and (B) – Definition of Separate Unit ▪ Treas. Reg. § 1.1503(d)-1(b)(9) – Definition of domestic owner ▪ Treas. Reg. § 1.1503(d)-1(b)(4)(ii) – SU combination rule ▪ Treas. Reg. § 1.367(a)-6T(g)(1) – Definition of Foreign Branch ▪ GLAM AM 2011-002 (August 1, 2011) – DCL Application of SRLY Rules – See discussion relating to indirect ownership of SUs and combined SU rule ▪ IRM 4.61.13.2.2 – Determining the Existence of DRCs and Separate Units 	

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Issue 1, Step 3: Additional Factual Development

Dual Consolidated Losses - Overview

Issue 1

Which entities and business operations are subject to the DCL rules?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Certain documents and other information that may be included with the U.S. income tax return may assist you in determining whether the taxpayer has any DRCs or SU's. For example: ▪ Form 8858 <i>"Information Return of U.S. Persons With Respect to Disregarded Entities"</i> if filed for a foreign DE that is owned directly or indirectly by a domestic corporation. 	<ul style="list-style-type: none"> ▪ Form 8858, <ul style="list-style-type: none"> – Line 3 – Sch. G , Ques. 4 -5 – Sch. H , Line 7 	
<ul style="list-style-type: none"> ▪ Form 8865 <i>"Return of U.S. Persons With Respect to Certain Foreign Partnerships"</i> if filed for a non-hybrid or hybrid foreign P/S and a domestic corporation is a direct or indirect owner of an interest in the P/S. 	<ul style="list-style-type: none"> ▪ Form 8865 <ul style="list-style-type: none"> – Lines 6, 7 and 8 – Sch. A – Sch. B 	

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Issue 1, Step 3: Additional Factual Development (cont'd)

Dual Consolidated Losses - Overview

Issue 1

Which entities and business operations are subject to the DCL rules?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Form 8832 “<i>Entity Classification Election</i>” if filed for an existing foreign business entity electing to be classified as a DE and is owned directly or indirectly by a domestic corporation. ▪ Form 8832 if filed for an existing foreign DE electing to be classified as a foreign corporation and is owned directly or indirectly by a domestic corporation. ▪ A corporation with a IRC § 1504(d) election. ▪ A corporation with a IRC § 953(d) election. ▪ “Domestic Use Election and Agreement” A domestic use election and agreement (DUE) filed with a return can be viewed as an acknowledgement by the taxpayer that it has a DRC or SU (The DUE is discussed in more detail later at Issue 4). 	<ul style="list-style-type: none"> ▪ Form 8832 ▪ Domestic Use Election and Agreement 	

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Issue 1, Step 3: Additional Factual Development (cont'd)

Dual Consolidated Losses - Overview

Issue 1

Which entities and business operations are subject to the DCL rules?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Determine if there are any foreign branches not disclosed on the organizational chart. ▪ Confirm that there were no other Forms 8832, 8858, or 8865 that should have been filed. ▪ Discuss with the taxpayer any discrepancies between the chart prepared by the taxpayer and your findings from reviewing the returns. ▪ Request that the taxpayer confirm that there are no other Forms 8832, 8858 or 8865 that should have been filed, but were not filed. ▪ A foreign branch that is not a hybrid entity does not file a Form 8858, but rather its results would have been combined with that of the owner's activity and the net would be reflected on the US return. 	<ul style="list-style-type: none"> ▪ Organizational chart 	

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Issue 1, Step 3: Additional Factual Development (cont'd)

Dual Consolidated Losses - Overview		
Issue 1		
Which entities and business operations are subject to the DCL rules?		
Fact Element	Resources	6103 Protected Resources
<p>In the course of development, you confirmed that DE operates a business the operation of which would be considered under Treas. Reg. § 1.367(a)-1T(g) a foreign branch (DE's FBR) in Country X, a non-treaty country.</p> <p>A Form 8858 may be filed on a consolidated basis and reflect the combined net income/loss for a DE if such DE owns a foreign branch or other DE's or P/S interests. A breakdown of net income/loss attributable to the different activities/entities of the DE may be required, especially if more than one country is involved.</p>	<ul style="list-style-type: none"> ▪ Organizational Chart ▪ Form 8858 ▪ Request a breakdown of net income/loss attributable to each separate unit or activity that constitutes a foreign branch separate unit or interest in a hybrid entity. 	

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Issue 1, Step 4: Develop Arguments

Dual Consolidated Losses - Overview

Issue 1

Which entities and business operations are subject to the DCL rules?

