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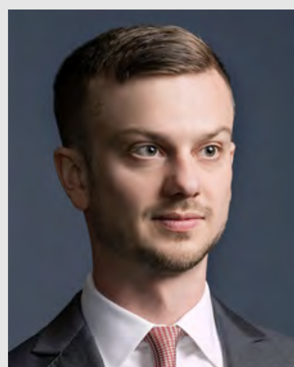
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In this article, Pastore and Himmelstein examine a federal district court's decision in *FedEx* and the recent controversy over U.S. multinationals claiming the foreign tax credit for their foreign offset earnings, including the interaction between subpart F, the Tax Cuts and Jobs Act, and the FTC regime.

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The tax press has paid a great deal of attention to disputes over the so-called global intangible low-taxed income doughnut hole in the Tax Cuts and Jobs Act. They have paid far less attention to disputes over another wrinkle arising from that law. Under the TCJA, U.S. multinationals were required to pay a transition tax on their previously untaxed foreign earnings, but they could use the losses from their unprofitable foreign subsidiaries to reduce or offset the earnings of their profitable foreign subsidiaries. Although those offset earnings are therefore not subject to U.S. tax, taxpayers have claimed a foreign tax credit for the taxes paid abroad. The IRS believes that taxpayers should not get this FTC and wrote regulations to make that position clear.[1]

Disputes over this issue are making their way through the court system now, with one district court reaching a taxpayer-favorable decision in *FedEx*, while other cases are pending.[2] The issue would be worth keeping on the radar screen if only because large dollars are at stake. But the cases also raise an interesting question of how far courts can and should go to reform a tax statute when the IRS does not like the result. In a recent dispute over the so-called GILTI doughnut hole, a court used the economic substance doctrine to prevent a taxpayer from relying on a plain-meaning interpretation of a tax statute.[3] That option might be unavailable to courts in offset earnings disputes, so they will need to use traditional tools of statutory interpretation to resolve them. This article surveys the relevant statutory rules, examines the arguments put forward in *FedEx*, and evaluates other potential arguments that taxpayers might choose to advance in the future.

I. Legal Background

The legal issue in *FedEx* and the other offset earnings cases hinges on three aspects of the code: the FTC rules, subpart F, and the transition tax in the TCJA. A basic understanding of the history, purpose, and mechanics of all three regimes is needed to understand the dispute over offset earnings.

[1] Reg. section 1.965-5(c).

[2] *FedEx Corp. v. United States*, No. 20-cv-02794 (W.D. Tenn. Mar. 31, 2023).

[3] *Liberty Global Inc. v. United States*, No. 1:20-cv-03501-RBJ (D. Colo. Oct. 31, 2023).

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A. History and Purpose

The FTC rules came first. They have existed in some form since 1918.[4] From the very beginning, the primary purpose of the FTC was "to mitigate the perceived evils of international double income taxation" that arose from the natural operation of the United States' worldwide tax system.[5] In the absence of an FTC, U.S. corporations would pay tax abroad on their foreign earnings and then a "double" tax on those same foreign earnings in the United States. Prevention of that double taxation is "one of the longest-held U.S. international tax principles."[6] An important "secondary objective" of the FTC provisions, however, "was to encourage, or at least not to discourage, American foreign trade."[7]

Subpart F came next. Congress introduced it into the code in 1962. Subpart F was "primarily concerned with ending tax haven abuses" and reflected Congress's uneasiness with the indefinite tax deferral that U.S. multinationals could achieve using foreign subsidiaries under the worldwide taxation system.[8] "To achieve this goal [subpart F] ended the deferral of the U.S. tax in the case of certain forms of income arising from insurance abroad of U.S. risks, from passive investments, from sales and service subsidiaries separately incorporated from the producing companies, and from funds which are brought back to this country without the payment of U.S. tax."[9] Under subpart F, certain categories of income earned by a U.S. parent's foreign subsidiaries could be taxed immediately in the United States, even if that income was not distributed to the U.S. parent until many years later.

