MANUAL TRANSMITTAL

4.61.13

Department of the Treasury
Internal Revenue Service

JULY 23, 2020

EFFECTIVE DATE

(07-23-2020)

PURPOSE

(1) This transmits revised IRM 4.61.13, International Examination Guidelines, Dual Consolidated Losses.

MATERIAL CHANGES

(1) Added IRM 4.61.13.1, Program Scope and Objectives, in accordance with the requirements described in IRM 1.11.2, Internal Management Documents System, Internal Revenue Manual (IRM) Process, and renumbered subsections accordingly.

(2) Revised various form titles and numbers in accordance with changes made by the Tax Cuts and Jobs Act of 2017 (P.L. 115-97).

(3) Removed List of Figures, 4.61.13-1.

(4) Made editorial changes throughout including updates to IRM and legal references where necessary.

EFFECT ON OTHER DOCUMENTS

This IRM supersedes IRM 4.61.13 dated September 28, 2015.

AUDIENCE

All LB&I and SB/SE personnel

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4.61.13
Dual Consolidated Losses

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4.61.13.1
(07-23-2020)
Program Scope

(1) **Purpose**: The purpose of this IRM is to provide general guidance to IRS personnel in identifying dual consolidated losses (DCLs) and developing selected issues for examination under the DCL rules.

(2) **Audience**: LB&I and SB/SE personnel

(3) **Policy Owner**: TTPO, LB&I

(4) **Program Owner**: TTPO

(5) **Primary Stakeholders**: LB&I and SB/SE

(6) The regulations promulgated under IRC 1503(d) provide the operating rules for DCLs. See 26 CFR 1.1503(d)-1 et. seq.

4.61.13.1.1
(07-23-2020)
Background

(1) The DCL provisions of IRC 1503(d) and its regulations are intended to prevent an entity from using a loss to offset income of a domestic affiliate in the United States while using the same loss to offset income of a foreign affiliate which is not subject to U.S. tax. The DCL provisions are intended to prevent the "double dipping" of a single loss.

Example: USP, a U.S. corporation, files a U.S. consolidated return with its domestic subsidiary, USSub. USP is managed and controlled in foreign country FC and is considered under the tax laws of FC to be a resident of FC. USP is taxed on its worldwide income under the tax laws of FC. Under the tax laws of FC, USP files a consolidated return in FC with its Country FC subsidiary, FSub. In year 1, USP incurs a net operating loss which it uses to (1) offset income of USSub on its U.S. consolidated return and (2) offset income of FSub on its FC consolidated return. Here, USP has "double dipped" a single economic loss.

(2) IRS personnel should have at least a basic understanding of the substantive DCL rules in order to effectively use this IRM section. This IRM section is not intended as an exhaustive explanation of the substantive DCL rules. For guidance on the substantive DCL rules refer to the Transfer Pricing Practice Network SharePoint site.

4.61.13.1.2
(07-23-2020)
Authority

(1) See IRM 4.46.1.1.2, Authority.

(2) IRC 1503(d) and the regulations promulgated thereunder provide the operating rules for DCLs. See 26 CFR 1.1503(d)-1 et. seq.

4.61.13.1.3
(07-23-2020)
Roles and Responsibilities

(1) IRS personnel performing examinations involving DCLs, their managers and executives share an equal responsibility in the conduct of quality examinations and an understanding of the DCL rules as they may apply to such examinations.

4.61.13.1.4
(07-23-2020)
Program Objectives and Review

(1) **Program Goals**: The goal of this program is to provide general guidance to IRS personnel on identifying DCLs and examination techniques to develop DCL issues. The guidance includes:

- Suggested examination techniques to identify dual resident corporations (DRCs), separate units and DCLs.

- Suggested examination techniques to develop prevalent DCL issues including the application of the mirror legislation rule and the recognition and treatment of triggering events.
- Explanation of how to compute the amount of recapture upon the occurrence of a triggering event and the corresponding interest charge.
- Suggested administrative procedures for processing and developing a request for reasonable cause relief pursuant to 26 CFR 1.1503(d)-1(d).