Explanation of Approach	Resources	6103 Protected Resources
Based upon your review of the return and the organizational chart you have determined that in our example (see Diagram of Transaction) USC, a domestic corporation, owns DE, a hybrid entity. DE is treated as an entity disregarded from USC for U.S. tax purposes and as a corporation under Country X law. As such, items of income, gain, loss and deduction attributable to DE flow through to, and impact, the computation of USC's U.S. taxable income.	<ul style="list-style-type: none"> ▪ Organizational Chart ▪ Form 8858 	
In addition, as depicted in the Diagram , USC operates USC's FBR, a foreign branch in Country X. The items of income, gain, loss and deductions of USC's FBR are included in the computation of USC's U.S. taxable income	<ul style="list-style-type: none"> ▪ Books and records of USC's FBR illustrates USC's FBR's net income/loss. 	
In addition, as depicted in the Diagram , DE owns CFC, a foreign corporation organized in Country X.	<ul style="list-style-type: none"> ▪ Organizational Chart ▪ Form 5471 for CFC 	


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Issue 1, Step 4: Develop Arguments (cont'd)

Dual Consolidated Losses - Overview

Issue 1

Which entities and business operations are subject to the DCL rules?

Explanation of Approach	Resources	6103 Protected Resources
 <p>DECISION POINT: You must consider whether USC's FBR, interest in DE, its indirect ownership of DE's FBR and its indirect ownership of CFC are the types or entities or operations that are subject to the DCL rules.</p> <p>CFC is a foreign corporation for U.S. tax purposes and therefore, CFC is not considered a DRC or a separate unit. CFC is not subject to the DCL rules.</p> <p>Note: A CFC is not an actual member of the US Form 1120 consolidated filing group and does not get taxed directly by the US. Only US persons owning an interest in a CFC get taxed on their pro rata share of CFC income under the Subpart F rules; whereas losses of a CFC generally remain at the CFC level and get factored into other calculations (i.e.. foreign E&P, dividends, etc).</p>	<ul style="list-style-type: none"> ▪ IRC § 1503(d) – General DCL rule ▪ Treas. Reg. § 1.1503(d)-1(b)(3) – Definition of hybrid entity ▪ Treas. Reg. § 1.1503(d)-1(b)(4)(i)(A) and (B) – Definition of Separate Unit ▪ Treas. Reg. § 1.1503(d)-1(b)(9) – Definition of domestic owner ▪ Treas. Reg. § 1.1503(d)-1(b)(4)(ii) – SU combination rule ▪ Treas. Reg. § 1.367(a)-6T(g)(1) – Definition of Foreign Branch ▪ IRM 4.61.13.2.2 – Determining the Existence of DRCs and Separate Units 	


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Issue 1, Step 4: Develop Arguments (cont'd)

Dual Consolidated Losses - Overview

Issue 1

Which entities and business operations are subject to the DCL rules?

Explanation of Approach	Resources	6103 Protected Resources
 <p>DECISION POINT: You must determine whether USC's FBR business operations in Country X carried on by USC and indirectly by USC through DE's FBR in Country X each constitute a foreign branch SU. In addition, you must determine whether USC's direct ownership in DE constitutes an interest in a hybrid entity SU.</p> <p>USC's FBR, its direct interest in DE and its indirect interest in DE's FBR are each a SU.</p> <p>Due to the fact that USC has three individual SUs in the same country, these three SUs are treated as one combined separate unit (CSU).</p> <p>You have identified a CSU that is subject to the DCL rules. As a result, you continue in the DCL analysis to Issue 2 to determine if the CSU has a DCL.</p>	<ul style="list-style-type: none"> ▪ IRC § 1503(d) – General DCL rule ▪ Treas. Reg. § 1.1503(d)-1(b)(3) – Definition of hybrid entity ▪ Treas. Reg. § 1.1503(d)-1(b)(4)(i)(A) and (B) – Definition of Separate Unit ▪ Treas. Reg. § 1.1503(d)-1(b)(9) – Definition of domestic owner ▪ Treas. Reg. § 1.1503(d)-1(b)(4)(ii) – SU combination rule ▪ Treas. Reg. § 1.367(a)-6T(g)(1) – Definition of Foreign Branch ▪ IRM 4.61.13.2.2 – Determining the Existence of DRCs and Separate Units ▪ GLAM AM 2011-002 (August 1, 2011) – DCL Application of SRLY Rules – See discussion relating to indirect ownership of SUs and combined SU rule ▪ See related Practice Unit “Entities and Operations Subject to DCL Rules” (to be developed) for further details. 	

