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## Recent DCL and Pillar 2 Guidance: Comments and Recommendations

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*Treasury must make significant changes to the DCL rules to avoid unintended consequences created by the Pillar 2 rules. Immediate guidance is needed to avoid inconsistent and uncertain financial reporting positions created by the Jan. 1, 2024, implementation of the Pillar 2 rules, says Guy A. Bracuti of KPMG.*

This article addresses the interaction of the U.S. dual consolidated loss (“DCL”) rules and “[Global Anti-Base Erosion Model Rules \(Pillar Two\)](#)” (the “Pillar 2 rules”), issued by the Organization of Economic Coordination and Development (“OECD”) and enacted into law by several foreign countries. This article discusses specifically the “Transitional CbCR Safe Harbour” guidance that was issued by the OECD on December 15, 2023, and [Notice 2023-80](#), which was published by the U.S. Treasury Department (“Treasury”) on December 26, 2023 (See 2023-52 I.R.B 1583). Although the official comment period to Notice 2023-80 expired on February 9, 2024, this article provides unofficial comments and recommendations with respect to Notice 2023-80, as well as to other aspects of the DCL regulations.

## I. Background and Law

### A. DCL Rules

The DCL rules apply to certain “separate business units” of domestic corporations (See [I.R.C. §1503\(d\)\(3\)](#) and [Treas. Reg. §1.1503\(d\)-1](#) through 8). The DCL rules also apply to dual resident corporations, but discussion of dual resident corporations is beyond the scope of this article.

A separate unit is: (1) a “foreign branch” of a domestic corporation, as that term is defined in [Treas. Reg. §1.367\(a\)-6T\(g\)](#); or (2) a “hybrid entity separate unit.” A hybrid entity separate unit is a domestic corporation’s interests in a “hybrid entity.” A hybrid entity is any entity that is subject to foreign income tax at the entity level but is treated as a disregarded entity or treated as a partnership for U.S. tax purposes. A U.S. corporation (or a U.S. consolidated group) must combine the U.S. tax results of all of its

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separate units on a country-by-country (“CbC”) basis. This is a mandatory rule that is referred to as the “separate unit combination rule.”

A separate unit incurs a DCL if there is a “net loss attributable to” the separate unit (or a net loss attributable to the combined separate unit) under special DCL accounting rules contained in [Treas. Reg. §1.1503\(d\)-5\(c\)](#).

The DCL rules prohibit a domestic corporation from having a “domestic use” of a DCL (the “domestic use limitation”). A domestic use of a DCL occurs when any portion of an item of deduction or loss taken into account in computing a DCL is used to offset or reduce any U.S. taxable income, except the U.S. taxable income earned by the separate unit that incurred the DCL. A DCL subject to the domestic use limitation is treated as a loss incurred in a “separate return limitation year” (“SRLY”) and may be absorbed as provided in [Treas. Reg. §1.1502-21\(c\)](#), as modified by [Treas. Reg. §1.1503\(d\)-4\(c\)\(3\)](#).

A taxpayer that makes a “domestic use election” (“DUE”) for a DCL may avoid the effect of the domestic use limitation and, thus, use items of deduction and loss taken into account in computing a DCL to offset or reduce U.S. taxable income that is not the income of the separate unit. The DUE is a contract made with the IRS in which the taxpayer is allowed to have a domestic use of a DCL, if the taxpayer makes certain certifications and promises with respect to the DCL. The three relevant certifications and promises a taxpayer makes on the DUE are that: (1) there has not been a “foreign use” of the DCL; (2) the taxpayer will certify on its five subsequent tax returns that there has not been a foreign use of the DCL during the 5-year certification period (the “annual certification”); and (3) the taxpayer will recapture the DCL as gross income, plus interest, if there is a “triggering event” during the 5-year certification period. Triggering events include a foreign use of a DCL during the 5-year certification period and certain enumerated transactions that are likely to cause a foreign use of a DCL within the 5-year certification period.

A foreign use occurs if any portion of an item of deduction or loss taken into account in computing a DCL is used (or is made available for use) under foreign income tax law to offset or reduce income or gain of an entity that is treated as a foreign corporation for U.S. tax purposes. The foreign use rule has a cliff effect: if a single dollar of an item of deduction or loss taken into accounting in computing a DCL is put to a foreign use, the entire DCL is put to a foreign use. This is colloquially referred to as the “all or nothing rule.”

A deemed foreign use can occur if a DCL is subject to the mirror legislation rule contained in [Treas. Reg. §1.1503\(d\)-3\(e\)](#). The mirror legislation rule provides in pertinent part:

*“(e) Mirror legislation rule.—(1) In general.—*Except as provided in paragraphs (e)(2) or (e)(3) of this section and [§1.1503\(d\)-6\(b\)](#) (relating to agreements entered into between the United States and a foreign country), a foreign use shall be deemed to occur if the income tax laws of a foreign country would deny any opportunity for the foreign use of the dual consolidated loss in the year in which the dual consolidated loss is incurred (mirror legislation), determined by assuming that such foreign country had recognized the dual consolidated loss in such year, for any of the following reasons:

(i) the dual resident corporation or separate unit that incurred the loss is subject to income taxation by another country (for example, the United States) on its worldwide income or on a resident basis;

(ii) the loss may be available to offset income (other than income of the dual resident corporation or separate unit) under the laws of another country (for example, the United States); or

(iii) the deductibility of any portion of a deduction or loss taken into account in computing the dual consolidated loss depends on whether such amount is deductible under the laws of another country (for example, the United States). See §1.1503(d)-7(c) Examples 17 through 19. (Treas. Reg. §1.1503(d)-3(e)(1).)”

Example (19)(iii) in the DCL regulations makes clear that if mirror legislation applies to an individual separate unit within a combined separate unit, there is a deemed foreign use with respect to the entire combined separate unit DCL, thereby preventing a taxpayer from making a DUE for any such combined separate unit DCL subject to the mirror legislation rule. (See Treas. Reg. §1.1503(d)-7(c)(19)(iii)).

Example (18)(iii) provides guidance with respect to foreign legislation that closely resembles the U.S. DCL rules (See Treas. Reg. §1.1503(d)-7(c)(18)(iii)). The facts of Example (18)(iii) are simple. P, a domestic corporation, owns FBX, a foreign branch operation located in Country X. FBX incurs a DCL in Year 1. Country X has enacted:

“*mirror legislation* that operates in a manner similar to the rules under section 1503(d). That is, it allows the taxpayer to elect to use the loss to either offset income of an affiliate in Country X, or income of an affiliate (or other income of the owner of the Country X branch or permanent establishment) in the other country, but not both. Because the Country X *mirror legislation* permits the taxpayer to choose to put the dual consolidated loss to a foreign use, it does not deny the opportunity to put the loss to a foreign use. Therefore, there is no deemed foreign use of the dual consolidated loss pursuant to §1.1503(d)-4(e) [sic: §1.1503(d)-3(e)] (emphasis added).”