4.61.13.1.5
(07-23-2020)
Acronyms

(1) The following are commonly used acronyms in this IRM section:

Acronym	Definition
DCL	Dual Consolidated Loss(es)
DLN	Document Locator Number
DRC	Dual Resident Corporation
FB	Foreign Branch
GAAP	Generally Accepted Accounting Principles
IDR	Information Document Request
LB&I	Large Business and International
LCC	Large Corporate Compliance
SRLY	Separate Return Limitation Year
TC	Transaction Code
TTPO	Treaty and Transfer Pricing Operations

4.61.13.1.6
(07-23-2020)
Related Resources

(1) Related resources include the following:

- Publication 5125, LB&I Examination Process
- IRM 4.10.3, Examination Techniques
- IRM 4.46.3, Planning the Examination
- IRM 4.46.4, Executing the Examination
- IRM 4.46.5, Resolving the Examination
- IRM 4.46.6, Workpapers and Reports Resources
- IRM 4.60.8, International Examination and Processing Procedures
- IRM 4.61.3, Development of IRC 482 Cases
- IRM 4.61.11, Development of IRC 367 Transactions and Issues
- IRM 20.1.1, Penalty Handbook, Introduction and Penalty Relief
- IRM 25.5, Summons
- IRS AM 2008-001 (addressing when appropriate to process a request for reasonable cause relief for failure to file DCL documents under particular factual scenarios)
- IRS AM 2009-011 (addressing foreign use and exceptions to foreign use under particular factual scenarios)
- IRS AM 2011-002 (addressing the application of the separate return limitation year (SRLY) rules, including the cumulative register, to the domestic use limitation rule)

- United Kingdom/United States Dual Consolidated Loss Competent Authority Agreement (2006)

4.61.13.2 (07-23-2020) **Examination Techniques**

(1) This sub-section provides suggested examination techniques for examining selected DCL issues.

4.61.13.2.1 (07-23-2020) **Preliminary Analysis**

(1) In the early stages of the examination, the issue team should identify any entity which is a dual resident corporation (DRC) or any business operation, or interest in an entity, which is a separate unit (including an interest in a hybrid entity separate unit) and whether any of these incurred a DCL. See 26 CFR 1.1503(d)-1(b)(2) and 26 CFR 1.1503(d)-1(b)(4) for the definitions of a DRC and separate unit.

4.61.13.2.1.1 (07-23-2020) **Organizational Chart of Worldwide Operations**

(1) Beginning with the first day of the first tax year under examination, the issue team should request a global tax and legal organizational chart with changes tracked chronologically and which reflects the following information for each entity worldwide:

- Classification of the entity for U.S. tax purposes (e.g., non-hybrid corporation, non-hybrid partnership, disregarded entity, branch (or permanent establishment), hybrid partnership, or reverse hybrid entity)
- Classification of the entity for foreign purposes
- Ownership interest(s) in the entity, including the identity of each owner and the amount of each owner's respective interest
- Whether the entity is considered domestic or foreign for U.S. tax purposes
- Legal name of the entity
- Branches (or permanent establishments under an applicable tax treaty) of any entities

The issue team should also:

- Review *Form 1120, Schedule N*, Foreign Operations of U.S. Corporations.
- Review Forms 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations, filed with the return.
- Review Forms 8832, Entity Classification Election, filed with the return.
- Review Forms 8858, Information Return of U.S. Persons With Respect to Foreign Disregarded Entities (FDEs) and Foreign Branches (FBs), filed with the return.
- Review each Form 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships, filed with the return.
- Request that the taxpayer confirm that no other Form 8832, Form 8858 or Form 8865 should have been filed but was not filed.
- Discuss with the taxpayer any discrepancies between the taxpayer's organizational charts and the issue team's findings from reviewing the tax returns.

(2) Any changes to the organizational chart which occur during tax years under examination should be tracked in chronological order and the chart should be updated to reflect the changes. Changes may include:

a. Change in entity classification (e.g., “check-the-box” election).
b. Merger or reorganization.
c. Change in ownership of an entity.

4.61.13.2.2
(07-23-2020)
Determining the Existence of DRCs and Separate Units

(1) A DRC is a domestic corporation that is subject to an income tax of a foreign country on its worldwide income or on a residence basis. See 26 CFR 1.1503(d)-(b)(2). In addition, for taxable years ending on or after December 20, 2018, a DRC includes a certain domestic reverse hybrid entity that elected to be treated as an association for U.S. tax purposes but is treated as fiscally transparent under the tax law of its investors. See 26 CFR 1.1503(d)-1(c).

(2) A separate unit is either of the following carried on or owned by a domestic corporation:

- A foreign branch
- An interest in a “hybrid entity” (i.e., an entity not taxed as a corporation for U.S. tax purposes but subject to an income tax of a foreign country on its worldwide income or on a residence basis)

(3) Based on the organizational chart of the taxpayer, the issue team can generally determine whether the taxpayer has any DRCs or separate units. See 26 CFR 1.1503(d)-1(b)(2) and 26 CFR 1.1503(d)-1(b)(4) for the definitions of a DRC and separate unit. See IRM 4.61.13.2.1.1, Organizational Chart of Worldwide Operations, for details on the creation of the organizational chart.

