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***By Electronic Delivery***

February 18, 2020

Lafayette “Chip” G. Harter III  
Deputy Assistant Secretary, International  
Tax Affairs  
US Department of the Treasury  
1500 Pennsylvania Avenue, NW  
Washington, DC 20220

Michael Desmond  
Chief Counsel  
Internal Revenue Service  
1111 Constitution Avenue, NW  
Washington, DC 20224

RE: Proposed Foreign Tax Credit  
Regulations (REG 105495-19)

Dear Mr. Harter and Mr. Desmond:

The Investment Company Institute<sup>1</sup> requests clarification of the definition of “financial services group” (FSG) in the recently proposed regulations under section 904. As currently drafted, the definition in Prop. Reg. § 1.904-4(e)(2)(ii) limits an FSG to an affiliated group that is in the lending or finance business by cross-referencing section 954(h)(2)(B)(i). We ask the Treasury Department and the Internal Revenue Service (IRS) to expand this definition to include banks and broker/dealers by cross-referencing all of section 954(h)(2)(B). This minor change would provide consistency between the definitions of FSG and “financial services entity” (FSE) in the proposed regulations.

ICI supports the Treasury Department and IRS’s efforts to promote simplicity and consistency within the Internal Revenue Code and regulations. We believe that this recommended change would further that objective.

**Current Law**

Section 904(d) provides that the foreign tax credit shall be applied separately with respect to certain types of income: (i) any amount includible in gross income under section 951A (other than passive category income); (ii) foreign branch income; (iii) passive category income; and (iv) general category income. Foreign taxes paid on amounts in these different buckets can only be offset by income in the same bucket. Section 904(d)(2)(C) provides that financial services income (FSI) shall be treated as general category income for a member of an FSG and any other

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<sup>1</sup> The [Investment Company Institute](http://www.ici.org) (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI’s members manage total assets of US\$25.2 trillion in the United States, serving more than 100 million US shareholders, and US\$7.0 trillion in assets in other jurisdictions. ICI carries out its international work through [ICI Global](http://www.ici.org/global), with offices in London, Hong Kong, and Washington, DC.

person predominantly engaged in the active conduct of a banking, insurance, financing or similar business.

An FSG is defined in section 904(d)(2)(C)(ii) as an affiliated group (as defined in section 1504(a) without regard to section 1504(b)(2) and (3)) that is predominantly engaged in the active conduct of a banking, insurance, financing, or similar business. For this purpose, only the income of members of the group that are US corporations and certain CFCs predominantly owned by such corporations are taken into account.

FSI is defined in section 904(d)(2)(D) as any income that is received or accrued by any person predominantly engaged in the active conduct of a banking, insurance, financing, or similar business. If a taxpayer falls within this definition, the taxpayer's passive income is not assigned to the passive category.

The current regulations under section 904 define FSI as income derived by an FSE that is "active financing income," as defined in Treas. Reg. § 1.904-4(e)(2), plus specified passive income. "Active financing income" for this purpose lists several types of income from financing, banking, and insurance businesses.<sup>2</sup> The regulations then provide that an individual or entity is an FSE if at least 80 percent of its gross income is active financing income.<sup>3</sup>

The regulations also provide a special rule for affiliated groups.<sup>4</sup> Under this rule, if a corporation is not an FSE under the regulations but is a member of an affiliated group (as defined in section 1504(a), determined without regard to section 1504(b)(3)), such corporation will be treated as an FSE if the affiliated group as a whole meets the definition of an FSE. Thus, under this special rule, passive income of a corporation that is a member of an affiliated group that meets these requirements would be categorized as general category income for purposes of section 904.

## **Proposed Regulations**

The proposed regulations would amend the definition of an FSE by limiting the types of activities that qualify as an active financing business. The proposed regulations define FSI as income derived by an FSE in the active conduct of a banking, financing, or similar business under section 954(h)(3)(A)(i); certain specified types of insurance income; and passive income as described in section 904(d)(2)(B) and the regulations thereunder (with certain modifications).<sup>5</sup> Section 954(h)(3)(A)(i) describes income derived in the active conduct of a banking, financing, or similar business by controlled foreign corporations (CFCs) or a qualified business unit of such CFCs.

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<sup>2</sup> Treas. Reg. § 1.904-4(e)(2)(i).

<sup>3</sup> Treas. Reg. § 1.904-4(e)(3)(i).

<sup>4</sup> Treas. Reg. § 1.904-4(e)(3)(ii).

<sup>5</sup> Prop. Reg. § 1.904-4(e)(1)(ii).

The proposed regulations also would amend the definition of an FSE.<sup>6</sup> The proposed regulations provide that an individual or corporation is predominantly engaged in an active financing business for any year if for that year it is predominantly engaged in the active conduct of a banking, financing, or similar business described in section 954(h)(2)(B), or otherwise falls within certain categories of insurance companies. Section 954(h)(2)(B) describes the circumstances in which a CFC is treated as predominantly engaged in the active conduct of a banking, financing, or similar business. Thus, by applying this cross-reference, a taxpayer (other than certain insurance companies) would be an FSE under the proposed regulations only if: (i) more than 70 percent of the gross income of the individual or corporation is derived directly from the active and regular conduct of a lending or finance business from transactions with customers which are not related persons; (ii) it is engaged in the active conduct of a banking business and is an institution licensed to do business as a bank in the US; or (iii) it is engaged in the active conduct of a securities business and is registered as a securities broker or dealer under section 15(a) of the Securities Exchange Act of 1934 (the 1934 Act) or is registered as a Government securities broker or dealer under section 15C(a) of the 1934 Act.

The proposed regulations also would amend the special rule for FSGs. They provide that a corporation that is a member of an FSG is deemed to be an FSE regardless of whether such corporation is itself an FSE. For this purpose, an FSG means an affiliated group (as defined in section 1504(a) but determined without regard to section 1504(b)(2) or (3)) if the affiliated group meets the requirements of section 954(h)(2)(B)(i) (substituting the term “affiliated group” for CFC).

The cross-reference in the definition of FSG applies only to section 954(h)(2)(B)(i), thus limiting the application of the FSG rule to affiliated groups that derive more than 70 percent of the group’s gross income directly from the active and regular conduct of a lending or finance business from transactions with customers that are not related persons. Affiliated groups that are engaged in the active conduct of a banking business or that are registered as a securities broker or dealer under the 1934 Act would not qualify as an FSG under this rule, even though such entities themselves would qualify as FSEs under the proposed regulations.

### **Requested Change**

ICI asks the Treasury Department and IRS to revise the cross-reference in the definition of FSG to apply to all of section 954(h)(2)(B). This would provide consistency with the definition of FSE in the proposed regulations. Absent such a change, affiliated groups that predominantly are banks or broker/dealers would not benefit from the special rule for FSG. We do not believe there is a sound policy reason for excluding these groups from the FSG definition.

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<sup>6</sup> Prop. Reg. § 1.904-4(e)(2)(i).

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ICI appreciates your consideration of our recommendation. Please do not hesitate to contact me (202-371-5432 or [kgibian@ici.org](mailto:kgibian@ici.org)) if you would like to discuss it further.

Sincerely,



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Associate General Counsel, Tax Law

cc: Douglas Poms  
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