The example concludes that because the foreign legislation provides a taxpayer with the same choice that the DCL rules provide—use the loss in U.S. consolidation or use the loss in foreign consolidation but not both—the foreign legislation does not deem a foreign use of the DCL. Thus, USP in Example (18)(iii) is provided a choice: (1) use the loss to offset a Country X affiliate income, creating a foreign use that prevents USP from making a DUE for the DCL; or (2) make a DUE for the DCL, which will trigger the Country X prohibition and prevent the loss from being used to offset a Country X affiliate’s income.

The result of Example (18)(iii) is clear, but the analytical roadmap to the destination is less so. The mirror legislation rule, as illustrated by Example (18)(iii), suggests at least two interpretations of the specific regulatory language: (1) a Two-Prong Definition Interpretation; and (2) a Rule of Application Interpretation.

### **1. Two-Prong Definition Interpretation**

The first interpretation of Treas. Reg. §1.1503(d)-3(e)(1) is that the regulation provides a two-prong definition of mirror legislation, *to wit*: mirror legislation is foreign legislation that:

(1) “would deny any opportunity for the foreign use of a dual consolidated loss in the year in which the dual consolidated loss is incurred (mirror legislation), determined by assuming that such foreign country had recognized the dual consolidated loss in such year”; and

(2) denies the opportunity for a foreign use for one of the enumerated reasons in Treas. Reg. §1.1503(d)-3(e)(1)(i) through (iii).

This interpretation is the most consistent with the syntax of Treas. Reg. §1.1503(d)-3(e)(1), although the syntax of Treas. Reg. §1.1503(d)-3(e)(1) is hardly the paragon of perspicuity. Indeed, the mirror legislation rule is a single, 189-word sentence that contains the term “mirror legislation” in parenthesis, but the specific placement of the term within the sentence creates interpretive confusion and the specific language used in Example (18)(iii) creates additional uncertainty regarding the proper interpretation of the provision.

Example (18)(iii) appears to be concluding that the Country X legislation is not mirror legislation because it does not satisfy the first prong of the mirror legislation definition. In other words, because USP has the option to use the loss to offset the income of a Country X affiliate, the foreign legislation does not deny all or “any opportunity” to put the DCL to a foreign use. The above quoted and emphasized portion of Example (18)(iii), however, arguably belies this interpretation because, rather than just concluding that the Country X legislation is not “mirror legislation,” the example twice refers to the Country X legislation as “mirror legislation” and concludes that there is no deemed foreign use under the mirror legislation rule because the foreign legislation does not deny the opportunity to put a DCL to a foreign use. A logical conundrum is thus revealed: how can Example (18)(iii) illustrate that the Country X legislation is not mirror legislation when Example (18)(iii), itself, twice refers to the Country X legislation as mirror legislation?

The two-prong definition interpretation of Treas. Reg. §1.1503(d)-3(e) requires a conclusion that the references to *mirror* legislation in Example (18)(iii) are drafting errors that should be ignored. This position is supportable because the structure and context of the mirror legislation rule are relevant in concluding that the use of certain words are drafting errors. (See, e.g., *King v. Burwell*, [576 U.S. 473 \(2015\)](#)). This is particularly true when the language of an example arguably conflicts with a substantive provision of a tax regulation. (See, e.g., *Cook v. Comm’r*, [269 F.3d 854](#) (7th Cir. 2001); *U.S. v. Brown*, [348 F.3d 1200](#), 1211 (10th Cir. 2003)). Example (18)(iii) is an “Alternative facts” example, which is a common drafting technique in the DCL regulations that allows the regulation drafters to make minor alterations to the facts of an example to illustrate different aspects of the rules without having to create a whole new example (See generally Treas. Reg. §1.1503(d)-7(c)(1) – (41) (14 of the 41 examples in the DCL regulations contain one or more Alternative facts examples)). Example (18)(iii) is based on the “Facts” set forth in Example (18)(i), which includes a factual statement that the Country X legislation is “Country X mirror legislation.” This same language appears to have been carried over to Example (18)(iii) erroneously and with the unintended consequence of creating this definitional uncertainty. Also, there is at least one other very clear drafting error in Example (18)(iii), which corroborates the assertion that the drafters did not achieve linguistic perfection in drafting Treas. Reg. §1.1503(d)-3(e)(1) and its related examples. Specifically, the citation to “§1.1503(d)-4(e)” at the end of Example 18(iii) is meant to be a citation to “§1.1503(d)-3(e).” Treas. Reg. §1.1503(d)-4(e) addresses “tainted income” rules that have no relationship to the mirror legislation rule, whereas Treas. Reg. §1.1503(d)-3(e) is the mirror legislation rule. So, the citation to §1.1503(d)-4(e) in Example (18)(iii) is clearly a drafting error—hence this author’s bracketed “sic” designation.

The DCL regulations are long, detailed and contain multiple rules addressing the interaction of U.S. income tax law and foreign income tax law. The final DCL regulations differ significantly from the proposed DCL regulations, which suggests that the drafting process involved multiple drafts and significant editing; indeed, Example (18)(iii) was not in the 2006 proposed DCL regulations. Drafting a

mirror legislation rule is particularly challenging because the rule involves the simultaneous interaction of competing loss disallowance rules—mirrors can be challenging things in many ways. The existence of a drafting error in this context is both unsurprising and understandable. For these reasons, the structure and the context of Example (18)(iii) support the conclusion that the references to *mirror* legislation therein are drafting errors.

## 2. Rule of Application Interpretation

The other way to interpret Treas. Reg. §1.1503(d)-3(e)(1), as illustrated by Example (18)(iii), is to reject the two-prong definition interpretation and to interpret the text of the first putative prong not as definitional, but rather as a rule of application. Under this interpretation, the mirror legislation rule has four distinct parts:

(1) a scoping provision (the rule does not apply to situations described in Treas. Reg. §§1.1503(d)-3(e)(2), (3), and -6(b));

(2) an operational rule (a foreign use is deemed to occur);

(3) a rule of application (the operational rule applies when mirror legislation would deny any opportunity for the foreign use of a dual consolidated loss in the year in which the dual consolidated loss is incurred, determined by assuming that such foreign country had recognized the DCL in such year); and

(4) a definition of mirror legislation (legislation described in Treas. Reg. §1.1503(d)-3(e)(1)(i) – (iii).

Under this alternative interpretation of Treas. Reg. §1.1503(d)-3(e)(1), the Country X legislation in Example (18)(iii) is mirror legislation as defined in Treas. Reg. §1.1503(d)-3(e)(1), but the Country X mirror legislation does not apply to USP's Country X DCL because USP is afforded an acceptable choice. Thus, while perhaps not as syntactically *pristine* as the two-prong interpretation, the rule of application interpretation has the virtue of explaining the result of Example (18)(iii) without having to disregard any words in the example.

