

Part I

Section 901.—Taxes of Foreign Countries and of Possessions of the United States

26 CFR 1.901-2: Income, War Profits, or Excess Profits Tax Paid or Accrued

Rev. Rul. 2011-19

ISSUE

Whether a credit is allowable under section 901 of the Internal Revenue Code for the Remittance Basis Charge (RBC) of £30,000.

FACTS

Effective as of April 6, 2008, the United Kingdom enacted legislation under Part 14 of the Income Tax Act 2007, as amended by the Finance Acts 2008, 2009, and 2010, that generally allows individuals who are U.K. residents but who are not domiciled in the United Kingdom (i.e., do not intend to live in the United Kingdom permanently) (non-domiciliaries) to elect each year to be taxed on an alternative basis. The default basis of taxation for non-domiciliaries – as it is for any U.K. resident individual – is to pay U.K. income and capital gains taxes on their worldwide income and capital gains (gains), which is known as the arising basis of taxation. The alternative method of taxation is the remittance basis, under which non-domiciliaries with non-U.K.-source income or gains can elect to be taxed on their non-U.K.-source income and gains only when they are remitted to the United Kingdom. Remittance basis taxpayers also are subject to tax on their U.K.-source income and gains, which are taxed in the year in which they arose, under separate statutory provisions applicable to all U.K. resident individuals.

Both the arising basis and the remittance basis of taxation are computed on the basis of realized gross receipts and permit recovery of significant costs and expenses. Losses and deductions allocated to one type of taxable U.K.-source or non-U.K.-source income or gains may be available to offset other categories of taxable income and gains, depending on the type of income or gains involved and the nature of the losses and deductions.

A special rule applies to U.K. residents who are non-domiciliaries age 18 years or older and who were U.K. residents in at least seven of the prior nine taxable years (long-term non-domiciliaries). Under this rule, a long-term non-domiciliary who elects the remittance basis of taxation is required to pay the RBC of £30,000 in addition to the remittance basis tax. The RBC constitutes tax imposed on the arising basis on part (or all) of a long-term non-domiciliary's unremitted non-U.K.-source income or gains that arose or accrued in that year and were nominated (i.e., identified) by the long-term non-domiciliary, where the nominated income or gains taxed on the arising basis would give rise to an increase in tax of £30,000, after taking into account any credit due for foreign tax paid. A minimum of £1 of non-U.K.-source income or gains must be nominated in order for a long-term non-domiciliary's election to be taxed on the remittance basis to be valid.

A long-term non-domiciliary's required nomination schedule must show specifics concerning the nominated income or gains and the expenses or capital losses that are deducted in arriving at the taxable income or gains giving rise to the £30,000 tax charge. U.K.-source, remitted non-U.K.-source, and nominated income or gains, although separately computed, are combined into a single base and taxed at the graduated rates of U.K. income or capital gains tax that are generally applicable in the relevant tax year, with the rate that applies to nominated income or gains being determined after the tax is calculated on U.K.-source income and gains and on remitted non-U.K.-source income and gains.

The U.K. statute provides ordering rules that treat nominated amounts remitted to the United Kingdom as paid first out of income or gains that have not previously been subject to U.K. tax. If and when nominated income or gains are treated as remitted to the United Kingdom, they will be regarded as previously taxed on the arising basis and the long-term non-domiciliary will not again be subject to U.K. tax with respect to such amounts.

If the long-term non-domiciliary realizes or accrues, but does not nominate, sufficient realized non-U.K.-source income or gains to result in a tax charge of £30,000, the long-term non-domiciliary will be taxed as if sufficient additional realized income or gains had been nominated to result in a tax charge of £30,000. The U.K. statute also

provides a rule for when a long-term non-domiciliary elects the remittance basis but does not have sufficient realized income or gains to result in a tax charge of £30,000. In that case, the long-term non-domiciliary is deemed to have sufficient realized income or gains and to have nominated an amount necessary to make the tax charge equal £30,000. Income or gains, whether realized but not nominated, or imputed, which were deemed to have been nominated in order to generate a tax charge of £30,000 are not treated as previously-taxed income and therefore will be subject to tax if and when such income or gains are actually remitted.