Volume	Part	Chapter	Sub-Chapter
Outbound Income Shifting	Limitations on Cross Border Losses	Dual Consolidated Losses (DCL)	N/A

Issue 2, Step 2: Review Potential Issues

Dual Consolidated Losses - Overview

Issue 2

What is a dual consolidated loss?

Explanation of Issue	Resources	6103 Protected Resources
<p>Once you have determined that you have a DRC or SU subject to the DCL rules, you must determine whether such DRC or SU has a dual consolidated loss (DCL).</p> <p>In the case of a dual resident corporation (DRC), a DCL is a net operating loss (NOL) incurred in a year in which the domestic corporation is a DRC.</p> <p>In the case of a separate unit (SU), a DCL is the “net loss attributable to” the SU.</p> <p>Detailed rules for determining the amount of income or DCL of a DRC or the amount of income or DCL attributable to a SU are set forth in the DCL regulations.</p>	<ul style="list-style-type: none"> ▪ IRC § 1503(d) – General DCL rule ▪ Treas. Reg. § 1.1503(d)-1(b)(5) – Definition of DCL ▪ Treas. Reg. § 1.1503(d)-5 – Determination of DCL ▪ IRM 4.61.13.2.3 – Determining the Existence of a DCL ▪ BNA 947-1st - TMFEDPORT No. 947 § X – <i>Dual Consolidated Losses</i> ▪ U.S. Tax. Int'l Mergers, Acquis. & Jt. Ventures ¶ 21.02[3] (USTIMAJV WGL ¶ 21.02) – <i>DCL Overview</i> ▪ U.S. Int'l Tax. ¶ B1.05 (Kuntz and Peroni) – <i>DCL Overview</i> ▪ Fed. Tax'n Income, Est.& Gifts ¶ 97.6 (Bittker and Lokken) – <i>DCL Overview</i> ▪ See related Practice Unit - “Amount of DCL – Computation” (to be developed) for further details. 	

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Issue 2, Step 3: Additional Factual Development

Dual Consolidated Losses - Overview

Issue 2

What is a dual consolidated loss?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ You have previously determined in Issue 1 that the taxpayer has a CSU which is subject to the DCL rules. The next step is determining whether the CSU has a DCL. ▪ Certain documents filed with a taxpayer's U.S. income tax return may provide useful information. <ul style="list-style-type: none"> – <u>DUE</u> – A DUE filed with a return can be viewed as an acknowledgement by the taxpayer that the DRC or SU (e.g. CSU) that is the subject of the DUE in fact incurred a DCL in the year for which the return is filed. The DUE is discussed in more detail later at Issue 4. – <u>Form 8858</u> – A review of the Form 8858 filed for each DE will provide information regarding the DE's items of income, gain, loss and deduction. You may need to request information from the taxpayer to segregate items of income, gain, loss and deduction attributable to the DE from those items attributable to any foreign branch of DE. 	<ul style="list-style-type: none"> ▪ Domestic Use Election (DUE) ▪ Form 8858, Sch G, Question 4-5, Sch H ▪ Treas. Reg. § 1.1503(d)-6(d)(1) - DUE 	

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Issue 2, Step 3: Additional Factual Development (cont'd)

Dual Consolidated Losses - Overview

Issue 2

What is a dual consolidated loss?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Certain documents filed with a taxpayer's U.S. income tax return may provide useful information. <ul style="list-style-type: none"> – <u>Form 8865</u> – A review of the Form 8865 for a foreign hybrid P/S will provide information regarding the foreign P/S's items of income, gain, loss and deduction. ▪ A foreign branch that is not a hybrid entity does not file a Form 8858 and its items are reported directly by the branch's owner. Therefore, you will need to request from the taxpayer information about items that are specifically attributable to a foreign branch. ▪ NOTE: Some foreign branch activities may be captured through the assistance of a CAS to pull accounts of income/expenses relating to a foreign branch. ▪ A review of the taxpayer's calculation of the DCL amount may be warranted to ensure accuracy and compliance with the determination of the DCL attributable to the SU. 	<ul style="list-style-type: none"> ▪ Form 8865, Line 6,7, and 8, Sch. A, Sch B ▪ Treas. Reg. § 1.1503(d)-5(c) <ul style="list-style-type: none"> – Determination of DCL Amount ▪ Request: <ul style="list-style-type: none"> – Information on foreign branch items – Taxpayer's calculation of DCL 	

Volume	Part	Chapter	Sub-Chapter
Outbound Income Shifting	Limitations on Cross Border Losses	Dual Consolidated Losses (DCL)	N/A

Issue 2, Step 4: Develop Arguments

Dual Consolidated Losses - Overview

Issue 2

What is a dual consolidated loss?