## 3. Final Views on Mirrors

Either of the two interpretations of the mirror legislation rule is acceptable because Example (18)(iii) illustrates an intended limitation of the mirror legislation rule that is consistent with Treasury's initial charge in creating the regulatory provision. Neither the DCL statutory provision nor the related legislative history discuss the prospect of a mirror legislation rule. Instead, the mirror legislation problem was first raised by the Joint Committee on Taxation ("Joint Committee") in its General Explanation of the Tax Reform Act of 1986 (the "Bluebook") (See Staff of Joint Comm. on Taxation, 100th Cong., 1st Sess., General Explanation of the Tax Reform Act of 1986, 1065-1067 (May 4, 1987)). The Joint Committee in the Bluebook described U.K. legislation that was enacted shortly after the enactment of §1503(d) in the U.S. Tax Reform Act of 1986. The Joint Committee observed that the new U.K. legislation was similar to the U.S. DCL rule but differed in that it did not provide taxpayers a choice of use and that Congress "did not intend that such a rule of foreign law cause all the revenue gain from termination of the dual resident company device to inure to the benefit of the foreign revenue authority." (*Id.* at 1065-1066.) In urging Treasury to address the mirror legislation problem through executive branch action, the Joint Committee noted that the DCL mirror rule restrictions should not apply in situations in which "the United States obtains an appropriate share of revenue from Congress' action in ending use of this dual resident company device[.]" (*Id.* at 1066). The Joint Committee suggested that one method of

addressing the problem was through a bi-lateral agreement in which a taxpayer could use the loss in one country but not in both. Thus, the Joint Committee urged Treasury to eliminate the loss of revenue created when a similar foreign rule effectively forces the loss into U.S. tax consolidation by foreign fiat but also wanted Treasury to allow the loss to be used in U.S. tax consolidation when a taxpayer is afforded a choice.

The principle illustrated by Example (18)(iii) is that, if a taxpayer is afforded a choice regarding where to use the loss, a competing foreign disallowance rule that resembles the U.S. DCL rule does not create a deemed foreign use under the mirror legislation rule. The precise manner by which a taxpayer effectuates its decision on where to use the loss ought not matter. So, it should not matter whether the competing foreign legislation requires an affirmative election similar to the DUE or whether it enables the taxpayer to effectuate its decision by merely claiming or foregoing a deduction or loss item on a foreign tax return through a prescribed method. As long as the taxpayer is afforded a choice, the mirror legislation rule should not deem a foreign use, irrespective of the specific interpretation of the rule.

## **B. Pillar 2 Rules**

### **1. In general**

The OECD on December 14, 2021, published the Model Pillar 2 Rules, which are part of the broader OECD Base Erosion and Profits Shifting Project (“BEPS Project”). The Pillar 2 rules are “designed to ensure large multinational enterprises (MNEs) pay a minimum level of tax on the income arising in each jurisdiction where they operate.” (Para. 1, OECD (2022), *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two)*, OECD, Paris,) The Model Pillar 2 Rules achieve this result by imposing a “Top-Up Tax” (a “TUT”) on an MNE’s “Low-Taxed Constituent Entity” (“LTCE”).

The imposition of a TUT on an LTCE requires the application of several formulae to determine, *inter alia*, whether a “Constituent Entity” is “Low-Taxed” and whether a LTCE group has “Excess Profits.” While the Pillar 2 computations are numerous and detailed, this article discusses only the formulae and determinations that are relevant to determine whether the Pillar 2 rules create a foreign use of a DCL.

The Pillar 2 rules require a Constituent Entity group to compute its “Net Global Anti-Base Erosion Income” (“Net GloBE Income”). The Net GloBE Income computation must be made by the Constituent Entity group on a CbC basis by aggregating the adjusted financial accounting profits and losses of all Constituent Entities and Permanent Establishments in the MNE group that are located in the same country. This is sometimes referred to as “jurisdictional blending.” The jurisdictional blending created by the Net GloBE Income computation raises the DCL foreign use issue because, if one member of the Constituent Entity group is a separate unit and another member of the Constituent Entity group is treated as a foreign corporation for U.S. income tax purposes (or is treated as disregarded entity or Permanent Establishment owned by an entity treated as a foreign corporation for U.S. income tax purposes), then the Net GloBE Income computation would aggregate the profits and losses of a separate unit against profits and losses of an entity that is treated as a foreign corporation for U.S. income tax purposes.

The Pillar 2 rules also require a Constituent Entity group to compute the “Effective Tax Rate” (“ETR”). The ETR is computed by dividing the Adjusted Covered Taxes paid by the Constituent Entity group by the Net GloBE Income of the Constituent Entity group. The TUT is applicable only if the ETR is less than the 15 percent Minimum Rate.

The Pillar 2 rules also require a Constituent Entity group to compute whether there is an “Excess Profit” in the Constituent Entity group. There is an Excess Profit in the Constituent Entity group if Net GloBE Income exceeds the “Substance Based Income Exclusion” (“SBIE”) amount. The SBIE is the sum of the “Payroll Carveout” and the “Tangible Asset Carveout.” The Payroll Carveout is computed by multiplying Eligible Payroll Costs by .05, unless a transitional rate applies. The Tangible Asset Carveout is computed by multiplying the carrying value of certain tangible assets owned by Constituent Entities by .05, unless a transitional rate applies. TUT is applicable only if there is an Excess Profit.

Each of these computations implicates the DCL foreign use rule because each of the computations requires a Net GloBE Income computation, which, as described above, may involve the aggregation of the profits and losses of separate units against profits and losses of entities that are treated as foreign corporations for U.S. income tax purposes.

## **2. Transitional CbCR Safe Harbours**

The OECD on December 15, 2022, issued three “Country by Country Reporting” (“CbCR”) transitional safe harbours designed to provide a “short-term measure that would effectively exclude an MNE’s operations in certain lower-risk jurisdictions from the scope of the GloBE in the initial years, thereby providing relief to MNEs in respect of their GloBE compliance obligations as they implement the rules.” (Para. 3, (OECD 2022), Safe Harbours and Penalty Relief: Global Anti-Base Erosion Rules (Pillar Two), OECD/G20 Inclusive Framework on BEPS, OECD Paris. [www.oecd.org/tax/beps/safe-harbours-and-penalty-relief-global-anti-base-erosion-rules-pillar-two.pdf](http://www.oecd.org/tax/beps/safe-harbours-and-penalty-relief-global-anti-base-erosion-rules-pillar-two.pdf)). The Transitional CbCR Safe Harbours expire for fiscal years ending after June 30, 2028. The OECD on December 15, 2023, issued additional guidance on the CbCR transitional safe harbours (the “Administrative Guidance”). (See OECD, [Tax Challenges Arising from the Digitalisation of the Economy—Administrative Guidance on the Global Anti-Base Erosion Rules \(Pillar Two\)](#), December 2023, OECD/G20 Inclusive Framework on BEPS, OECD Paris).

As the name suggests, the CbCR transitional safe harbours use data provided on an MNE’s CbC reports that generally are required by the tax laws of the MNE’s parent jurisdiction. A U.S. parent MNE is required to file a CbCR on Form 8975, Schedule A, pursuant to Treas. Reg. §1.6038-4. Two of the CbCR transitional safe harbours—the Simplified ETR Test and the Routine Profits Test—are relevant to this article because they obviate the requirement of making a Net GloBE Income computation.