(4) The following may indicate the existence of an interest in a separate unit:

- A “domestic use election” is attached to the return. See IRM 4.61.13.2.4.1, Domestic Use Election.
- A Form 8832 filed for a foreign corporation, owned directly or indirectly by a domestic corporation, to be treated as disregarded or classified as a partnership. The domestic corporation’s interest in the disregarded entity or partnership may be a hybrid entity separate unit.
- A Form 8832 filed for a foreign disregarded entity, owned directly or indirectly by a domestic corporation, to be classified as an association taxable as a corporation. The domestic corporation’s interest in the foreign disregarded entity may be a hybrid entity separate unit.
- A Form 8858 filed by a domestic corporation.
- If a Form 8865 (for years 2018 or 2019) is filed by a domestic corporation and line H9 indicates that the partnership is organized as a corporation in the foreign country, the domestic corporation’s interest in the partnership may be a hybrid entity separate unit.

  Note: This information is captured on line H7 of the Form 8865 for years prior to 2018.

- If a Form 8865 (for years 2018 or 2019) is filed by a domestic corporation and line H8 indicates that one or more Forms 8858 are attached, the domestic corporation may have an interest in one or more separate units.

  Note: This information is captured on line H6 of the Form 8865 for years 2014-2017.

- If a Form 8865 (for years 2018 or 2019) is filed and line H10a is answered in the affirmative for an interest, the interest is a separate unit or part of a combined separate unit.

Note: This information is captured on line H8a of Form 8865 for years 2014-2017.

(5) If two or more individual separate units are owned by a domestic owner or two or more domestic owners that are members of the same consolidated group and the individual separate units are located or subject to tax in the same foreign country, then such individual separate units shall be treated as one separate unit (a "combined separate unit"). This separate unit combination rule is mandatory and not elective. See 26 CFR 1.1503(d)-1(b)(4)(ii) for further details.

(6) The issue team should review the prior international examiner's audit reports for potential leads on identifying DRCs or separate units and/or DCLs claimed in prior years that may have an impact on the current examination.

4.61.13.2.3
(03-27-2009)
Determining the Existence of a DCL

(1) Generally, the loss of a DRC or a separate unit (or an interest in a hybrid entity separate unit) is a DCL.

4.61.13.2.3.1
(07-23-2020)
Techniques for Determining the Existence of a DCL

(1) A domestic use election attached to the tax return establishes that the entity for which the election is made is a DRC or separate unit (or the taxpayer has an interest in a separate unit) that has a DCL.

(2) The following may indicate that a separate unit has a DCL:

- An affirmative answer to Form 8858 (December 2018), Schedule G, Questions 10(a) or 11(a) indicates that the separate unit has a DCL for the current year or incurred a DCL. Answers to Questions 10(b), 11(b), 11(c), 12 and 13 should provide additional information with respect to a DCL. For years prior to 2018, review answers to Schedule G, Questions 4 and 5.
- Form 8858 (rev. 2018), Schedule H, reflects a current negative earnings and profits in U.S. dollars.
- The income statement of the DRC or separate unit reflects a loss for the year.

Note: The income statement of the DRC or separate unit may be based upon foreign Generally Accepted Accounting Principles (GAAP) and may not necessarily reflect the amount of income or loss for DCL purposes.

(3) If the taxpayer files with a U.S. income tax return a statement entitled "No Possibility of Foreign Use of Dual Consolidated Loss Statement," the issue team should scrutinize this statement because it means the taxpayer acknowledges that the loss at issue on the statement is a DCL but the taxpayer is submitting that the loss should not be subject to the DCL rules. See IRM 4.61.13.2.4.2, No Possibility of Foreign Use.

4.61.13.2.4
(07-23-2020)
Examination of DCL in the Year of Loss

(1) If a DRC or separate unit exists and that DRC or separate unit incurs a loss which is a DCL in the tax year, the general rule is that the DCL may not be used to offset the income of any domestic affiliate on the U.S. return in that tax year or any other tax year ("domestic use limitation").

a. When the domestic use limitation applies, a DCL is subject to the SRLY provisions of 26 CFR 1.1502-21(c), as modified by the DCL regulations.
b. IRS AM 2011-002 (August 1, 2011) discusses the application of the SRLY rules to DCLs, including the concept of the cumulative register.