Explanation of Approach	Resources	6103 Protected Resources
<p>You have verified that USC's FBR has a (\$100) net loss, DE has a \$100 net income attributed to it and DE's FBR has a (\$300) net loss attributed to it. Since you previously determined under Issue 1 that USC's FBR, DE and DE's FBR are treated as a combined separate unit (CSU) for purposes of the DCL rules, the combined position is a net (\$300) loss ((-\$100) + \$100 +(-\$300)). As a result, this \$300 net loss attributed to the CSU is a DCL.</p> <p>You have identified a CSU with a DCL. As a result, you continue in the DCL analysis to Issue 3 to determine how the \$300 DCL is treated under the DCL rules.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. § 1.1503(d)-1(b)(5) – Definition of DCL ▪ Treas. Reg. § 1.1503(d)-5 – Determination of DCL ▪ IRM 4.61.13.2.2 – Determining the Existence of DRCs and Separate Units ▪ See related Practice Unit - “Entities and Operations Subject to DCL Rules” (to be developed) for further details. ▪ See related Practice Unit - “Amount of DCL – Computation” (to be developed) for further details 	

Volume	Part	Chapter	Sub-Chapter
Outbound Income Shifting	Limitations on Cross Border Losses	Dual Consolidated Losses (DCL)	N/A

Issue 3, Step 2: Review Potential Issues

Dual Consolidated Losses - Overview

Issue 3

What is the general rule for a DCL?

Explanation of Issue	Resources	6103 Protected Resources
<p>Based on your analysis under Issue 1, you have determined that the taxpayer has a CSU.</p> <p>Based upon your analysis under Issue 2, you have determined that CSU has a net loss attributed to it which is a DCL.</p> <p>The next issue to consider is whether the taxpayer has properly treated the DCL on its U.S. income tax return</p>	<ul style="list-style-type: none"> ▪ IRC § 1503(d) – General DCL rule ▪ Treas. Reg. § 1.1503(d)-1(b)(5) – Definition of DCL ▪ BNA 947-1st - TMFEDPORT No. 947 § X – <i>Dual Consolidated Losses</i> ▪ U.S. Tax. Int'l Mergers, Acquis. & Jt. Ventures ¶ 21.02[3] (<i>USTIMAJV WGL</i> ¶ 21.02) – <i>DCL Overview</i> ▪ U.S. Int'l Tax. ¶ B1.05 (Kuntz and Peroni) – <i>DCL Overview</i> ▪ Fed. Tax'n Income, Est.& Gifts ¶ 97.6 (Bittker and Lokken) – <i>DCL Overview</i> 	

Volume	Part	Chapter	Sub-Chapter
Outbound Income Shifting	Limitations on Cross Border Losses	Dual Consolidated Losses (DCL)	N/A

Issue 3, Step 2: Review Potential Issues (cont'd)

Dual Consolidated Losses - Overview

Issue 3

What is the general rule for a DCL?

Explanation of Issue	Resources	6103 Protected Resources
<p>The general rule for the treatment of a DCL is commonly referred to as the “domestic use limitation” rule (DUL rule). The DUL rule generally provides that, unless an exception applies, a DCL may not be used at any time to offset the income of any domestic affiliate. In other words, no “domestic use” of the DCL is permitted. When the DUL rule applies, the DCL is in effect treated as a separate return year limitation (SRLY) loss that may be carried forward to offset only income of the DRC or SU (and only to the extent the income is related to the activities of the DRC or SU to which the loss is attributable). The DCL is subject to all of the limitations of Treas. Reg. § 1.1502-21(c) (SRLY limitation), treating a separate unit as a separate domestic corporation for this purpose.</p> <p>See Practice Unit – “DCL Domestic Use Limitation Rule and SRLY Rules” (to be developed) for further details.</p>	<ul style="list-style-type: none"> ▪ IRC § 1503(d) – General DCL rule ▪ Treas. Reg. § 1.1503(d)-4(b) – Domestic use limitation rule ▪ Treas. Reg. § 1.1503(d)-4(c)(3) – SRLY limitation rules under DCL ▪ Treas. Reg. § 1.1502-21(c) – SRLY limitation rules ▪ IRM 4.61.13.2.4 – Examination of DCL in the Year of Loss 	