The TCJA came last, in 2017. The international provisions in the new regime were premised on Congress's belief that "the worldwide system of taxation with deferral provides perverse incentives to keep funds offshore because dividends from foreign subsidiaries are not taxed until repatriated to the United States."[10] The TCJA therefore ushered in "a territorial system with appropriate anti-base erosion safeguards, combined with a lower corporate tax rate."[11] Beyond the general desire to make "American workers and companies competitive again," Congress explained that the primary goal of the TCJA's international provisions was to "remove tax-driven incentives to keep funds offshore."[12]

Of course, all three regimes exist in the IRC today. When Congress enacted the TCJA, it left much of the architecture of subpart F and the FTC rules in place. Indeed, Congress engrafted certain TCJA provisions onto that architecture. Congress did so even though the TCJA is premised (at least in theory) on a territorial system of taxation, rather than the worldwide system that underpinned subpart F and the FTC rules. Because these three regimes have different historical rationales and purposes, it is unsurprising that tax controversies are now starting to arise over the way Congress tried to stitch all of them together.

B. The Relevant Statutes

With this history and background explained, we now turn to the specific rules at issue in the offset earnings cases.

The provision at the heart of the dispute is section 965, the so-called transition tax in the TCJA. To move the United States from a worldwide system of taxation to a territorial one, section 965 provides that a U.S. company is subject to a one-time tax on the previously untaxed earnings of its foreign subsidiaries.[13] The provision does so by treating these previously untaxed earnings as immediately taxable under subpart F.[14] Because some of the U.S. company's foreign subsidiaries might have generated losses, though, section 965(b) permits the company to offset the earnings of its profitable foreign subsidiaries with the losses of its unprofitable

[4] Revenue Act of 1918, ch. 18, section 222(a).

[5] Joseph Isenbergh and Bret Wells, *International Taxation: U.S. Taxation of Foreign Persons and Foreign Income*, para. 56.1.2 (2023).

[6] *Id.*

[7] *Phillips Petroleum Co. v. Commissioner*, 104 T.C. 256, 284 (1995).

[8] S. Rep. No. 87-1881 (1962).

[9] *Id.*

[10] H.R. Rep. No. 115-409 at 370 (2017).

[11] *Id.*

[12] *Id.*

[13] Section 965(a).

[14] *Id.*

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foreign subsidiaries (hence the term "offset earnings"). Offset earnings are therefore not subject to the transition tax. Further, section 965 provides — "for purposes of applying section 959" — that offset earnings will be treated as if they had previously been subpart F income.[15] In turn, section 959 — a long-standing feature of subpart F — provides that earnings that were already subject to tax under subpart F are not taxed again when repatriated to the United States.[16]

That brings us to the relevant FTC rules. Both before and after the TCJA, section 901 provided the FTC. Before the TCJA, section 902 provided for an FTC when a foreign subsidiary paid a dividend to its U.S. parent (the so-called deemed paid credit).[17] Under that old system, what if the U.S. company was required to pay tax on the foreign subsidiary's income under subpart F, even though the foreign subsidiary did not pay a dividend in that year? Section 960(a)(1) treated the subsidiary as having paid a dividend in the year of the subpart F inclusion so that the U.S. parent would be able to claim the FTC in that year. Section 960(a)(2) granted a credit for any additional foreign tax that had been imposed after the subpart F inclusion and for which the taxpayer had not yet received an FTC. If the foreign subsidiary later paid a dividend, section 960(a)(3) would ensure that the U.S. parent was not entitled to claim the FTC a second time.

A table at the end of this article simplifies the relevant code provisions.

