

Carryback of 2018 Foreign Branch Taxes to 2017

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The 2017 tax act added two new separate foreign tax credit limitation categories, or baskets. Under current law, there are now baskets for income attributable to a foreign branch (the foreign branch basket) and for amounts includible in gross income under section 951A (the GILTI basket), as well as baskets for general and passive category income.

Although income of a US person attributable to a foreign branch in 2018 is allocated to a separate foreign branch basket, there may be opportunities to carry back excess creditable foreign branch taxes to the 2017 tax year and claim credits for such taxes in 2017 in the appropriate basket (*i.e.*, the passive or general basket) even though the foreign branch basket did not exist in 2017.

For example, assume that a US multinational has active income attributable to a foreign branch and, in 2018, such income is subject to foreign income tax in the branch's country. If the US multinational has insufficient foreign source income in the foreign branch basket, it will not be able to fully credit such foreign income taxes paid or accrued in 2018. However, provided that such US multinational had excess foreign tax credit limitation in 2017 (*e.g.*, due to a large section 965 transition tax inclusion), it should be entitled to carry such excess foreign income taxes back to the 2017 tax year.

As a general rule, any creditable foreign taxes which exceed the section 904 limitation (determined on a basket-by-basket basis) for a taxable year must be carried back and are "deemed taxes paid or accrued" in the first preceding taxable year and then carried forward and deemed paid in the next 10 succeeding taxable years. The notable exception to this rule is that taxpayers may not carry back or carry forward foreign taxes allocated to the new GILTI basket.

Moreover, the amount allowed as a carryback under section 904(c) is generally equal to "the amount by which the limitation under [section 904(a)] for such preceding or succeeding taxable year" exceeds the total creditable foreign taxes paid or accrued in such preceding or succeeding taxable years. Thus, it appears that under current law excess foreign taxes in any basket other than the GILTI basket may be carried back to a prior year, and that such carryback should be allowed to the extent the limitation under section 904(a) exceeds the relevant creditable taxes for such year.

While the statute does not expressly confirm that foreign branch taxes can be carried back to another basket in a prior year, in the absence of any contrary US Treasury or IRS guidance, the statutory

language treating carried-back taxes as having been paid or accrued in the carry-to year strongly supports the position that these taxes can be carried back to the appropriate baskets that were in place for 2017. This interpretation is also supported by the fact that the only explicit disallowance of carrybacks set forth in section 904(c) is for GILTI basket taxes. To the extent excess creditable foreign branch taxes generated in 2018 can be carried back to 2017, they will typically be creditable in the general basket. Under both 2017 and 2018 law, section 904(d) provides that general category income includes all income not described in other baskets. Thus, in the example above, where the active income of the foreign branch would have been included in the general basket if incurred under pre-2018 law, it is appropriate for foreign taxes associated with such income to be carried back to the general basket in 2017.

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