(2) However, there are exceptions to the general rule. For these exceptions see:

- IRM 4.61.13.2.4.1, Domestic Use Election
- IRM 4.61.13.2.4.1.1.1, Elective Agreement Between U.S. and Foreign Country
- IRM 4.61.13.2.4.2, No Possibility for Foreign Use

(3) If the taxpayer uses a DCL to offset income of a domestic affiliate in the year the loss is incurred, the issue team should determine whether the taxpayer was able to do so and appropriately did so.

Note: The issue team should cross-check any timely filed domestic use elections to the DRC or separate unit that filed the domestic use election. Any DRC or separate unit that has a loss without a corresponding domestic use election should be examined to ensure that an improper use of such loss has not occurred.

4.61.13.2.4.1
(07-23-2020)
Domestic Use Election

(1) The taxpayer may use a DCL to offset income of a domestic affiliate if the taxpayer files a domestic use election for the particular DCL incurred by the particular DRC or separate unit. See 26 CFR 1.1503(d)-6(d).

(2) A taxpayer may not file a domestic use election if a triggering event occurs (and no exception applies) with respect to the DCL in the same taxable year in which the DCL is incurred. See 26 CFR 1.1503(d)-6(d)(2) and IRM 4.61.13.4.2, Triggering Events.

(3) A taxpayer may not make a domestic use election if a foreign use with respect to the DCL occurs in the year in which the DCL was incurred or in any prior year. See 26 CFR 1.1503(d)-6(d)(1)(v) and 26 CFR 1.1503(d)-6(d)(2).

Note: A foreign use may occur if an existing foreign corporation with a U.S. corporate owner properly elects under 26 CFR 301.7701-3 (“check-the-box” regulations) to be classified as disregarded or a partnership. See IRS AM 2009-011 (October 2, 2009).

(4) The issue team should compare the amount of the DCL claimed on the domestic use election with the amount of loss of the DRC or separate unit and should discuss any disparity with the taxpayer.

(5) The issue team should determine whether there was a foreign use of the DCL in the year it was incurred. The issue team may review the foreign income tax returns to determine this. If there has been a foreign use of the DCL, the taxpayer may not file a domestic use election for the DCL and the DCL is subject to the SRLY rules as modified by the DCL regulations.

Note: The use of the DCL to offset income attributable to the DRC or separate unit itself is generally not considered a foreign use. See 26 CFR 1.1503(d)-4(c)(3).

4.61.13.2.4.1.1
(07-23-2020)
Mirror Legislation

(1) The DCL regulations provide a specific mirror legislation rule which may prohibit a taxpayer from filing a domestic use election agreement for an otherwise eligible DCL. See 26 CFR 1.1503(d)-3(e).

(2) Under the mirror legislation rule, if the foreign country has its own DCL-type rule which "mirrors" that of the United States and that foreign country's DCL-type rule applies to the loss at issue, then for purposes of the U.S. DCL rules a foreign use of the DCL will be deemed to occur. Therefore, since there is deemed to be a foreign use of the DCL, the taxpayer cannot file a domestic use election for the loss. As a result, the taxpayer may not utilize this loss to offset a domestic affiliate's income for U.S. tax purposes and the DCL is subject to the domestic use limitation rule which requires such loss to be treated as a SRLY loss.

Note: Under a "stand alone exception," the mirror legislation rule does not apply where a foreign use could not occur absent the mirror legislation rule. For example, when there is no affiliate to which the loss can be surrendered. See 26 CFR 1.1503(d)-3(e)(2). In addition, the mirror legislation rule does not apply to deem a foreign use of a DCL incurred by certain domestic reverse hybrid entities. See 26 CFR 1.1503(d)-3(e)(3).

(3) Countries with some form of mirror legislation include the United Kingdom (U.K.), Australia, New Zealand and Germany.

(4) The mere existence of mirror legislation in the foreign country does not by itself make the mirror legislation rule applicable to every DRC or separate unit in that country. Rather, the mirror legislation rule only applies if the mirror legislation in the foreign country applies to the specific DRC (or separate unit) and DCL at issue.

4.61.13.2.4.1.1.1
(07-23-2020)
Elective Agreement Between U.S. and Foreign Country

(1) The domestic use limitation does not apply to a DCL to the extent that the taxpayer elects to use the loss in the United States pursuant to an agreement entered into between the United States and a foreign country. See 26 CFR 1.1503(d)-6(b).

(2) The mirror legislation rule does not apply to a DCL if such a bilateral elective agreement exists which applies to the specific DRC or separate unit and DCL at issue.