Volume	Part	Chapter	Sub-Chapter
Outbound Income Shifting	Limitations on Cross Border Losses	Dual Consolidated Losses (DCL)	N/A

Issue 3, Step 3: Additional Factual Development

Dual Consolidated Losses - Overview

Issue 3

What is the general rule for a DCL?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Note: The cumulative register concept of the SRLY limitation rules applies to DCLs subject to the DUL rule. If a member of an affiliated group filing a consolidated U.S. income tax return is a DRC or a domestic owner (DO) of a SU that incurs a DCL after having contributed to consolidated taxable income in prior years, the DCL may be absorbed currently in the year the DCL is incurred as an offset to income of domestic affiliates. ▪ You should request and analyze the taxpayer’s computation of the SRLY cumulative register for accuracy. ▪ If a taxpayer uses a portion of a DCL to offset income of domestic affiliates without filing a DUE (as described in Issue 4), you should issue an IDR to determine whether it has available SRLY register enabling it to use a portion of the DCL. ▪ See Practice Unit – “DCL Domestic Use Limitation Rule and SRLY Rules” (to be developed) for a detailed discussion of the SRLY rules as applied to the DCL rules. 	<ul style="list-style-type: none"> ▪ GLAM AM 2011-002 (August 1, 2011) – DCL Application of SRLY Rules ▪ Form 8858, sch. G, ques. 5c. – Indication of the SRLY Register 	

Volume	Part	Chapter	Sub-Chapter
Outbound Income Shifting	Limitations on Cross Border Losses	Dual Consolidated Losses (DCL)	N/A

Issue 3, Step 4: Develop Arguments

Dual Consolidated Losses - Overview

Issue 3

What is the general rule for a DCL?

Explanation of Approach	Resources	6103 Protected Resources
<p>In our example, if the DUL rule applied, without exception, to CSU's \$300 DCL, USC could not use the \$300 DCL to offset any income of any domestic affiliate on the U.S. income tax return. For example, if USC filed as a member of an affiliated group of corporations filing a consolidated return, CSU's \$300 DCL could not be used to offset the income of any other members of the group. Also, USC could not use CSU's \$300 DCL to offset any of the \$1,000 income earned by USC that is unrelated to the activities of USC's FBR or DE. The \$300 DCL is effectively treated as a SRLY loss and subject to the SRLY limitation. Although a DCL may be subject to the DUL rule, such DCL will be able to be used in the U.S. to offset income of the same SU that generated the DCL under the SRLY limitation rules.</p>	<ul style="list-style-type: none"> ▪ IRC § 1503(d) – General DCL rule ▪ Treas. Reg. § 1.1503(d)-4 – Domestic use limitation rule ▪ Treas. Reg. § 1.1503(d)-4(c)(3) – SRLY limitation rules under DCL ▪ Treas. Reg. § 1.1502-21(c) – SRLY limitation rules ▪ GLAM AM 2011-002 (August 1, 2011) – DCL Application of SRLY Rules ▪ Treas. Reg. § 1.1503(d)-1(b)(12) – Definition of affiliate 	

Volume	Part	Chapter	Sub-Chapter
Outbound Income Shifting	Limitations on Cross Border Losses	Dual Consolidated Losses (DCL)	N/A

Issue 3, Step 4: Develop Arguments (cont'd)

Dual Consolidated Losses - Overview			
Issue 3			
What is the general rule for a DCL?			
Explanation of Approach	Resources	6103 Protected Resources	
<p>Note: If USC was a member of an affiliated group filing a consolidated U.S. income tax return and CSU's \$300 DCL was subject to the DUL rule, the DCL could be used to offset domestic affiliate income currently in year 3 to the extent CSU contributed to consolidated taxable income in prior years ("CSU's cumulative register"). For example, if CSU's cumulative register was \$50, \$50 of the \$300 DCL could be used to offset domestic affiliate income in year 3. The remaining \$250 of CSU DCL would remain subject to the DUL rule. Using the cumulative register to offset the income of domestic affiliates is done under the general DUL rule. Technically, it is not an exception to the DUL rule under the DCL regulations.</p>			
<p>You have identified a CSU with a DCL and therefore the general DUL rule applies. As a result, you continue in the DCL analysis to Issue #4 to determine if an exception to the DUL rule applies.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. § 1.1503(d)-4 – Domestic use limitation rule ▪ Treas. Reg. § 1.1503(d)-6 – Exceptions to DUL rule 		

Volume	Part	Chapter	Sub-Chapter
Outbound Income Shifting	Limitations on Cross Border Losses	Dual Consolidated Losses (DCL)	N/A

Issue 4, Step 2: Review Potential Issues

Dual Consolidated Losses - Overview

Issue 4

Does an exception to the general rule apply?

