DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

LARGE BUSINESS AND
INTERNATIONAL DIVISION

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Affected IRM(s): Proposed New IRM 4.61.X

MEMORANDUM FOR ALL LB&I EMPLOYEES

FROM: Ronald H Hodge II /s/ *Ronald H Hodge II*
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SUBJECT: Interim Guidance on Foreign Tax Redeterminations for Taxpayers Under Exam, Where the Relation-Back Tax Year is Not Under Exam

This memorandum issues new guidance on foreign tax redeterminations (FTRs) for taxpayers under exam, where the relation-back tax year is not under exam. Please ensure this information is distributed to all affected employees within your organization.

Purpose: The purpose of this memorandum is to help exam teams streamline their examinations of FTRs and ensure exam teams are analyzing and applying FTRs consistently. The existing notification requirements for FTRs have proved administratively burdensome for exam and taxpayers, and the IRS is evaluating approaches to alleviate this burden, including by providing alternative notification procedures under Treas. Reg.1.905-4(b)(3) or Treas. Reg.1.905-4(b)(4).

Background/Source(s) of Authority: Generally, taxpayers are required to notify the IRS of an FTR by filing amended returns for the affected years that have changes in U.S. tax liability from the FTR. See Treas. Reg.1.905-4(b). For taxpayers under exam with respect to a year that requires a redetermination of U.S. tax liability, there is an exception to the general rule in Treasury Reg.1.905-4(b)(4). Treas. Reg. 1.905-4(b)(3) also provides that the IRS may prescribe alternative notification requirements through forms, instructions, publications, or other guidance.

Procedural Change: The new procedures can be found in Attachment 1.

Effect on Other Documents: This guidance will be incorporated into proposed new IRM 4.61.X within two years from the date of this memorandum.

Contact: Exam teams should consult with Cross Border Activities (CBA) management assigned to the case.

Attachment

Distribution: www.IRS.gov

Attachment 1 – LB&I-04-0824-0010
Guidance to LB&I Examiners on Foreign Tax Redeterminations for Taxpayers under Exam, where the Relation-Back Tax Year is Not Under Exam

The following changes are hereby effective August 6, 2024 for proposed new IRM 4.61.X.

4.61.X (08-06-2024)
FTRs that Occur During or Before the Audit of an Exam Year

(1) IRC 905(c) requires taxpayers to notify the Commissioner of an FTR, and any change in U.S. tax liability resulting from the FTR is calculated based on the year to which the tax relates (relation-back year) and any other affected years. See Treas. Reg. 1.905-1(d)(1)(ii). The following sections address taxpayers that failed to file an amended return as required by IRC 905(c) and Treas. Reg. 1.905-4 for FTRs that change the U.S. tax liability of an affected year (FTR Liability), and the taxpayer is currently being audited by exam. If the FTR occurs during or before exam's audit, and the affected year is the exam year or a prior year, then exam may accept, as part of the examination, immaterial FTRs in an open exam year. If accepted, exam may include the FTR Liability in the exam year. However, in such case, the calculation of the FTR Liability is still determined based on the relation-back year and affected year(s) and such calculation must be provided by the taxpayer and established to the satisfaction of exam. The following principles and guidelines describe, for purposes of this procedure, the:

a. items the exam team should obtain from the taxpayers.
b. factors for determining materiality.
c. guidelines for addressing immaterial FTRs.

4.61.X.X (08-06-2024)
What the Exam Team Should Obtain from the Taxpayer

(1) For purposes of determining whether the FTR Liability is immaterial, the exam teams should obtain pro forma tax returns, or functionally equivalent documentation (the method at the sole discretion of the exam team), for the relation-back year and all affected year(s). Exam should obtain from the taxpayer all information necessary for the exam team to determine the effect of the FTR on the relation-back year and other affected year(s) and the effect on tax attributes in all affected years. The information must be presented in a manner that is accessible, clear, and provides an organized audit trail.

Note: Pro forma tax returns must include all information which would be included on a return if the taxpayer filed amended returns as required by IRC 905(c) and Treas. Reg. 1.905-4. This will include, but is not limited to, the information filed on Schedule L of Form 1118 and, if relevant, Form 5471. Functionally equivalent documentation must include all information that would be included in a pro forma return.

(2) To ensure consistency in the information provided to the exam teams, the information must include, at a minimum:

a. the type of FTR that occurred (e.g., difference between accrued and paid, additional assessment of tax by foreign country, refund of foreign income tax paid and claimed as a credit);
b. the year that such FTR occurred;
c. the relation-back year;
d. the direct and indirect effect of the FTR on tax items in each affected year including (but not limited to): foreign income taxes paid or deemed paid; effect on IRC 904 categories and carryovers (including any effect on the high-tax kickout); IRC 951(a) or IRC 951A inclusion amounts (as affected by a change in earnings and profits or high tax exclusion eligibility), such as the effect on any IRC 965 tax paid in 2017 or 2018;
e. the relevant currency translation rates for the FTR, which includes the rate used to translate the amount of foreign tax when originally accrued (or paid if taxpayer is on the cash-basis method) and the spot rate on the date of any refunds received; and
f. the effect of the FTR on the taxpayer's U.S. tax liability in each affected year.