Note: The United States has entered into one such bilateral elective agreement. On October 6, 2006, the United States and the U.K. entered an elective agreement which provides that a taxpayer may elect to use the DCL of a U.K. permanent establishment to offset income of a U.S. affiliate notwithstanding mirror legislation which would otherwise be applicable to losses incurred by the permanent establishment. See Announcement 2006-86, 2006-45 IRB 842, United Kingdom/United States Dual Consolidated Loss Competent Authority Agreement. The U.S.-U.K. agreement does not apply to losses incurred by DRCs or hybrid entity separate units.

4.61.13.2.4.2
(07-23-2020)
No Possibility of Foreign Use

(1) The domestic use limitation does not apply to a DCL if the taxpayer demonstrates to the satisfaction of the IRS that there can be no foreign use of the DCL at any time by any means. See 26 CFR 1.1503(d)-6(c). The IRS generally considers this exception to entail a difficult burden for the taxpayer and will apply only in rare and unusual situations.

(2) The taxpayer makes the claim by attaching a statement entitled “No Possibility of Foreign Use of Dual Consolidated Loss Statement” to a timely filed return for the taxable year in which the DCL is incurred.

(3) The issue team should scrutinize any “No Possibility of Foreign Use Statement.” By filing this statement, the taxpayer is acknowledging that the loss at issue is a DCL but nevertheless should not be subject to the DCL rules.

(4) The taxpayer must submit a detailed analysis of the foreign law in support of its “No Possibility of Foreign Use of Dual Consolidated Loss Statement.” See 26 CFR 1.1503(d)-6(c)(2).

(5) If assistance is required in analyzing the taxpayer’s “No Possibility of Foreign Use of Dual Consolidated Loss Statement,” the issue team should initially contact local Area Counsel.

(6) If available and as necessary, the issue team may consider contacting a tax attaché of the foreign country to request assistance with understanding the foreign country’s law.

(7) As necessary, the issue team may consider procuring outside expert(s) to assist in understanding the foreign law and analyzing the taxpayer’s analysis of the foreign law. See IRM 4.46.10, Outside Expert Program, for obtaining outside expert services.

4.61.13.3 (07-23-2020) Disallowance of a DCL

(1) If the taxpayer has not properly filed, or is prohibited from filing, a domestic use election for a particular DCL and has not properly demonstrated that there is no possibility of a foreign use, the issue team should disallow any use of the DCL to offset domestic affiliate income and propose adjustments as appropriate. See IRM 4.61.13.6.1, Report Writing for Disallowing the Use of a DCL.

4.61.13.4 (07-23-2020) Examination of Tax Years Following the Year of the DCL

(1) If the taxpayer incurs a DCL in a given taxable year and the taxpayer files a domestic use election for that DCL, the issue team should be aware that events in subsequent taxable years may affect the tax treatment of the DCL. See IRM 4.61.13.4.2, Triggering Events.

4.61.13.4.1 (07-23-2020) Annual Certifications

(1) If the taxpayer files a domestic use election for a DCL, the taxpayer must file an annual certification in each of the subsequent five taxable years. During the certification period, the taxpayer is prohibited from making a foreign use of the DCL. See IRM 4.61.13.4.2.4, Certification Period.

Note: Under the prior version of the DCL regulations, the equivalent of the domestic use election was the so-called “(g)(2) election.” See 26 CFR 1.1503-2(g)(2).

(2) If the taxpayer fails to file an annual certification, the taxpayer generally must recapture into income the amount of the DCL covered by the domestic use election to which the annual certification relates. The failure to file an annual certification is a “triggering event.” See IRM 4.61.13.4.2, Triggering Events, and IRM 4.61.13.5, Recapture of a DCL.

(3) A taxpayer may seek to remedy a failure to timely file an annual certification by requesting reasonable cause relief pursuant to 26 CFR 1.1503(d)-1(d). See IRM 4.61.13.7, Requests for Reasonable Cause Relief.

(4) On audit, the issue team should review the income tax returns for the taxable years under audit and, if feasible, the five prior taxable years in order to:

a. Track each domestic use election that has been filed (including any domestic use election filed during the five taxable years prior to a taxable year under audit) since the domestic use election will necessarily require the taxpayer to file annual certifications.
b. Determine whether annual certifications have been properly filed for any DCL subject to a domestic use election.
c. Determine whether there has been a foreign use of a DCL subject to a domestic use election during the certification period.

Note: To determine whether there has been a foreign use of the DCL may require a review of foreign income tax returns and/or changes in the taxpayer's organizational chart.

(5) Review prior cycle international examiner's reports and/or planning files to identify any domestic use elections that require annual certifications to be included with the return(s) for tax years currently under examination.