Explanation of Issue	Resources	6103 Protected Resources
<p>The general DUL rule covered in Issue 3 is subject to exceptions. If an exception applies, the taxpayer may, subject to the rules governing the particular exception, use the DCL to currently offset income of domestic affiliates. However, the taxpayer may not avail itself of the exceptions if there has been a “foreign use” of the DCL. While the concept of foreign use under the DCL rules is complex, a foreign use most commonly occurs when any portion of the DCL is made available under the income tax laws of a foreign country to offset or reduce income of a foreign corporation.</p> <p>The three exceptions to the DUL rules are:</p> <ol style="list-style-type: none"> 1. an elective agreement between the U.S. and a foreign country (currently only one exists, with the United Kingdom, and it applies only in limited circumstances), 2. no possibility of foreign use (used in rare and unusual circumstances) and 3. domestic use election and agreement (DUE). 	<ul style="list-style-type: none"> ▪ IRC § 1503(d) – General DCL rule ▪ Treas. Reg. § 1.1503(d)-6(a)(1) – Exceptions to DUL rule ▪ Treas. Reg. § 1.1503(d)-3(a) – Foreign use ▪ Treas. Reg. § 1.1503(d)-6(b),(c) and (d) – Exceptions to DUL rule ▪ Treas. Reg. § 1.1503(d)-6(d)(1) – Domestic Use Election ▪ United Kingdom/ United States Dual Consolidated Loss Competent Authority Agreement (2006) ▪ GLAM AM 2009-011 (Oct. 2, 2009) – Definition of Foreign Use – in CTB tax year ▪ IRM 4.61.13.2.4.1 - DUE ▪ IRM 4.61.13.2.4.1.1.1 – Mirror Legislation ▪ IRM 4.61.13.2.4.2 – No Possibility of Foreign Use 	

Volume	Part	Chapter	Sub-Chapter
Outbound Income Shifting	Limitations on Cross Border Losses	Dual Consolidated Losses (DCL)	N/A

Issue 4, Step 2: Review Potential Issues (cont'd)

Dual Consolidated Losses - Overview

Issue 4

Does an exception to the general rule apply?

Explanation of Issue	Resources	6103 Protected Resources
<p><u>Domestic Use Election</u></p> <p>The most common exception to the DUL rule is the “domestic use election and agreement” (DUE). With a DUE, the taxpayer certifies that there has not been and will not be a foreign use of the DCL at any time up to and during the five-year period following the year the DCL was incurred. In effect, the taxpayer is certifying that there has not and will not be any “double dip” of the DCL during that time. The taxpayer also certifies on the DUE that it will recapture the amount of the DCL into income if a triggering event occurs during the five-year period. For example, a foreign use of the DCL is a triggering event. As part of the DUE, the taxpayer must also certify in each year of the five-year period that there has been no foreign use of the DCL.</p> <p>If the taxpayer files a DUE for a DCL, the general DUL rule does not apply and the DCL may be used to offset income of domestic affiliates on the US return. However, the taxpayer continues to be subject to the rules in the regulations governing DUEs, including filing annual certifications and recapturing the DCL if a triggering event occurs and no exception to the triggering event applies.</p> <p>Note that a taxpayer may not file a DUE for a DCL if a triggering event occurs in the same year that the DCL is incurred.</p>	<ul style="list-style-type: none"> ▪ IRC § 1503(d) – General DCL rule ▪ Treas. Reg. § 1.1503(d)-6(a)(1) – Exceptions to DUL rule ▪ Treas. Reg. § 1.1503(d)-3(a) – Foreign use ▪ Treas. Reg. § 1.1503(d)-6(b),(c) and (d) – Exceptions to DUL rule ▪ Treas. Reg. § 1.1503(d)-6(d)(1) – Domestic Use Election ▪ Treas. Reg. § 1.1503(d)-6(d)(2) – Restriction of filing a DUE in same year of triggering event. ▪ Treas. Reg. § 1.1503(d)-6(e) – DUE triggering events ▪ GLAM AM 2009-011 (Oct. 2, 2009) – Definition of Foreign Use – in CTB tax year ▪ IRM 4.61.13.2.4.1 - DUE 	