(3) This information is necessary to help exam teams determine:

a. Whether FTRs ultimately result in a material increase or decrease to the taxpayer's U.S. tax liability in each affected year and all affected years in the aggregate, and
b. The effects of the FTRs on other relevant tax items in each affected year.

4.61.X (08-06-2024)
Factors for Determining Materiality

(1) For cases under examination, a core principle in the risk analysis process is materiality. Materiality is a relative concept relating to the significance of an amount or issue given surrounding circumstances. See IRM 4.46.3.3.5.4. To assess whether the FTR Liability is immaterial (Immaterial FTRs), the following factors should be considered and are detailed further below:

a. Amount of FTR Liability for each of the affected years
b. FTR event type
c. Cooperation of the taxpayer (including if the taxpayer voluntarily disclosed the FTR to exam)
d. Aggregate amount of the FTR and FTR Liability for all affected years
e. Other factors

(2) When evaluating the amount of the FTR Liability in relation to the taxpayer's U.S. liability for the affected year(s), the exam team should consider the effect of the FTR on other tax items or positions in any affected year. Such items and positions include, but are not limited to:

a. the taxpayer's foreign tax credit position in the relevant IRC 904 categories (whether excess credit or excess limit; the foreign tax credit amounts carried over to other years; etc.)
b. the effect on any high-tax elections or the high-tax kick-out
c. the effect on E&P
d. the effect on Global Intangible Low-Taxed Income (GILTI) and subpart F calculations
e. the effect on any IRC 965 tax paid in 2017 or 2018
f. the effect on any other tax items or positions deemed relevant by the exam team

(3) The type of event that occurred should be considered, such as:

a. FTRs that occur because the amount of foreign taxes accrued and claimed as credits differs from the amount of foreign taxes actually paid, and where the difference appears reasonable, are less likely to be material
b. FTRs that result from a foreign-initiated adjustment are more likely to be material and generally should be evaluated under Treas. Reg. 1.901-2(e)(5)

(4) Whether the FTR was disclosed or not disclosed voluntarily in the exam process should be considered.

(5) The amount of each FTR and the aggregate amount of FTRs that relate to the same year should be considered.

Example: If FTR1 does not result in an FTR Liability (perhaps because it reduces excess GILTI credits and the taxpayer still has remaining excess GILTI credits) and would be deemed immaterial, and FTR2 affects the same year and results in what would be deemed a material FTR Liability (perhaps because FTR2 further reduces the excess GILTI credits until the taxpayer has a material residual U.S. tax liability), then both FTR1 and FTR2 would be deemed material for the purpose of applying this interim guidance.

(6) The exam team may consider any other factor(s) that it considers appropriate.

4.61.X (08-06-2024)
Options for Addressing Immaterial FTRs

(1) Engaging a CBA agent is important to the success of this process. CBA agents should exercise professional judgment and should engage their

managers, as needed, to determine whether the tax effect is material for the examination.

(2) Using their experience, judgment, and objective analysis of the materiality of FTRs based on the above factors, exam teams may consider whether certain FTRs are immaterial in the context of their examination.

(3) For immaterial FTRs, exam teams may input the immaterial change in the U.S liability due to the FTR in the open exam year instead of requiring amended returns for the relation-back year and affected years when:

   a. The exam team timely receives all the information needed and requested from the taxpayer, and doing so is in the best interest of the U.S. government, and
   b. The exam team has considered the effect of making an adjustment in the exam year on tax attributes for that year and all other years impacted by the FTR.

(4) If the exam team accounts for the immaterial FTR Liability in the open exam year, then the exam team may input the immaterial FTR Liability as a stand-alone tax adjustment (separate from all other adjustments in the RAR) for the open exam year. The immaterial FTR Liability should be input in a manner which will allow tracking of these adjustments should there be additional FTRs relating to these years in the future. The documentation of the immaterial FTRs should be included in, but is not limited to, the International Examiner's Report, and all computations and workpapers should be saved in IMS under SAIN 604-01, Foreign Tax Credits (FTC).

(5) As an alternative, the exam team may allow the taxpayer to satisfy the immaterial FTR Liability by submitting a payment to account # 6400 (miscellaneous payments). Payments made to this account would not be attributed to any given tax year, and therefore payments would be made outside of the exam context.

(6) Regardless of the approach taken, the exam team should document all immaterial FTRs and changes to the tax attributes in the case file.

(7) If the exam team determines that an FTR is material, or the taxpayer has not timely provided the requested information, or the interests of the government otherwise cannot be protected through adjustments to open years or payments to account # 6400, the process described in this document does not apply.

(8) Exam teams may consult with the FTC Cadres, Practice Network and other relevant LBI subject matter experts, in addition to counsel, as appropriate for technical matters. Cadre email box: *LB&I FTC Field Issues.

Exam teams should follow existing documentation procedures for the risk analysis performed using these guidelines.