4.61.13.4.2
(03-27-2009)
Triggering Events

(1) The DCL regulations provide that upon the occurrence of certain events, the taxpayer may be required to recapture into income some or all of a DCL subject to a domestic use election. These events are called "triggering events."

Note: Triggering events are only relevant and considered if the taxpayer has a timely filed and valid domestic use election for a DCL.

(2) 26 CFR 1.1503(d)-6(e) provides a list of triggering events. Possible triggering events include, but are not limited to:

- A foreign use of the DCL (including a deemed use pursuant to the mirror legislation rule under 26 CFR 1.1503(d)-3(e)).
- Disaffiliation of the DRC or the domestic owner of a separate unit.
- Affiliation of an unaffiliated DRC or the domestic owner of a separate unit with a consolidated group.
- Conversion of certain entities to foreign corporations (e.g. a reorganization or a check-the-box election by a foreign disregarded entity).
- Failure to file an annual certification with respect to a DCL.
- Certain transfers of assets of the DRC or separate unit or an interest in a separate unit.
- Cessation of the stand-alone exception to the mirror legislation rule.
- Conversion to a regulated investment company, a real estate investment trust, or an S Corporation.

4.61.13.4.2.1
(07-23-2020)
Examination of Triggering Events

(1) The issue team should review the list of triggering events contained in the DCL regulations to determine whether a triggering event has occurred.

(2) The following events should be particularly scrutinized as potential triggering events:

- The use of losses by the DRC or separate unit to offset income other than income of the DRC or separate unit (or combined separate unit) under the income tax laws of the foreign country.

Note: This may include reviewing foreign income tax returns to determine whether there has been a foreign use of the DCL during the certification period.

- The DRC or domestic owner of the separate unit either leaves a U.S. affiliated group or becomes a member of a new U.S. affiliated group.
- A transfer of assets of the DRC or separate unit.
- A transfer of an interest in the separate unit.
- A disregarded entity checks-the-box to become a foreign corporation.
- A DRC or separate unit subject to the stand-alone exception to the mirror legislation rule becomes affiliated under the laws of the foreign country.

Note: To determine whether there has been a triggering event may require reviewing foreign income tax returns and/or the taxpayer's organizational chart.

(3) If a triggering event, including a foreign use, is identified during audit and the taxpayer failed to report the corresponding recapture amount on its income tax return for the year of the triggering event, a proposed audit adjustment will include the recapture of the entire amount of the DCL into income plus the interest charge. For guidance see:

- IRM 4.61.13.5, Recapture of a DCL, for the recapture of a DCL upon the occurrence of a triggering event.
- IRM 4.61.13.5.1, Interest Charge, for the computation of the interest charge.
- IRM 4.61.13.5.4, Computation of Taxable Income in Year of DCL.
- IRM 4.61.13.6.2, Report Writing for Recapturing a DCL.

4.61.13.4.2.2
(07-23-2020)
Rebuttal of Triggering Events

(1) A taxpayer may rebut a triggering event by demonstrating that there can be no foreign use of the DCL during the remaining portion of the certification period by any means or, if the triggering event is described in 26 CFR 1.1503(d)-6(e)(1)(iv) (the sale or other disposition of 50 percent or more of the DRC or separate unit's assets), the triggering event did not result in a carryover of losses, deductions or expenses under foreign law. See 26 CFR 1.1503(d)-6(e)(2).

(2) In order to make the rebuttal the taxpayer must prepare and attach a statement labeled "Rebuttal of Triggering Event" to the taxpayer's timely filed income tax return for the taxable year in which the triggering event occurs.

(3) The taxpayer must submit a detailed analysis of the foreign law in support of its "Rebuttal of Triggering Event."

(4) If assistance is required in analyzing the taxpayer's "Rebuttal of Triggering Event" then the issue team should initially contact local Area Counsel.

(5) If available and as necessary, the issue team may consider contacting a tax attaché of the foreign country to request assistance with understanding the foreign country's law.

(6) As necessary, the issue team may consider procuring outside expert(s) to assist in understanding the foreign law and reviewing the taxpayer's analysis of the foreign law.

4.61.13.4.2.3
(07-23-2020)
Triggering Event Exceptions

(1) The DCL regulations list certain events that do not constitute triggering events and do not require the recapture of the DCL.

(2) Many of the events listed that do not constitute triggering events can generally be categorized into two groups:

a. Events that will not constitute triggering events without the requirement of additional filings. See 26 CFR 1.1503(d)-6(f)(1).