Volume	Part	Chapter	Sub-Chapter
Outbound Income Shifting	Limitations on Cross Border Losses	Dual Consolidated Losses (DCL)	N/A

Issue 4, Step 3: Additional Factual Development

Dual Consolidated Losses - Overview

Issue 4

Does an exception to the general rule apply?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> A DUE for a DCL must be filed with the taxpayer's income tax return for the year in which the DCL was incurred to meet the exception to the DCL rule. If the taxpayer fails to timely file the DUE, the taxpayer may request reasonable cause relief for the failure. 	<ul style="list-style-type: none"> Treas. Reg. § 1.1503(d)-6(d)(1) - DUE Treas. Reg. § 1.1503(d)-1(c)(2) – Reasonable Cause Relief IRM 4.61.13.7 – Reasonable Cause Relief Process See related Practice Unit – “DCL Reasonable Cause” (to be developed) for details on Reasonable Cause process. 	Reasonable Cause Toolkit – Administrative Procedures for addressing request for relief on failure to file DCL documents

Volume	Part	Chapter	Sub-Chapter
Outbound Income Shifting	Limitations on Cross Border Losses	Dual Consolidated Losses (DCL)	N/A

Issue 4, Step 3: Additional Factual Development (cont'd)

Dual Consolidated Losses - Overview

Issue 4

Does an exception to the general rule apply?

Fact Element	Resources	6103 Protected Resources
<p>If there is no DUE filed with the return for the DCL, and no other exception to the DUL rule applies, the DUL rule applies.</p> <p>If it appears that the DUL rule applies without exception to a DCL, yet the taxpayer has used the DCL to offset domestic affiliate income on the US return, you should consider issuing an IDR to the taxpayer requesting the taxpayer's position on the treatment of the DCL.</p> <p>Note: Whether a taxpayer takes the position that an exception applies should be readily apparent from reviewing the return. Each exception to the DUL rule has its own unique filing requirement with the return by which the taxpayer unambiguously stakes its reliance on the exception. For example, the DUE filed with the return must be labeled "Domestic Use Election and Agreement."</p>	<ul style="list-style-type: none"> ▪ Domestic Use Election ▪ Treas. Reg. § 1.1503(d)-6(d) – DUE 	

Volume	Part	Chapter	Sub-Chapter
Outbound Income Shifting	Limitations on Cross Border Losses	Dual Consolidated Losses (DCL)	N/A

Issue 4, Step 4: Develop Arguments

Dual Consolidated Losses - Overview

Issue 4

Does an exception to the general rule apply?

Explanation of Approach	Resources	6103 Protected Resources
<ul style="list-style-type: none"> Based upon your analyses conducted under Issues 1-3, you have determined that USC has a Country X combined SU (CSU) consisting of USC's FBR, direct interest in DE and its indirect interest in DE's FBR (through USC's interest in DE) with a DCL totaling (\$300) and therefore, is initially subject to the general DUL rule. You next need to determine under this Issue 4 whether USC treated the DCL under the general DUL rule or if USC takes the position that an exception applies, such as filing a DUE. 	<ul style="list-style-type: none"> Treas. Reg. § 1.1503(d)-4 – Domestic use limitation rule Treas. Reg. § 1.1503(d)-6 – Exception to the Domestic Use Limitation Rule 	

Volume	Part	Chapter	Sub-Chapter
Outbound Income Shifting	Limitations on Cross Border Losses	Dual Consolidated Losses (DCL)	N/A

Issue 4, Step 4: Develop Arguments (cont'd)

Dual Consolidated Losses - Overview

Issue 4

Does an exception to the general rule apply?