An MNE’s TUT will be zero if the MNE satisfies the Simplified ETR Test, which closely resembles the Pillar 2 ETR test and the Top-Up Tax Percentage computation. The Simplified ETR Test is satisfied if the “Simplified ETR” equals or exceeds the “Transitional Rate.” The Simplified ETR is computed by dividing the Constituent Entity group’s “Simplified Covered Taxes” by the Constituent Entity group’s “Profit (Loss) before Income Tax” (“PBT”). Simplified Covered Taxes are the Constituent Entity group’s income tax expense as reported on the MNE Group’s Qualified Financial Statements, after eliminating taxes that are not Covered Taxes (defined in the Pillar 2 rules) and uncertain tax positions reported on the MNE Group’s Qualified Financial Statements. This amount is used in lieu of the Adjusted Covered Taxes amount in the Pillar 2 ETR test. The PBT is the amount required to be reported on the MNE parent’s CbCR—in the case of the U.S., Line 2, Form 8975, Schedule A. This amount is used in lieu of the Net GloBE Income amount used in the Pillar 2 ETR test. The Transition Rate is 16 percent for fiscal years beginning in 2025 and 17 percent in fiscal years beginning in 2026.

An MNE’s TUT will be zero if the MNE satisfies the Routine Profits Test. The Routine Profits Test is satisfied if the SBIE equals or exceeds the PBT.

The OECD in the Administrative Guidance clarifies that the PBT must be adjusted to account for “Hybrid Arbitrage Arrangements entered into after December 15, 2022” (See Administrative Guidance, para. 35 (adding paragraph 74.25 to the Pillar 2 rules)). A Hybrid Arbitrage Arrangement includes a “duplicate loss arrangement” (“DLA”) (See *id.*).

A DLA is an “arrangement that results in an expense or loss being included in the financial statement of a Constituent Entity to the extent that ... the arrangement also gives rise to a duplicate amount that is deductible for purposes of determining the taxable income of another Constituent Entity in another jurisdiction.” (*Id.* (adding paragraph 74.28 to the Pillar 2 rules)).

A DLA does not include an arrangement to the extent that the amount of the relevant expense is offset against revenue or income which is included in both:

- i. the financial statements of the Constituent Entity including the expense or loss in its financial statements; and
- ii. the taxable income of the Constituent Entity claiming the deduction for the relevant expense or loss. (*Id.* (adding paragraph 74.28(f)).

The Administrative Guidance requires that the PBT is calculated by excluding any expense or loss arising from a DLA (See *id.* (adding paragraph 74.26)).

As described and illustrated below, a DLA includes an item of deduction or loss taken into account in computing a DCL that has been put to a domestic use via a DUE. While the DLA limitation appears to target certain abusive transactions designed to evade the Pillar 2 rules (see Administrative Guidance, para. 31-32), the DLA limitation also appears to have been a sympathetic attempt to coordinate the Pillar 2 rules with the DCL foreign use issue that suddenly emerged in the latter half of 2023 (see Jeff Maydew, *Guidance Requested That the Pillar 2 Jurisdictional Blending Rules Do Not Constitute the Foreign Use of Dual Consolidated Losses*, Tax Notes Int’l, Vol. 111, p. 845 (Aug. 3, 2023)). Accordingly, the interaction of the DUE and DLA requires a careful analysis of the DCL mirror legislation rule.

### **C. Notice 2023-80**

Treasury in Notice 2023-80 addressed the interaction of the DCL rules and the Pillar 2 rules (See 2023-52 I.R.B 1583). In doing so, Treasury stated that it intended to issue a proposed rule that would provide “certainty” regarding the interaction of the current DCL foreign use definition and the Pillar 2 rules for “legacy DCLs,” which generally are DCLs incurred in tax years ending on or before December 31, 2023 (See Notice 2023-80, §3.03). The proposed rule will provide that the computation of Net GloBE Income under the Pillar 2 rules will not create a foreign use of a legacy DCL, except in certain deemed abusive circumstances (See *id.*).

Treasury also expressed uncertainty as to whether aggregation resulting from a Net GloBE Income computation “giv[e] rise to the double dipping concerns that the DCL rules were intended to address.” (Notice 2023-80, §3.02). Treasury stated that it was currently “studying” the issue and observed that the Pillar 2 rules differ significantly from the DCL rules in many respects. In particular, Treasury observed that:



"[T]he [Pillar 2 Rules] do not include a mechanism through which a taxpayer can decline aggregation, with the result that the taxpayer might effectively be required to put a DCL to a foreign use (thereby removing what otherwise might have been a choice between a domestic use and a foreign use). (*Id.*)"

Accordingly, Treasury requested comments regarding the specific issue of whether the Pillar 2 rules should result in a foreign use of a DCL, as well as comments addressing other aspects of the interaction of the Pillar 2 rules and the DCL rules (*See* Notice 2023-80, §3.02, §4).

## II. Application of Mirror Legislation Rule and Pillar 2

Treasury is currently studying whether to amend the DCL foreign use definition to include situations in which Pillar 2 computations create a foreign use of a DCL, thereby subjecting a DCL to the domestic use limitation without the option of making a DUE. To be sure, there are good technical and Congressional purpose-based arguments militating against amending the foreign use definition to include Pillar 2 related computations, but most of that discussion is not the subject of this article or of this section. Rather, this section assumes, *arguendo*, that Treasury will issue a new rule changing the definition of foreign use to include all Pillar 2 related computations involving separate units (the "New Foreign Use Definition") and, instead, suggests that U.S. taxpayers that avail themselves of the Simplified ETR Test or the Routine Profits Test may be eligible to file a DUE for DCLs incurred in jurisdictions where the Pillar 2 rules apply, if Treasury can make some clarifying amendments to the DCL regulations.

The following examples illustrate the interaction of the mirror legislation rule and the Pillar 2 rules using simplified facts and certain "Working Assumptions" during 2025. For the sake of simplicity, the examples: (i) include facts relevant to only the Routine Profits Test, but the analysis and result would be substantially similar when a taxpayer relies on the Simplified ETR Test; (ii) do not account for the effect of foreign corporate income taxes; and (iii) use amounts in U.S. dollars.

Unless otherwise indicated, the examples proceed from the following Working Assumptions:

- (1) Treasury has issued a New Foreign Use Definition;
- (2) There are no base or timing differences in items of income, gain, deduction, or loss for purposes of financial accounting, U.S. tax accounting, and foreign tax accounting;
- (3) USP is potentially subject to Country X Pillar 2 rules because it has met the €750 Million annual revenue threshold;
- (4) Country X corporate income tax law does not include tax consolidation or tax loss sharing rules;
- (5) Country X has adopted Pillar 2 rules, including the Routine Profits Test described in the Administrative Guidance;
- (6) The Routine Profits Test is foreign legislation described in Treas. Reg. §1.1503(d)-3(e)(i)-(iii); and
- (7) All entities report their financial profits and their tax results on a calendar year basis.