LAW AND ANALYSIS

Section 901 generally allows a credit for the amount of any income, war profits and excess profits tax (collectively, an “income tax”) paid or accrued during the taxable year to any foreign country or to any possession of the United States. A foreign levy is an income tax if and only if (i) it is a tax and (ii) the predominant character of that tax is that of an income tax in the U.S. sense. §1.901-2(a)(1).

A. Single Levy or Separate Levies

Each levy must be analyzed separately to determine if it is an income tax under section 901. §1.901-2(d)(1). For purposes of section 901, whether a single levy or separate levies are imposed by a foreign country depends on U.S. principles and not on whether foreign law imposes the levy or levies in a single or separate statutes. Where the base of a levy is different in kind, and not merely in degree, for different classes of persons subject to the levy, the levy is considered for purposes of section 901 to impose separate levies for such classes of persons. For example, regardless of whether they are contained in a single or separate foreign statutes, a foreign levy identical to the tax imposed under section 871(b) on a U.S. nonresident alien individual’s income that is effectively connected with the conduct of a U.S. trade or business is a separate levy from a foreign levy identical to the tax imposed by section 1 on the income of a U.S. citizen or resident, as the tax on nonresidents has a more limited scope and therefore is different in kind from the tax on the worldwide income of U.S. citizens and residents.

Where foreign law imposes a levy that is the sum of two or more separately computed amounts, and each such amount is computed by reference to a separate base, separate levies are considered, for purposes of section 901, to be imposed. Amounts are not separately computed if they are computed separately merely for purposes of a preliminary computation and are then combined as a single base. §1.901-2(d)(1). For example, where excess deductible expenses allocated to one type of income are applied to reduce other types of income, a single levy exists, since despite a separate preliminary computation the bases are combined before computing the tax due. See §1.901-2(d)(3), Examples (3), (4), and (5).

1. The Remittance Basis and the Arising Basis of Taxation Are Separate Levies

Under both the arising basis and the remittance basis of taxation, a non-domiciliary is subject to tax on U.K.-source and non-U.K.-source income and gains. However, under the arising basis, a non-domiciliary is subject to tax on worldwide income and gains that arise or accrue in a particular taxable year; while under the remittance basis, a non-domiciliary is subject to tax only on U.K.-source income and gains and on non-U.K.-source income or gains that are remitted in a particular taxable year, whether the non-U.K.-source income or gains arise or accrue in the year remitted or in an earlier year. Thus, the bases of these levies are different in kind, and not merely in degree; therefore, the arising basis and remittance basis of taxation are considered for purposes of section 901 to impose separate levies.

2. The RBC, in Combination with the Remittance Basis of Taxation, is a Single Levy that is a Separate Levy

All non-domiciliaries who elect the remittance basis of taxation are subject to tax on their U.K.-source and remitted non-U.K.-source income and gains. In addition, long-term non-domiciliaries must pay the RBC on nominated but unremitted non-U.K.-source income and gains (and, if the amount nominated generates a tax charge of less than £30,000, on income or gains realized but not nominated and on imputed income such that the tax charge equals £30,000). Losses and deductions allocated to U.K.-source income or gains, remitted non-U.K.-source income or gains, or nominated but unremitted non-U.K.-source income or gains may offset income or gains in another category in determining the amount of the long-term non-domiciliary's taxable income. Therefore, under §1.901-2(d)(1), despite a separate preliminary computation, the long-term non-domiciliary's U.K.-source income or gains, remitted non-U.K.-source income or gains, and unremitted non-U.K.-source income or gains giving rise to the RBC are combined in determining the long-term non-domiciliary's taxable income; therefore, the tax imposed on the sum of the long-term non-domiciliary's three separately computed amounts of income constitute a single levy (the Long-Term Non-Domiciliary (LTND) Levy).