Explanation of Approach	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ If, for example, a DUE for the DCL has been timely filed with USC's tax return for year 3, the DCL may be used to offset domestic affiliate income on the US return. For example, the \$300 DCL could be used to offset \$300 of USC's \$1,000 net income that is unrelated to CSU. If USC filed as a member of an affiliate group filing as part of a consolidated return, the DCL could be used to offset income of other members. ▪ If a DUE for the DCL has been timely filed with USC's tax return for year 3, annual certifications must be filed for tax years 4-8 certifying there has been no foreign use of the DCL. If a triggering event (e.g., a foreign use of the DCL) occurs and no exception applies, USC generally must recapture into gross income the full amount of the \$300 DCL. ▪ If no exception to the DUL limitation applies (e.g. DUE filed), the DCL is subject to the DUL limitation and must be treated as a SRLY loss. As a result, the DCL can not offset income of the domestic affiliates. 	<ul style="list-style-type: none"> ▪ Domestic Use Election ▪ Annual Certification of Dual Consolidated Loss ▪ Treas. Reg. § 1.1503(d)-6(d) – DUE ▪ Treas. Reg. § 1.1503(d)-6(e) – Triggering Events ▪ Treas. Reg. § 1.1503(d)-6(g) – Filing of annual certification. ▪ See related Practice Unit “Subsequent Transactions to Timely Filed DUE – (Triggering Events, Exceptions and Recapture Computations)” (to be developed) for further details on subsequent events relating to a DUE. 	

Volume	Part	Chapter	Sub-Chapter
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Training and Additional Resources

Chapter 1.9.1 Dual Consolidated Losses

Type of Resource	Description(s) and/or Instructions for Accessing	References
CENTRA sessions	<ul style="list-style-type: none"> ▪ CENTRA FY2012 CPE-DCL Refresher of Basic Rules and Hot Topics ▪ CENTRA - 2009 Advanced DCL topics ▪ CENTRA - 2007 DCL Final Regulations – 2008 CENTRA ▪ 2006 CENTRA - DCL reasonable cause 	
White Papers / Guidance	<ul style="list-style-type: none"> ▪ IRM 4.61.13 – International Audit Guidelines – Dual Consolidated Losses ▪ GLAM AM 2011-002 (August 1, 2011) – DCL Application of SRLY Rules ▪ GLAM AM 2009-011 (Oct. 2, 2009) – Definition of Foreign Use – in CTB tax year ▪ GLAM AM 2008-001 (Jan. 25, 2008) – DCL Reasonable Cause Requests Relating to Barred Statute Years ▪ United Kingdom/ United States Dual Consolidated Loss Competent Authority Agreement (2006) 	
Reference Materials – Treaties	<ul style="list-style-type: none"> ▪ BNA 947-1st - TMFEDPORT No. 947 § X – <i>Dual Consolidated Losses</i> ▪ U.S. Tax. Int'l Mergers, Acquis. & Jt. Ventures ¶ 21.02[3] (USTIMAJV WGL ¶ 21.02) – <i>DCL Overview</i> ▪ U.S. Int'l Tax. ¶ B1.05 (Kuntz and Peroni) – <i>DCL Overview</i> ▪ Fed. Tax'n Income, Est.& Gifts ¶ 97.6 (Bittker and Lokken) – <i>DCL Overview</i> 	

Volume	Part	Chapter	Sub-Chapter
Outbound Income Shifting	Limitations on Cross Border Losses	Dual Consolidated Losses (DCL)	N/A

Glossary of Terms and Acronyms

Acronym	Definition
CFC	Controlled Foreign Corporation
CSU	Combined Separate Unit
CTB	Check-The-Box
DCL	Dual Consolidated Loss
DE	Disregarded Entity
DE's FBR	DE's Foreign Branch
DO	Domestic Owner
DRC	Dual Resident Corporation
DUE	Domestic Use Election
DUL rule	Domestic Use Limitation Rule
ETR	Effective Tax Rate
FBR	Foreign Branch
GLAM	General Legal Advice Memorandum issued by Chief Counsel
NOL	Net Operating Loss

Volume	Part	Chapter	Sub-Chapter
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Glossary of Terms and Acronyms (cont'd)

Acronym	Definition
P/S	Partnership
SU	Separate Unit
SRLY	Separate Return Limitation Year
USC	Domestic Corporation
USC's FBR	USC's Foreign Branch

Volume	Part	Chapter	Sub-Chapter
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Index of Related Issues

Issue	Associated UIL(s)	References
Entities and Operations Subject to DCL Rules	9411.09-01	Practice Unit to be developed
Amount of DCL - Computation	9411.09-01	Practice Unit to be developed
DCL Domestic Use Limitation Rule and SRLY Rules	9411.09-01	Practice Unit to be developed
Foreign Use of DCL	9411.09-01	Practice Unit to be developed
Domestic Use Election (DUE) – Overview and Filing Requirements	9411.09-01	Practice Unit to be developed
DCL Reasonable Cause	9411.09-01	Practice Unit to be developed
Subsequent Transactions to Timely Filed DUE – (Triggering Events, Exceptions and Recapture Computations)	9411.09-01	Practice Unit to be developed