II. *FedEx*: A Tax Controversy Over Offset Earnings

This patchwork of rules led to an interesting result. Taxpayers that had offset earnings were able to repatriate them tax free while also claiming a tax credit for the foreign taxes paid on those earnings. Offset earnings were thus not subject to tax in the United States. And because the U.S. parent corporation received an FTC when the earnings were repatriated, the earnings were not subject to the economic effect of the tax abroad either. Naturally, Treasury disagreed with that interpretation of the rules. In its view, Congress did not intend to grant taxpayers an FTC for offset earnings and wrote regulations under section 965 to memorialize that position.[18]

FedEx recognized the opportunity and repatriated its offset earnings shortly after the passage of the TCJA. It explained that the purpose of the repatriation was to "ensure there was sufficient cash in the United States leading up to peak season . . . and to account for liquidity needs in the wake of [a cyberattack]."[19] FedEx treated the regulations as valid on its original tax return, but it then filed amended returns seeking refunds of the FTCs on the offset earnings.[20] FedEx then sued for a refund in a federal district court in Tennessee.[21]

The parties soon filed cross-motions for summary judgment. In its motion, FedEx argued that it is entitled to claim FTCs for its offset earnings under a plain reading of the statutes.[22] FedEx argued that the section 965 regulations — which attempted to disallow the credit — were invalid.[23]

In contrast, the government argued that section 965 disallowed a credit for offset earnings.[24] The government relied principally on section 965(b)(4)(A), which provided that offset earnings will be treated as if they had been subpart F income "for purposes of applying section 959."[25] According to the government, that means that the FTC rules treat the taxpayer as already having received the credit, barring the taxpayer from receiving the credit a second time when the money is repatriated.[26]

[15] Section 965(b)(4)(A).

[16] Section 959(a).

[17] Section 902 was repealed for taxable years after 2017.

[18] Treasury issued those regulations under section 965 in proposed form in 2018. *See* REG-104226-18. It issued final regulations in 2019. *See* T.D. 9846.

[19] Plaintiff's Appendix in Support of Motion for Partial Summary Judgment at Exhibit 1, *FedEx Corp.*, No. 20-cv-02794 (W.D. Tenn. July 25, 2022).

[20] Complaint at 6, *FedEx Corp.*, No. 20-cv-02794 (W.D. Tenn. Nov. 2, 2020).

[21] *Id.* at 20.

[22] Plaintiff's Motion for Partial Summary Judgment at 8, *FedEx Corp.*, No. 20-cv-02794 (W.D. Tenn. July 25, 2022).

[23] *Id.* at 7.

[24] United States' Memorandum in Support of Its Motion for Partial Summary Judgment at 7, *FedEx Corp.*, No. 20-cv-02794 (W.D. Tenn. Sept. 9, 2022).

[25] *Id.* at 16-18, 21-23.

[26] *Id.* at 22.

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Sensing some vulnerability, the government argued that the statutes could be open to multiple interpretations, in which case the regulations resolve the ambiguity in favor of the IRS.[27] To shore up that position, the government argued that the taxpayer's position would lead to a "novel windfall" — the United States could not tax offset earnings but then must essentially make the taxpayer whole for the taxes that it paid abroad.[28] In the government's view, this result contravenes the purpose of the FTC rules to prevent double taxation.

In a well-reasoned opinion, the district court resolved this dispute on summary judgment in favor of the taxpayer.[29] The court carefully walked through the relevant provisions of the FTC regime, subpart F, and section 965. According to the court, the fatal flaw in the government's statutory argument was that offset earnings are treated as previously included in subpart F income only "for purposes of applying section 959," a provision that is not part of the FTC regime. The court correctly identified this as "limiting language," which means that offset earnings are not treated as previously included in subpart F income for purposes of the FTC rules.[30] Because the statutory scheme therefore grants the taxpayer the FTC, the regulations cannot be applied to take the credit away.

III. Evaluation

FedEx reached the right result — the statutes on their face do not bar the taxpayer from claiming the credit. The government's position, by contrast, is implausible. In fact, it is comprehensible only when you look beyond the statutes and consider that the primary purpose of the FTC regime is to prevent the incidence of double taxation. Because the government did not have a plausible statutory interpretation, it was left to argue that the taxpayer's interpretation eliminates all taxation and hope the court would rewrite the statute. The *FedEx* court wisely did not take the bait. And the court correctly alluded to a potential countervailing purpose: The TCJA was meant to encourage the repatriation of foreign earnings.