B. The LTND Levy Is a Tax in the U.S. Sense

A foreign levy is an income tax if and only if it is a tax and the predominant character of that tax is that of an income tax in the U.S. sense. §1.901-2(a)(1). A foreign levy is a tax if it requires a compulsory payment pursuant to the authority of a foreign country to levy taxes. §1.901-2(a)(2)(i). The LTND Levy is a tax because it is required to be paid pursuant to the authority of the government of the United Kingdom to levy taxes.

C. The Predominant Character of the LTND Levy Is that of an Income Tax in the U.S. Sense

The predominant character of a foreign tax is that of an income tax in the U.S. sense if the tax is likely to reach net gain in the normal circumstances in which it applies, and liability for the tax is not dependent, by its terms or otherwise, on the availability of a credit for the tax against income tax liability to another country. §1.901-2(a)(3). Liability for the LTND Levy is not dependent on the availability of a credit for the LTND Levy against income tax liability to another country.

Thus, whether the LTND Levy has the predominant character of an income tax depends on whether it is likely to reach net gain in the normal circumstances in which it applies. A foreign tax is likely to reach net gain in the normal circumstances in which it applies if and only if the tax, judged on the basis of its predominant character, satisfies each of the realization, gross receipts, and net income requirements set forth in §1.901-2(b)(2), (b)(3), and (b)(4), respectively.

1. Realization

A foreign tax satisfies the realization requirement if, judged on the basis of its predominant character, it is imposed upon or subsequent to the occurrence of events that would result in the realization of income under the income tax provisions of the Code. §1.901-2(b)(2)(i)(A). A foreign tax that, judged on the basis of its predominant character, is imposed upon the occurrence of realization or pre-realization events described in §1.901-2(b)(2)(i) satisfies the realization requirement even if it is also imposed in some situations upon the occurrence of events not described in that paragraph. For example, a foreign tax that, judged on the basis of its predominant character, is imposed upon the occurrence of realization events satisfies the realization requirement even though the base of that tax also includes imputed rental income from a personal residence used by the owner. §1.901-2(b)(2)(i).

The U.K.-source and remitted non-U.K.-source income and gains of a long-term non-domiciliary electing the remittance basis of taxation generally are computed on the basis of amounts that satisfy the realization requirement. In addition, the income or gains nominated for purposes of the RBC must be part (or all) of the non-U.K.-source income and gains arising or accruing in that taxable year. Income tax is charged on nominated income, and capital gains tax is charged on nominated gains, as if the arising basis applied for the relevant taxable year. In other words, the nominated income and gains are subject to tax, even though they have not been remitted in the taxable year. Thus, the RBC is imposed on nominated income or nominated gains that have been realized or accrued in the taxable year.

If the long-term non-domiciliary realizes or accrues, but fails to nominate, sufficient income or gains, with the result that the tax charge on nominated income would be less than £30,000, an amount of income or gains is deemed to be nominated so as to make the tax charge equal £30,000. Thus, income or gains that have been realized or accrued but not nominated will be subject to the RBC. If a long-term non-domiciliary elects the remittance basis but does not have sufficient realized or accrued income or gains to make the tax charge equal £30,000, the long-term non-domiciliary is deemed to have sufficient realized or accrued income or gains and to have nominated such imputed income or gains to make the tax charge equal £30,000.