### Example 1—Base Case

Facts: USCo is a domestic corporation that owns all equity interests in DRE1 and DRE2, entities organized under the laws of Country X and subject to Country X corporate income tax as a resident at the entity level. DRE1 and DRE2 are formed on January 1, 2024, and from inception are treated as entities that are disregarded as separate from their owner for U.S. income tax purposes (“foreign disregarded entities”). USCo also owns all equity interests in FC, an entity organized under the laws of Country X and subject to Country X corporate income tax as a resident at the entity level. FC is treated as a foreign corporation for U.S. income tax purposes. USCo, DRE1, DRE2, and FC are the Constituent Entities in USCo’s MNE group, and DRE1, DRE2, and FC constitute USCo’s Country X Constituent Entities.

The USCo MNE group has the following book and tax items during 2025. USCo earns \$500x of gross income and incurs no items of deduction or loss. DRE1 incurs \$200x of salary expense and earns no gross income. DRE2 incurs \$100x of depreciation deductions and earns no gross income. FC earns \$500x of gross income and incurs no items of deduction or loss. USCo’s Country X SBIE is \$225x.

Analysis: DRE1 and DRE2 constitute USCo’s Country X combined separate unit, which has incurred a \$300x DCL, consisting of \$200x of salary expense deductions and \$100x of depreciation deductions. Accordingly, unless USCo makes a DUE for the DCL, its Country X \$300x DCL will be subject to the domestic use limitation and will be treated as a SRLY loss. USCo in 2025 will pay \$105x of U.S. corporate income tax on \$500x of taxable income ( $105 = 500 \times .21$ ). If USCo makes a DUE for the \$300x DCL, it will reduce its U.S. taxable income to \$200x and pay \$42x of U.S. corporate income tax ( $42 = 200 \times .21$ ). USCo can make a DUE for the \$300x DCL only if it determines that there is no foreign use of the DCL in 2025.

USCo also must determine whether it will owe Country X TUT. In doing so, USCo must determine whether it has Excess Profits either by using the Routine Profits Test or by computing its Net GloBE Income and applying the Pillar 2 rules without regard to Routine Profits Test. If USCo does not apply the Routine Profits Test, then its Net GloBE Income will be \$200x ( $200 = 500 - 200 - 100$ ), and its SBIE will exceed its Net GloBE Income by \$25x ( $25 = 225 - 200$ ). Accordingly, USCo would not owe Country X TUT because it has not earned a Country X Excess Profit. USCo, however, would not be eligible to make a DUE for the \$300x DCL because Net GloBE Income computation creates a foreign use under the New Foreign Use definition.

If USCo applies the Routine Profits Test, then it must determine whether its \$225x SBIE equals or exceeds its PBT, as adjusted to eliminate amounts attributable to DLAs pursuant to the Administrative Guidance. Whether the items of deduction incurred by DRE1 and DRE2 are expenses or losses arising as a result of DLAs depends, in part, on whether USCo makes a DUE for the \$300x DCL attributable to USCo’s Country X separate unit. Because the Country X Routine Profits Test is foreign legislation described in Treas. Reg. §1.1503(d)-3(e)(1)(i) through (iii), USCo must perform alternate hypothetical computations (*viz.*, a no DUE Scenario and a DUE Scenario) to determine whether there is a deemed foreign use under mirror legislation rule.

#### i) No DUE Scenario

If USCo does not make a DUE for the DCL, the expenses attributable to DRE1 and DRE2 would not appear to be expenses arising as a result of DLAs because the \$200x salary expense deduction and the \$100x depreciation deduction would be subject to the domestic use limitation and would not be deductible on USCo’s 2025 U.S. federal income tax return. If this is the correct interpretation of Country X law, then USCo’s adjusted PBT in this case would be \$200x ( $200 = 500 - 200 - 100$ ), which means the

SBIE would exceed the adjusted PBT by \$25x ( $25 = 225 - 200$ ). USCo would satisfy the Routine Profits Test and would not owe Country X TUT.

#### ii) DUE Scenario

If USCo makes a DUE for the DCL, USCo's items of deduction incurred by DRE1 and DRE2 would seem to be amounts arising as a result of DLAs because the salary and depreciation expenses would be included in the financial statements of DRE1 and DRE2 (Country X Constituent Entities) and would be deductible amounts for purposes of determining the U.S. taxable income of USCo (a U.S. Constituent Entity). If this is the correct interpretation of Country X law, USCo's adjusted PBT would be \$500x, and USCo would not satisfy the Routine Profits Test because its adjusted PBT would exceed its SBIE by \$275x ( $275 = 500 - 225$ ). Thus, USCo could owe Country X TUT, depending on the resolution of other Pillar 2 issues.

#### iii) Mirror Legislation Rule

Working Assumption (6) states that the Country X Routine Profits Test is legislation described in Treas. Reg. §1.1503(d)-3(e)(1)(i)-(iii), which raises the possibility that the Country X Routine Profits Test creates a deemed foreign use under the mirror legislation that would preclude the filing of a DUE for the Country X DCL. The Country X Routine Profits Test, however, is substantially similar to the foreign legislation described in Example (18)(iii) because USCo is afforded a choice: USCo can either (1) include in its adjusted PBT computation the items of deduction taken into account in the Country X DCL, making the DCL subject to the domestic use limitation or (2) treat the salary and depreciation deductions attributable to DRE1 and DRE2 as amounts arising as a result of DLAs and thereby exclude them as deductions in its adjusted PBT computation as if USCo had made a DUE for the DCL. Because of this choice, there would be no deemed foreign use under the mirror legislation rule, leaving USCo with the option of: (1) making the DUE, thereby reducing its U.S. taxable income but subjecting itself to possible Country X TUT; or (2) using the deductions attributable to DRE1 and DRE2 in its adjusted PBT computation, thereby paying more U.S. corporate income tax but eliminating its Country X TUT. Thus, under the two-prong definition interpretation of the mirror legislation rule, the Country X's Pillar 2 rule is not mirror legislation. Alternatively, under the rule of application interpretation, the Country X Pillar 2 rule is mirror legislation but it does not apply to USCo's Country X DCL. USCo may make a DUE for the Country X DCL.

The conclusion that the Routine Profits Test, as amended by the Administrative Guidance, is substantially similar to Example (18)(iii) and does not create a deemed foreign use under the mirror legislation rule seems inconsistent with Treasury's observation in Notice 2023-80 that the Pillar 2 rules "do not include a mechanism through which a taxpayer can decline aggregation" thereby providing "a choice between a domestic use and a foreign use." (See Notice 2023-80, §3.02 (quoted in section I.C of this article)). This inconsistency is explainable. First, Treasury's observation might have been addressing the general Pillar 2 rules without regard to the Transitional CbCR Safe Harbours, which are temporary and expire for fiscal years ending after June 30, 2028. Second, while Notice 2023-80 was published in the Internal Revenue Bulletin 11 days after the OECD's issuance of the Administrative Guidance, it was released on December 11, 2023, which is before December 15, 2023, the publication date of the Administrative Guidance. The actual overlap between the documents is unclear. Also, given the flurry of activity and limited work days during December, the notice might have been internally approved long before the issuance of the Administrative Guidance. Finally, the Administrative Guidance addresses many issues and Treasury personnel might not have appreciated this nuanced point in time to change the language in the notice.

