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## **Overview of the foreign tax provisions in the 2010 Education and Jobs Act**

To help offset the cost of a temporary increase in funding for Medicaid and state education, the recently enacted 2010 Education and Jobs Act (Act) tightens the rules on the use of foreign tax credits that multinationals use to lower their U.S. tax bill. In general, the new law's foreign tax provisions attempt to (1) make foreign tax credits (FTCs) available only when the income to which the FTCs relate is actually taxed by the U.S., (2) prevent artificial inflation of foreign source income, and (3) modify the resourcing rules to limit FTCs. Here is a brief overview of the new foreign tax provisions.

### **Foreign tax credit "splitting"**

The Act prevents splitting FTCs from income by implementing a matching rule that suspends the recognition of foreign tax until the related foreign income is taken into account for U.S. tax purposes. The provision applies to all "split" foreign taxes paid or accrued in tax years beginning after Dec. 31, 2010 and is expected to raise \$4.25 billion over 10 years.

### **Covered asset acquisition**

The new law denies a FTC for the disqualified portion of any foreign income tax paid or accrued in connection with a covered asset acquisition (e.g., acquiring interests in entities that are corporations for foreign tax purposes, but are non-corporate entities (such as partnerships) for U.S. tax purposes). The provision generally applies to covered asset acquisitions after Dec. 31 2010 and is expected to raise \$3.645 billion over 10 years.

### **Separate application of foreign tax credit limitation to items resourced under tax treaties**

The Act prevents artificially inflating foreign source income by providing a separate foreign tax credit limitation for each item of income that could be treated as U.S. source income under the Code or foreign source income under a treaty and that the U.S. taxpayer elects to treat as foreign source. The provision applies to tax years beginning after the date of the new law's enactment and is expected to raise \$250 million over 10 years.

### **Limit FTCs with respect to "hopscotched" dividends**

Under a prior anti-abuse rule, U.S. corporations with multiple lower-tier subsidiaries could create a "deemed dividend" from a lower-tier subsidiary that may be eligible for a higher FTC than if the dividend flowed up through the full chain of ownership to the U.S. parent. The new law limits FTCs to the maximum that could be claimed if the dividend did not "hopscotch" over the intermediary subsidiaries. The provision applies to the affirmative use of the deemed dividend rule after Dec. 31, 2010 and is expected to raise \$704 million over 10 years.



### **Redemptions by foreign subsidiaries**

The Act provides a new limitation on when a foreign acquiring corporation's earnings and profits may be reduced by a Code Sec. 304 deemed dividend. Under the Act, the foreign earnings remain subject to U.S. income tax when repatriated to a higher-tier U.S. subsidiary and subject to U.S. withholding tax when distributed to the foreign parent as a dividend. The provision applies to acquisitions after Dec. 31, 2010 and is expected to raise \$250 million over 10 years.

### **Repeal of 80/20 rules**

The Act repeals the 80/20 rules for interest and dividends paid by U.S. corporations or resident alien individuals. Thus, regardless of the amount of active foreign business income earned by the payor, dividends and interest paid by U.S. corporations or resident alien individuals to foreign persons are classified as U.S. source and subject to 30% withholding tax. The Act includes relief for existing 80/20 companies that meet specific requirements and are not abusing the 80/20 company rules. Subject to the relief for existing 80/20 companies, the provision applies to tax years beginning after Dec. 31, 2010 and is expected to raise \$153 million over 10 years.

### **Modification of affiliation rules for allocating interest expense**

The Act modifies the affiliation rules to provide that the assets and interest expense of foreign corporations, satisfying income and ownership tests, are taken into account in allocating and apportioning the interest expense of the affiliated group for purposes of computing the foreign tax credit limitation. The provision applies to tax years beginning after the date of the new law's enactment and is expected to raise \$390 million over 10 years.

### **Suspension of three-year assessment limitations period for failure to disclose certain foreign transactions limited if due to reasonable cause**

The Act modifies the foreign compliance provisions provided in the Hiring Incentives to Restore Employment (HIRE) Act enacted earlier this year relating to the tolling the statute of limitations period on assessment for corporations that fail to provide certain information to IRS on cross-border transactions and foreign assets. The Act provides that if the failure to furnish the specified information to IRS is due to reasonable cause and not willful neglect, the assessment limitation period will be tolled only with respect to the item or items related to the taxpayer's failure, and not to the entire tax return to which it relates.

We hope this information is helpful. If you would like more details about these changes or any other aspect of the new law, please do not hesitate to call.