Note: These events typically involve the DRC or domestic owner remaining in the same consolidated group or the assets of the DRC or domestic owner remaining in the same consolidated group or with the same unaffiliated DRC or domestic owner after the event.

b. Events that will not constitute triggering events only if a new domestic use election is filed by a subsequent elector and in some events, a statement is filed by the original elector. See 26 CFR 1.1503(d)-6(f)(2).

Note: These events typically involve transfers of the DRC or domestic owner or the assets of the DRC or domestic owner to a new or different domestic corporation or consolidated group.

(3) 26 CFR 1.1503(d)-6(f)(3) through (5) provide other triggering event exceptions in addition to those described in (2)(a) and (b) above.

(4) If the taxpayer takes the position that a triggering event exception applies, the issue team should:

a. Obtain from the taxpayer a complete factual basis and legal analysis for the exception.
b. Confirm that any additional filings which were required for the event to be considered an exception were timely and properly filed. This may include confirming that a filing was made by another taxpayer (the "subsequent elector").

4.61.13.4.2.4
(07-23-2020)
Certification Period

(1) The certification period is the period of time up to and including the fifth taxable year following the year in which the DCL that is the subject of a domestic use agreement was incurred. See 26 CFR 1.1503(d)-1(b)(20).

(2) A taxpayer that makes a domestic use election must file an annual certification in each of the five tax years following the year in which the DCL that is the subject of the domestic use election was incurred. If the taxpayer has made a domestic use election the issue team should:

a. Review the income tax return to determine if the annual certification has been filed.
b. Analyze the taxpayer's facts to determine if any triggering events (including the failure to file the annual certification) have occurred. See IRM 4.61.13.4.2, Triggering Events.
c. Review the foreign tax returns to determine if there has been any foreign use (which is also a triggering event).

4.61.13.5
(07-23-2020)
Recapture of a DCL

(1) Upon the occurrence of a triggering event which applies to a DCL, generally the taxpayer must recapture the entire amount of the DCL. This is the "presumptive rule" in 26 CFR 1.1503(d)-6(h)(1)(i).

(2) The taxpayer recaptures the DCL as gross income on its income tax return for the taxable year in which the triggering event occurs.

(3) The taxpayer may rebut the presumptive rule of full recapture. See IRM 4.61.13.5.2, Rebuttal of the Presumptive Rule of Full Recapture Amount.

(4) If the taxpayer reports a DCL recapture amount on the original return for the taxable year of the triggering event, the issue team should confirm that the taxpayer:

a. Reported the recapture amount correctly. If a rebuttal of the presumptive full recapture amount is filed, see IRM 4.61.13.5.2, Rebuttal of the Presumptive Rule of Full Recapture Amount.
b. Computed taxable income correctly in that taxable year. See IRM 4.61.13.5.4, Computation of Taxable Income in Year of DCL Recapture.

4.61.13.5.1
(07-23-2020)
Interest Charge

(1) In connection with the DCL recapture, the taxpayer must pay an interest charge computed under IRC 6601(a).

(2) The interest charge is determined by treating the additional tax resulting from the DCL recapture for the year of the triggering event as though the additional tax had been due and unpaid from the taxable year in which the DCL gave rise to a tax benefit. The taxable year in which the DCL gave rise to a tax benefit is typically the taxable year in which the DCL was incurred.

(3) Normally for corporations, the additional tax owed as a result of the DCL recapture will equal the amount of the DCL recapture amount multiplied by the applicable corporate income tax rate.

Note: The corporate income tax rate was 35 percent for tax years beginning before January 1, 2018.

(4) For other taxpayers, the additional tax owed as a result of the DCL recapture will equal the amount of the DCL recapture amount multiplied by the taxpayer's applicable income tax rate.

(5) A manual computation of the interest charge by the issue team will be necessary.

(6) The interest charge becomes a part of the tax liability for the taxable year of the triggering event and should be included as an identifiable "Miscellaneous Tax" on the examination report. See IRM 4.61.13.6.2.1, Report Writing for the Interest Charge Upon Recapture, for guidance on report writing.