### **Example 2—SBIE exceeds adjusted PBT**

Facts: The facts are the same as Example 1, except USCo's Country X SBIE is \$500x.

Analysis: The analysis would be the same as in Example 1, except USCo's SBIE would be equal to its PBT, even if USCo makes a DUE for the Country X DCL. Thus, USCo would satisfy the Routine Profits Test and not owe Country X TUT, in both scenarios described in Example 1. This would not change the analysis and conclusion because USCo is still afforded a choice—either exclude the DCL deductions in the computation of adjusted PBT or include the DCL deductions in adjusted PBT. That USCo satisfies the Routine Profits Test in either scenario should be of no consequence.

### **Example 3—DRE1 earns gross income from third-party transactions**

Facts: The facts are the same as Example 1, except DRE1 also earns \$100x of gross income and USCo's 2025 SBIE is \$300x.

Analysis: The analysis would be the same as in Example 1, except for the following.

The domestic use limitation in the context of a combined separate unit achieves its own form of jurisdictional blending that effectively treats the entire combined separate unit as a single entity for DCL purposes. As a result, if any individual separate unit within the combined separate unit earns any gross income—by far the most common scenario—the items of deduction and loss incurred by all individual separate units within the combined separate unit are offset by the income amounts earned by all individual separate units within the combined separate unit on a pro rata basis. In Example 3, USCo's Country X DCL would be \$200x, consisting of \$133x of salary expense attributable to DRE1 and \$67x of depreciation deduction attributable to DRE2 (*See* Treas. Reg. §§ 1.1503(d)-4(c)(2), -7(c)(29)). If USCo does not make a DUE for the DCL and treats the DCL subject to the domestic use limitation, USCo would include on its U.S. federal income tax return \$67x of DRE1's salary expense, \$33x of DRE2's depreciation deductions, and DRE1's \$100x of income (*See id.*). The \$133x of salary expense and the \$67x of depreciation deduction would be treated as a SRLY loss.

#### **i) No DUE Scenario**

DRE1's \$133x salary expense and DRE2's \$67x depreciation expense are subject to the domestic use limitation and, therefore, are not amounts arising from DLAs. The exception in paragraph 74.28(f) provides that a DLA does not include expenses that offset revenue that appears both in the financial statements of the Constituent Entity that incurred the expense and the taxable income of the Constituent Entity that claims a tax deduction for the expense or loss. In this case, DRE1's \$67x salary expense appears to meet this exception, but DRE2's \$33x of depreciation expense does not appear to meet this exception because it is offsetting DRE1's financial accounting revenue under the domestic use limitation, not DRE2's financial accounting revenue. USCo's adjusted PBT in the case appears to be \$333x ( $333 = 500 + 100 - 200 - 67$ ). Because USCo's \$333x adjusted PBT exceeds its \$300x SBIE, USCo would fail the Routine Profits Test under this scenario.

#### **ii) DUE Scenario**

If USCo makes a DUE for the DCL, then the DLA amounts would be the \$133x of salary expense and the \$100x of depreciation deduction, making the adjusted PBT \$533x ( $533 = 500 + 100 - 67$ ). USCo would fail the Routine Profits Test under this scenario as well.

### iii) Mirror Legislation Rule

Because USCo would fail the Routine Profits Test even if it does not make a DUE, USCo is not afforded the choice to satisfy the Routine Profits Test by having a foreign use of the DCL. Accordingly, it does not appear that the result in Example (18)(iii) obtains in Example 3, suggesting that the mirror legislation rule would deem a foreign use of the DCL and preclude the filing of a DUE.

If the domestic use limitation rule did not create its own jurisdictional blending in this scenario and instead allowed DRE1's \$100x gross income to be offset solely by DRE1's items of deduction, then USCo's adjusted PBT would be \$300x ( $300 = 500 + 100 - 200 - 100$ ), which means USCo would have met the Routine Profits Safe Harbour in the No DUE Scenario. This would mean there would be no deemed foreign use under the mirror legislation rule and USCo would be free to make a DUE for the DCL.

### iv) Computational Problems in More Realistic Scenarios

Example 3 presents simplified facts to illustrate the interaction of the domestic use limitation and the DLA rule when an individual separate unit within a combined separate unit earns gross income. The Example 3 facts, however, are highly unusual because most individual separate units within a combined separate unit earn some gross income and there is no ordering or stacking rule to determine which items of deduction offset which items of income. Instead, all items of deductions incurred by the combined separate unit offset all items of income earned by the combined separate unit on a pro rata basis, frustrating any supportable application of the DLA rule.

The following additional Country Y example illustrates the comingling point, although even this Country Y example still presents a simplified fact pattern that underrepresents the degree of computational complexity in typical outbound structures. Assume that USCo owns four Country Y foreign disregarded entities that constitute USCo's Country Y combined separate unit: DRE1, DRE2, DRE3, and DRE4. DRE1 has the following items of expense and income: (1) \$60x salary expense; (2) \$10x depreciation deduction; (3) \$10x interest; and (4) \$20x of gross income. DRE2 has the following items of expense and income: (1) \$100x salary expense; and (2) \$120x of gross income. DRE3 has the following items of expense and income: (1) \$40x salary expense; (2) \$10x depreciation deduction; (3) \$20x interest; and (4) \$10x of gross income. DRE4 has the following items of expense and income: (1) \$100x salary expense; (2) \$10x interest; and (3) \$10x of gross income.

USCo's Country Y DCL would be \$200x, consisting of: (1) \$167x of salary expense; (2) \$11x of depreciation deduction; and (3) \$22x of interest expense. If the domestic use limitation applies to the Country Y DCL, USCo would include in its U.S. taxable income computation: (1) \$160x of gross income; (2) \$133x of salary expense; (3) \$9x of depreciation deduction; and (4) \$18x of interest expense. The DCL rules do not contain an ordering or stacking rule to determine which items of deduction offset which items of gross income. So, there is no apparent method to apply the DLA exception contained in paragraph 74.28(f), unless Country Y tax law provides some unilateral relief from this problem.

### **Example 4—Foreign disregarded entities formed prior to December 16, 2022**

Facts: The facts are the same as Example 1, except DRE1 and DRE2 are formed prior to December 16, 2022, and are treated as foreign disregarded entities from inception.

Analysis: DLAs include duplicate loss arrangements entered into after December 15, 2022. As explained in Examples 1 and 3, USCo's investments in DRE1 and DRE2 are duplicate loss arrangements, but Example 4 raises a different issue because USCo owned DRE1 and DRE2 prior to December 16, 2022,

which might suggest that the DLA rules are inapplicable because the arrangements were entered into prior to December 16, 2022.

The OECD regularly uses term “arrangement” throughout the BEPS Project. The OECD defines the term arrangement in pertinent part to “include a number of separate arrangements that all form part of the same plan or understanding and will include all the steps and transactions by which that plan or understanding is carried into effect.” (Recommendation 10.1, OECD (2015), [Neutralising the Effects of Hybrid Mismatch arrangements, Action 2—2015 Final Report](#) (“Action 2 Report”), OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris). Circularity notwithstanding, the definition might be helpful in that arrangement is defined by reference to all arrangements that form part of the plan.

