

FDU: U.S. International Corporate Tax

147 Exercises

148 Interest Apportionment

» Reg. §1.861-8 thru 12

- **Consolidated return interest expense apportioned based on consolidated return assets**
 - 3 methods: tax basis, AMT basis, FMV
- **Apportion to all baskets having assets, whether income or not**
- **May cause losses in some baskets**
- **Expired temp. regs vs. proposed regs**

149 Interest Defined

- **Same meaning as §163**
- **Includes:**
 - **OID**
 - **Imputed interest**
 - **Costs for use of funds**
 - **Amounts treated as interest under notional principal contracts**
 - **Bond premium**

150 Int.App: Partnerships

- **Special allocations at p/s level**
- **Corp. >10% GP: look thru for assets & interest**
- **Indiv. GP or >10% LP: special rules**
- **<10% partner:**
 - **directly allocate share of p/s interest exp. to p/s income**
 - **treat p/s interest as asset for allocating other interest**

151 Int.App: Corporations

– Reg. §1.861-9T(f),(g),(h)

- **US corps must use asset method**
- **Default is adjusted tax basis**
- **May permanently switch to fair market value**
- **Special rules for CFCs & foreign branches**
- **Rules for basketizing assets**
- **Special basis adjustments for this**

152 Int.App: Asset Method

- **Interest expense apportioned to basket =**
$$\text{Total interest} \times \frac{\text{Assets in basket}}{\text{Worldwide assets}}$$

153 Int.App: Asset Values

- **Tax Book Value: very adjusted tax basis (below) (default)**
- **Alternative Tax Value: very adjusted AMT basis**
- **Fair Market Value**
- **One time election to convert to AMT or FMV**

FDU: U.S. International Corporate Tax

- 154 **Int.App: Basketizing Assets**
- **Single category assets:** allocate value
 - **Multiple category assets:** apportion value based on income they produce (typically based on GI)
 - **No yield assets:** excluded from calculations
- 155 **Int.App: Adjustments**
– Reg. §1.861-12T
- **Adjust basis in 10/50 and CFC stock for E&P**
 - **Basketize CFC stock & notes:** look thru
 - **Reduce basis by debt on which interest is capitalized**
 - **NO apportionment to FSC or DISC stock**
- 156 **Exercises**
- 157 **Int.App: CFC Netting**
– Reg. §1.861-10T(e)
- **Interest expense must be directly allocated to interest income from CFCs**
 - **Technical formula based on comparative debt ratios, using escalated base period amounts as limitations**
- 158 **Int.App: within CFCs**
– Reg. §1.861-9T(f)(3)
- **Annual election of method:**
 - Asset method, as above
 - Gross income method
 - But may use only if not using FMV method
 - **Must use same method for all CFCs**
 - **GI method: must tier up gross income of lower tier subs, excluding:**
 - Dividends
 - Other payments except look thru interest
 - Subpart F income, as adjusted
- 159 **Impact on 904 Look Thru—
Rents & Royalties**
- **Same basket as rent or royalty expense is allocable or apportionable to**
 - **See Interest**
- 160 **Look Thru—Interest**
- **Same basket as interest expense of CFC is apportioned:**
 - **Allocation & apportionment: Follow these steps:**
 - Determine gross income by basket
 - Allocate definitely related expenses
 - Allocate related person interest expense to passive FPHC income (to the extent thereof)
 - Unallocated balance of interest apportioned as below
- 161 **Look Thru—Interest, cont.**
- Apportion interest then other expenses to other income:
 - Gross income method:
Gross income in basket

FDU: U.S. International Corporate Tax

$$\begin{array}{r} \text{Balance} \times \text{-----} \\ \text{Total non-passive gross income} \\ - \text{ Asset method:} \\ \text{Assets which produce basket income} \\ \text{Balance} \times \text{-----} \\ \text{Total non-passive assets} \end{array}$$

162 Re-sourcing Losses

- §904(f) & regs

- Apportionment of expenses (esp. interest) may cause loss
- Current loss in basket reduces other baskets
- Overall or basket losses carried forward

163 Re-sourcing Losses

- Future income in prior loss basket resourced to basket which absorbed loss
- Future income when prior overall loss recaptured:
 - Lesser of balance of loss or
 - 50% of current foreign source income
- May elect higher %

164 Overall Foreign Loss (OFL)

- Deductions allocated & apportioned to foreign source are less than foreign source gross income
 - Exclude NOL, expropriation & casualty loss deductions
- Apply both overall and by separate baskets

165 Foreign Currency / Foreign Exchange

166 Foreign Currency: Concepts

- §§985-989 and SFAS 52

- Exchange rate
- Functional currency
- Foreign exchange gain/loss
- Recognized vs. unrecognized
- Hedging
- Synthetic instruments