The concern about the taxpayer's windfall, though, is something that *FedEx* never fully resolves. The taxpayer tried to justify it by claiming that there actually was no windfall at all. The offset earnings would — or at least could — be taxed in the United States eventually.[31] The court rejected this argument in a footnote.[32] That left the taxpayer with its plain reading of the statute, which was sufficient to carry the day. But plain reading arguments may not invariably prevail when a court is faced with what it thinks might be a statutory loophole.[33]

There are two other — potentially better — approaches to deal with this atmospheric issue. One way of justifying the plain meaning of the statutory scheme is to argue that it simply contains a glitch and — although Congress might not have intended it — the plain reading of the statutes must stand.[34] As one court succinctly put it, if the correct interpretation of a tax statute "results in an unintended loophole created by Congress, then it is up to Congress to remedy it, not the courts."[35] But it is unclear whether the statutes here actually do contain a glitch. A Joint Committee on Taxation report did state that "a technical correction may be needed to reflect [Congress's] intent" to disallow credits or deductions for offset earnings.[36] But JCT reports are "not a legitimate tool of statutory

[27] *Id.* at 25 n.14; *see also* United States' Reply in Support of Its Motion for Partial Summary Judgment at 18, *FedEx Corp.*, No. 20-cv-02794 (W.D. Tenn. Nov. 10, 2022).

[28] United States' Memorandum in Support of Its Motion for Partial Summary Judgment, *FedEx Corp.*, No. 20-cv-02794 at 27 n.15.

[29] *FedEx Corp.*, No. 20-cv-02794 at *11.

[30] *Id.* at *8.

[31] Plaintiff's Motion for Partial Summary Judgment, *FedEx Corp.*, No. 20-cv-02794 at 31.

[32] *FedEx Corp.*, No. 20-cv-02794 at *10 n.13.

[33] *See Crooks v. Harrelson*, 282 U.S. 55, 60 (1930) ("Courts have sometimes exercised a high degree of ingenuity in the effort to find justification for wrenching from the words of a statute a meaning which literally they did not bear in order to escape consequences thought to be absurd or to entail great hardship.").

[34] A recent article discussed the IRS's inability to correct drafting mistakes and glitches. *See* Monte A. Jackel, "The IRS as Legislator: Are Things Working as They Should?" *Tax Notes Federal*, Apr. 29, 2024, p. 891.

[35] *Estate of Litman v. United States*, No. 89-1302 at *4 (W.D. Pa. Apr. 23, 1990); *see also Summa Holdings Inc. v. Commissioner*, 848 F.3d 779, 790 (6th Cir. 2017). "The last thing the federal courts should be doing is rewarding Congress's creation of an intricate and complicated Internal Revenue Code by closing gaps in taxation whenever that complexity creates them."

[36] JCT, "General Explanation of Public Law 115-97," JCS-1-18, at 362 n.1695 (Dec. 2018).

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construction" because they are published after tax laws have been drafted.[37]

Another approach would be to further develop the *FedEx* court's rather offhand comment that the TCJA was designed to encourage repatriation. This latter approach is worth serious consideration. It is beyond dispute that one of the primary purposes of the TCJA — and specifically its international provisions — was to increase U.S. investment. When former President Donald Trump signed the TCJA into law, he said, "We're going to bring back probably $4 trillion from overseas. Nobody knows the exact number, but it's massive. It will be over $3 trillion; it could be $5 trillion. But it's a tremendous amount of money that was caught overseas that the bureaucracy plus the tax laws didn't allow it to reasonably be brought back into our country. So we think at least $4 trillion is going to be brought back."[38]