The duplicate loss arrangement in the context of Example 4 could be limited to USCO’s investments in DRE1 and DRE2 and the related entity classification election that resulted in treating DRE1 and DRE2 as foreign disregarded entities for U.S. income tax purposes. If this is the proper interpretation of Country X law, then DRE1 and DRE2’s items of deduction would not be amounts arising as a result of DLAs because the investments in the entities and the election to treat the entities as foreign disregarded entities occurred prior to December 16, 2022, which would mean USCo would include the deduction amounts attributable to DRE1 and DRE2 in the adjusted PBT computation and the mirror legislation rule would deem a foreign use of the DCL.

A broader definition of arrangement might suggest that the duplicate loss arrangement includes not just the investments in DRE1 and DRE2 and the related U.S. tax classification elections, but also the underlying transactions that generated the deductions. So, if DRE1’s obligation to pay the salary amounts occurred after December 15, 2022—presumably the case for salary expenses that accrue in 2025—then perhaps the salary expense deductions arise from DLAs because the duplicate loss arrangement—which would include USCo’s obligation to pay the 2025 salary—was entered into after December 15, 2022. The depreciation deductions might raise more complicated questions. If the depreciable asset were acquired after December 15, 2022, then the position would be similar to DRE1’s salary expense deductions. If the depreciable asset were acquired prior to December 16, 2022, then the argument seems to be more difficult because the depreciation deductions accrue as a matter of U.S. income tax law and not by operation of any arrangement DRE2 entered into after December 15, 2022.

Depending on the Country X interpretation of the word “arrangement” and a particular taxpayer’s facts, the adjustments to PBT required by the Administrative Guidance may prove to have very limited applicability and very limited utility in the context of avoiding a foreign use of a DCL.

#### **Example 5—Timing differences**

**Facts:** The facts are the same as Example 1, except DRE2’s depreciation deduction relates to a \$100x expenditure made on January 1, 2025. The financial accounting rules provide that the full \$100x expenditure is deductible against 2025 profits. The \$100x expenditure for U.S. tax purposes is treated as an amount used to acquire a depreciable asset that is depreciable on a straight-line basis over a ten-year period. Accordingly, USCo’s 2025 Country X combined separate unit DCL is \$210x, consisting of \$200x of salary expense and \$10x of depreciation deduction.

**Analysis:** There does not appear to be any Pillar 2 guidance addressing timing differences, suggesting that DRE2’s depreciation deductions can create a DLA only in 2025 and that remaining \$90x of cost recovery that accrues for U.S. income tax purposes for the remaining nine years does not create a

potential DLA amount. The analysis becomes less clear if the expenditure creates annual cost recovery for both financial accounting purposes and U.S. income tax purposes but the cost recovery periods are not identical, which is the most likely scenario.

The text of the mirror legislation rule contains language that appears relevant to situations in which the facts are reversed (i.e., the expenditure creates \$10x of deductions over a ten-year period for financial accounting purpose but creates a \$100x 2025 deduction for U.S. income tax purposes), but it is not clear how the regulatory text resolves the issues created by this alternative to Example 5. The mirror legislation rule provides, in pertinent part, that there is a deemed foreign use “if the income tax laws of a foreign country would deny any opportunity for the foreign use of the dual consolidated loss in the year in which the dual consolidated loss is incurred (mirror legislation), *determined by assuming that such foreign country had recognized the dual consolidated loss in such year[.]*” The emphasized portion of the rule appears to address a fact pattern in which foreign mirror legislation creates a foreign use in a different tax year because of foreign tax timing differences. The emphasized language, however, provides no guidance in determining whether foreign legislation resembles the foreign legislation described in Example (18)(iii).

#### **Example 6—SRLY carryforward**

Facts: The facts are the same as Example 1, except: (1) in 2024, DRE1 earns \$200x of gross income and incurs no deductions; and (2) in 2024, DRE2 earns \$100x of gross income and incurs no deductions.

Analysis: Advice Memorandum 2011-002 states that USCo may absorb its \$300x Country X DCL in 2025 without making a DUE because USCo’s Country X separate unit has sufficient positive SRLY register to absorb the loss under the principles of Treas. Reg. §1.1502-21(c), as modified by Treas. Reg. §1.1503(d)-4(c)(3). This absorption rule is a rule of administrative convenience, because without current year absorption, USCo would be forced to carryback its 2025 Country X DCL to its 2024 tax year by filing a 2024 Form 1120X. A current year absorption through a positive SRLY register attains the correct U.S. income tax result without having to file an amended return.

The DLA exclusion rule does not appear to contemplate the U.S. tax result attained through this SRLY current year absorption principle. Rather, the definition of a DLA appears to be restricted to the current year results. Thus, in Example 6, DRE1’s salary expense deductions and DRE2’s depreciation deductions would offset USCo’s \$500x, which would make the deductions amounts arising from a DLA. This would cause USCo to fail the Routine Profits Test in the no DUE scenario. This is the case even though the deductions under paragraph 74.28(f) would be excluded from the definition of DLA if the gross income amounts were earned in the year of the deduction accruals.

### **III. Recommendations and Conclusion**

The DCL regulations were issued in 2007 and, thus, were not drafted to dovetail with the Pillar 2 global minimum tax regimes. As acknowledged in Notice 2023-80, the DCL rules should be updated to reflect the effect to the Pillar 2 rules. While this article focuses primarily on the mirror legislation rule and adjustments needed to coordinate the mirror legislation rule with a potential New Foreign Use definition, the examples illustrate other issues created by the interaction of the DCL rules and the Pillar 2 rules. Accordingly, Treasury should consider the following comments and recommendations while updating the DCL rules:

1. The mirror legislation rule should be clarified to reflect its proper interpretation, as illustrated by Example (18)(iii) and the discussion above.
2. The mirror legislation rule should contain a provision describing foreign tax rules that satisfy the principles described in Example (18)(iii), with a particular emphasis on Pillar 2 rules. There is current disagreement in the tax advisor community regarding the proper interpretation and scope of the mirror legislation rule, particularly Example (18)(iii) and its application to foreign tax rules that resemble the U.S. DCL rules. Guidance in this respect hopefully would resolve the disagreement. Finally, there should be an example that reflects the result in Example 2, in which the SBIE equals or exceeds the PBT irrespective of whether the taxpayer makes a DUE.
3. The mirror legislation rule should be clarified to reflect situations when there are timing differences and/or base differences between U.S. income tax law and other applicable foreign provisions. Example 5 illustrates unresolved issues that can arise when there are differences between the U.S. tax accounting rules and applicable financial accounting rules, but Example 5 illustrates only part of the problem. Taxpayers already have the burden under the DCL rules to track differences between U.S. tax accounting and foreign tax accounting to avoid a foreign use under a country's traditional corporate income tax law. Also, a country that has enacted a Pillar 2 rule might have also enacted another form of foreign mirror legislation as part of its corporate income tax law (*See, e.g.*, European Union Council Directive 2017/952, Art. 1 ("ATAD 2")). Drafting rules that are effective and administrable will need to address the complexity of tracking three sets of timing rules. This might prove challenging.
4. The DCL rules should be amended to create ordering or stacking rules that allow taxpayers to identify items of income or gain that are offset by items of deduction and loss for purposes of applying the domestic use limitation to combined separate units. Example 3 illustrates the effect of the domestic use limitation in the context of Pillar 2 rules, but like the previous comment, the domestic use limitation also has implications under another country's traditional corporate income tax law and its other mirror legislation, if applicable. Drafting administrable rules that address all these things may be challenging. Also, such ordering or stacking rules might prove incompatible with the combined separate unit rule.
5. The DCL rules should provide guidance on the interaction of the DCL rules and the Pillar 2 rules when a U.S. corporation's U.S. tax year differs from any other relevant financial accounting period or foreign tax year.
6. Treasury should abandon the "all or nothing rule" and limit a foreign use to the items of deduction and loss that are actually put to a foreign use. In light of the computational challenges illustrated by the examples and the prior comments, abandoning the "all or nothing rule" might be the only way to dovetail successfully the DCL rules with Pillar 2 rules and other corporate income tax regimes.