Section 1.901-2(b)(2)(i) states that, as provided in §1.901-2(a)(1), a tax either is or is not an income tax, in its entirety, for all persons subject to the tax; therefore, a foreign tax on a base that includes imputed rental income will satisfy the realization requirement even though some persons subject to the tax will on some occasions not be subject to the tax except with respect to such imputed income. However, a foreign tax based only or predominantly on such imputed income would not satisfy the realization requirement. Although it is possible for a long-term non-domiciliary to elect the remittance basis without having sufficient non-U.K.-source income or gains to support a £30,000 tax charge, in which case the base of the tax would include imputed income or gains, it is highly unlikely that substantial numbers of long-term non-domiciliaries in this situation would elect to be taxed on the remittance basis. Accordingly, it is reasonable to conclude that the RBC is not based only or predominantly on such imputed income or gains. The RBC in general is imposed on realized income or gains, whether nominated by the long-term non-domiciliary or considered by the U.K. statute to have been nominated. Thus, judged on its predominant character, the LTND Levy meets the realization test.

2. Gross Receipts

A foreign tax satisfies the gross receipts requirement if, judged on the basis of its predominant character, it is imposed on the basis of gross receipts or gross receipts computed under a method that is likely to produce an amount that is not greater than fair market value. §1.901-2(b)(3)(i). A foreign tax that, judged on the basis of its predominant character, is imposed on the basis of amounts described in §1.901-2(b)(3)(i) satisfies the gross receipts requirement even if it is also imposed on the basis of some amounts not described in that paragraph. As is the case with income and gains that are taxed under either the arising basis or the remittance basis, nominated income and gains subject to the RBC generally are based on gross receipts. Therefore, the LTND Levy meets the gross receipts test.

3. Net Income

A foreign tax satisfies the net income requirement if, judged on the basis of its predominant character, the base of the tax is computed by reducing gross receipts to permit recovery of the significant costs and expenses (including significant capital expenditures) attributable, under reasonable principles, to such gross receipts; or recovery of such significant costs and expenses computed under a method that is likely to produce an amount that approximates, or is greater than, recovery of such significant costs and expenses. §1.901-2(b)(4)(i). Since the LTND Levy is imposed on U.K.-source income and gains, remitted non-U.K.-source income and gains, and nominated but unremitted non-U.K.-source income and gains, all of which consist of gross receipts less costs and expenses, the LTND Levy satisfies the net income requirement.

4. Conclusion

Because the LTND Levy is likely to reach net gain in the normal circumstances in which it applies, it has the predominant character of an income tax in the U.S. sense.

HOLDING

Because the LTND Levy is a tax (within the meaning of §1.901-2(a)(2)), and its predominant character is that of an income tax in the U.S. sense, the LTND Levy, including the Remittance Basis Charge (RBC) of £30,000, is an income tax for which a credit is allowable under section 901. However, a credit for the LTND Levy will be available only if the other legal requirements for obtaining a foreign tax credit are satisfied. For example, an amount paid is treated as a compulsory payment of income tax only to the extent the taxpayer applies the substantive and procedural provisions of foreign law, including elective provisions such as those available under U.K. law relating to the LTND Levy, in such a way as to reduce, over time, the taxpayer's reasonably expected liability under foreign law for income tax. §1.901-2(e)(5).

Taxpayers generally may rely upon revenue rulings to determine the tax treatment of their own transactions and need not request a ruling that would apply the principles of a published revenue ruling to the facts of their own particular cases. However, because each revenue ruling represents the conclusion of the Internal Revenue Service (IRS) as to the application of the law to the specific facts involved, taxpayers, IRS personnel, and others concerned are cautioned against reaching the same conclusion in other cases unless those cases present facts and circumstances that are substantially the same as those in the revenue ruling. §601.601(d)(2)(v)(e). Accordingly, because the provisions of U.K. law described in this revenue ruling are facts on which this revenue ruling bases its holding, a taxpayer may not rely on the revenue ruling if the relevant provisions have been amended in any material respect,

and the taxpayer is responsible for determining whether any such modification has occurred.

DRAFTING INFORMATION

The principal author of this revenue ruling is Teresa Burrige Hughes of the Office of Associate Chief Counsel (International). For further information regarding this revenue ruling, contact Ms. Hughes at (202) 622-3850 (not a toll-free call).