Other TCJA legislative history underscores that purpose. According to the House report, Congress sought "to enhance both the global competitiveness of U.S. businesses and to encourage investment in the United States."[39] Under the new TCJA rules, "the repatriation of foreign earnings will not carry negative tax consequences thereby discouraging such repatriation, which is one of the reasons for moving to a participation exemption system of taxation."[40]

These statements perhaps show why Congress intended to permit taxpayers to take FTCs for offset earnings — or at least did not expressly intend to disallow them. Offset earnings might be put to better use in the United States. It is also important to note that the taxpayer's interpretation justified the FTC only when the money is actually repatriated. Other aspects of the TCJA provide incentives for U.S. investment at the expense of the fisc — for example, 100 percent bonus depreciation and foreign-derived intangible income.

IV. Parting Thoughts

Offset earnings disputes can involve big dollars. The refund at issue in *FedEx* is $89 million. And it is not the only dispute pending. This same basic dispute is at issue in other pending litigation, including *Sysco* in the Tax Court.[41] It would not be surprising to see more disputes on this issue crop up in the next year or two, especially given the 10-year statute of limitations under section 6511.[42]

It is also worth adding that *FedEx* itself is not over. The government recently tried another line of attack against FedEx's position. It argues that it can "haircut" the FTCs on the offset earnings under section 965(g).[43] Procedural wrangling over this issue is ongoing, and the district court has not yet reached a decision.[44]

Right now, it is looking very good for taxpayers, but the dust has not cleared yet. If taxpayers in offset earnings disputes lean into the legislative history of offset earnings, they might be able to counteract some of the negative atmospherics that the IRS will invariably attempt to conjure up in these cases. While it might be true that the FTC regime was primarily designed to prevent double taxation, the TCJA was targeted at something different — putting money back into the United States from abroad.

[37] *United States v. Woods*, 571 U.S. 31, 47-48 (2013).

[38] Remarks by President Trump at Signing of H.R. 1, Tax Cuts and Jobs Bill Act, and H.R. 1370 (Dec. 22, 2017).

[39] H.R. Rep. No. 115-409 at 375.

[40] *Id.* at 374.

[41] *Sysco Corp. v. Commissioner*, T.C. No. 5728-23 (2023).

[42] Section 6511(d)(3).

[43] Plaintiff's Motion for Entry of Judgment, *FedEx Corp.*, No. 20-cv-02794 (W.D. Tenn. Mar. 8, 2024); United States of America's Response to Plaintiff's Motion for Entry of Judgment, *FedEx Corp.*, No. 20-cv-02794 (W.D. Tenn. Apr. 12, 2024).

[44] Andrew Velarde, "FedEx Attacks DOJ's Offset Earnings Argument as 'Pure Fiction,'" *Tax Notes Federal*, Apr. 29, 2024, p. 926.

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V. Appendix: Relevant Code Provisions

TCJA	
Section 965(a)	The transition tax.
Section 965(b)(1)	Provides that losses of foreign controlled foreign corporations may be used to offset earnings of CFCs that are subject to the transition tax.
Section 965(b)(4)(A)	Provides, for purposes of applying section 959, that offset earnings will be treated as if they had been subpart F income (so that these earnings will not be taxed upon distribution to the United States).
Subpart F	
Section 951(a)(1)	Immediately taxes certain earnings of a U.S. taxpayer's CFCs.
Section 959	Prevents second inclusion of subpart F income when the foreign CFC actually distributes earnings to the U.S. parent.
Foreign Tax Credit Rules (pre-TCJA)	
Section 901	Foreign tax credit.
Section 902	Deemed foreign taxes paid when an amount was paid by a CFC to the parent as a dividend.
Section 960(a)(1)	Treated a CFC as having paid a dividend when an amount of the CFC is included in subpart F income (to give the U.S. parent the ability to claim an FTC).
Section 960(a)(2)	Ensured that a taxpayer with a subpart F inclusion would only get the FTC a single time (in the year of the inclusion).
Section 960(a)(3)	Granted a credit for any additional foreign tax that had been imposed after the subpart F inclusion and for which the taxpayer had not yet received an FTC.

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