Treasury has on several occasions resisted requests to abandon the "all or nothing rule," citing the administrative complexity of having to verify the application of foreign income tax law to a specific set of facts. (*See, e.g.*, Preamble to Final DCL Regulations, [72 Fed. Reg. 12910-12911](#); *see also* McDonald, *All or Nothing Rule Leaves Taxpayers Empty Handed*, Tax Notes Today, 2010 TNT 50-8 (Mar. 16, 2010)). While that is an understandable concern, the DCL rules already require a detailed analysis of foreign law to make a DUE and to comply with its requirements. Specifically, a taxpayer on the DUE must certify that there has not been a foreign use in the year the DCL was incurred and must file annual certifications during the 5-year certification period certifying that there has not been a foreign use of the DCL during the 5-year period. Exercising triggering event rebuttal rights also involves a careful analysis of foreign



income tax law. Certifying that only a portion of the DCL was not put to a foreign use does not add incremental analysis or documentation—in fact, it probably reduces the burden because the universe of deduction and loss items that must be identified, analyzed, and sequestered is smaller. If there are any additional audit verification concerns created by abandoning the existing “all or nothing rule,” such concerns could be mitigated or eliminated by more detailed certification and documentation requirements. Finally, the U.S. international income tax rules in recent years have become more interrelated with foreign tax rules (*see, e.g.*, I.R.C. §267A and Treas. Reg. §1.861-20); therefore, these administrability concerns seem to have yielded to the necessity of coordinating increasingly interrelated international tax systems. Consistent with the evolution of the U.S. international tax rules and to dovetail the DCL rules with the Pillar 2 rules, the “all of nothing rule” should be abandoned.

7. If Treasury decides that all jurisdictional blending resulting from Pillar 2 computations creates a foreign use of a DCL, it should make any such final rule prospective and expand the definition of legacy DCLs to include all DCLs incurred in tax years prior to the effective date of the new foreign use definition. Treasury should issue clear guidance that provides U.S. multinational corporations sufficient time to assess their current structures and to make necessary adjustments to comply with the DCL rules and with the Pillar 2 regimes most efficiently. Moreover, the application of the existing foreign use definition to various Pillar 2 taxing provisions has created significant uncertainty in financial reporting positions. (*See, e.g., Tax Executive Institute Comment Letter Re: Notice 2023-80, the Dual Consolidated Loss and GloBE Rules* (Feb. 9, 2024); *Silicon Valley Tax Group Comment Letter Re: Notice 2023-80* (Feb. 9, 2024)). Immediate interim guidance providing that DCLs incurred in 2024 are legacy DCLs is needed.

8. Addressing the DCL foreign use problem from the Pillar 2 side would be a simpler approach. Specifically, the foreign use problem would be solved if taxpayers were provided an option under the Pillar 2 rules to exclude loss making individual separate units from the Net GloBE Income computation. This appears to have been a goal of the DLA limitation, but as illustrated above, the computational aspects of the domestic use limitation rule and the DLA rules severely frustrate this intent. Also, the remedy would be short-lived because of the temporary nature of the transitional safe harbours. Addressing the foreign use problem on the Pillar 2 side could involve the U.S. government’s participation within the OECD Inclusive Framework or through the bi-lateral agreement authority set forth in Treas. Reg. §1.1503(d)-6(b). The OECD in paragraph 33 of the Administrative Guidance appears to be willing to consider a similar approach. If this approach is taken, the mirror legislation rule would still need to be amended in accordance with some of the Recommendations above.

9. Alternatively, Treasury should exclude from foreign use all jurisdictional blending created by Pillar 2 computations. As noted above, this article does not discuss the technical and Congressional purpose-based considerations militating in favor of this position, but the examples in this article illustrate independent reasons for this result. The DCL rules are the product of over 30 years of development and refinement. The rules provide a predictable framework within which U.S. multinational corporations have been structuring overseas operations while hewing to Congressional restrictions on inappropriate double dipping of U.S. tax deductions. The new Pillar 2 rules, by contrast, do not address double dipping issues and, instead, are “designed to ensure large multinational enterprises (MNEs) pay a minimum level of tax on the income arising in each jurisdiction where they operate.” Indeed, the OECD already addressed double dipping issues exhaustively in its 2015 Action 2 Report. Thus, Treasury in Notice 2023-80 was correct to question whether the Pillar 2 rules truly “giv[e] rise to the double dipping concern that the DCL rules were intended to address.” They don’t, at least from an OECD perspective. Other than the creation of the DLA limitation, which appears to have been created with the dual purpose of combatting certain Pillar 2 abusive transactions and coordinating the Pillar 2 rules with the DCL foreign use issue,

there is no indication that the OECD thinks that double deductions that were not specifically created to avoid the Pillar 2 rules inappropriately decrease the tax base for purposes of the Pillar 2 minimum tax computations. The DCL rules and the Pillar 2 rules address different things.

Amending the DCL rules to provide relief in the mirror legislation rule context as described in this article might prove to be very challenging. Even if successful, the relief will be limited because many cross-border structures pre-date December 15, 2022, and the transitional safe harbours upon which the relief would be based expire for fiscal years ending after June 30, 2028. Moreover, each country that has enacted the Pillar 2 rules likely will develop their own interpretation of the provisions as they implement new minimum tax regime. Thus, amending the DCL rules to dovetail successfully with so many foreign rules might prove to be an insurmountable task with limited application and short duration.

The final result may be that many U.S. multinational corporations that have structured operations to be compliant with the DCL rules will have done so in vain, at least with respect to future years. If Treasury determines that Pillar 2 computations create a foreign use of a DCL, altering existing structures to be more efficient or to be compliant with both regimes might prove prohibitively expensive because of potential DCL recapture and potential section 91 recapture generated by many restructuring alternatives. A foreign minimum tax regime should not have such unintended reach and should not render futile and costly the overseas operational structures of U.S. multinationals, which have been painstakingly developed in reliance on and in compliance with long-standing DCL rules.

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