Example: A domestic corporation with a taxable year ending December 31, 2018 (2018 tax year) properly filed a domestic use election with respect to a $10,000,000 DCL and used the full amount of the DCL to offset domestic affiliate income in the 2018 tax year. During the tax year ending December 31, 2019 (2019 tax year), a triggering event occurred requiring the recapture of the DCL from the 2018 tax year. The taxpayer failed to report the DCL recapture in any amount on its income tax return for the 2019 tax year. Assuming that the applicable rate for this taxpayer on any additional tax assessment for the 2019 tax year is 21 percent, an audit adjustment may be made to include the full amount of the DCL ($10,000,000) in taxable income for the 2019 tax year. The additional tax assessment attributable to such recapture is $2,100,000 ($10,000,000 *

.21). The interest charge is computed under IRC 6601(a) on the $2,100,000 amount for the period March 15, 2019 (the due date of the 2018 tax year return) through March 15, 2020 (the due date for the 2019 tax year return). The interest charge becomes part of the tax liability for the 2019 tax year. Assuming the interest charge is $100,000, the total tax liability resulting from the recapture is $2,200,000, i.e. $2,100,000 (the amount of the additional tax assessment from the recapture) plus $100,000 (the interest charge). IRC 6601 applies to the tax liability if it is not paid timely.

(7) If the taxpayer reports the DCL recapture on the original return for the year of the triggering event, confirm that the taxpayer paid the additional interest charge.

(8) The additional interest charge may be reflected on the front page of the return as a write-in amount.

(9) If the taxpayer properly reports the DCL recapture on its return for the year of the triggering event, but does not pay the interest charge, a Form 5701, Notice of Proposed Adjustment, should be issued for the interest charge. See IRM 4.61.13.6.3, Report Writing for Interest Charge on Properly Reported DCL Recapture Amount, for the administrative procedures in addressing the interest charge in the audit report.

4.61.13.5.2
(07-23-2020)
Rebuttal of the Presumptive Rule of Full Recapture Amount

(1) The taxpayer may rebut the presumptive rule requiring recapture of the full amount of the DCL and thus reduce the recapture amount that must be included in income in the year of the triggering event.

(2) To rebut the presumptive amount of full recapture, the taxpayer must establish an amount by which the presumptive full amount of recapture is reduced (a "lesser amount" or "reduction of recapture amount").

(3) The "reduction of recapture amount" is an amount by which the DCL would have offset other taxable income reported on a timely filed U.S. income tax return for any taxable year up to and including the taxable year of the triggering event if no domestic use election had been made for the loss.

Note: The reduction of recapture amount represents the amount of the DCL which the DRC or separate unit could have used to offset its own income under the SRLY rules, as modified by 26 CFR 1.1503(d)-4(c)(3).

Note: For practical purposes, the reduction of recapture amount is the amount by which the presumptive full recapture amount is reduced.

(4) If the taxpayer establishes the reduction of recapture amount, the taxpayer will report as recapture income the full amount of recapture less the reduction of recapture amount.

(5) The taxpayer bears the burden of establishing the reduction of recapture amount.

a. To satisfy its burden of establishing the reduction of recapture amount, the taxpayer must prepare a separate accounting labeled "Reduction of Recapture Amount." See 26 CFR 1.1503(d)-6(h)(2)(i).

b. The accounting must show the income for each year that would have offset the DRC or separate unit's recapture amount if no domestic use election had been made.
c. The accounting must be attached to, and filed by, the due date (including extensions) of the taxpayer's income tax return for the taxable year in which the triggering event occurs.

4.61.13.5.3
(07-23-2020)
Rebuttal of Presumptive Rule of Full Interest Charge

(1) The taxpayer may rebut the full amount of the interest charge. See IRM 4.61.13.5.1, Interest Charge.

(2) To rebut the full amount of the interest charge the taxpayer must demonstrate that the "net interest owed" is less than the presumptive full amount.

(3) The taxpayer demonstrates the lesser amount of net interest owed by computing the amount of interest owed had the taxpayer filed an amended return for the taxable year in which the DCL was incurred and any other affected taxable years up to and including the year of recapture and no domestic use election had been filed for the DCL.

Note: The net interest owed is calculated by treating the additional tax owed on the presumptive full amount of recapture as due and owing from the year in which the DCL was incurred and then applying the SRLY rules, as modified by 26 CFR 1.1503(d).

(4) The taxpayer bears the burden of establishing the net interest amount owed.

a. To satisfy its burden of establishing the net interest amount owed, the taxpayer must prepare a computation labeled "Reduction of Interest Charge." See 26 CFR 1.1503(d)-6(h)(2)(ii).
b. The computation must be attached to, and filed by, the due date (including extensions) of the taxpayer's income tax return for the taxable year in which the triggering event occurs.

4.61.13.5.4
(03-27-2009)
Computation of Taxable Income in Year of DCL Recapture

(1) **Presumptive rule.** Except as provided in (2) below for the computation of the taxable income for the year of recapture, no current, carryover, or carryback losses may be used to offset and absorb the recapture amount. See 26 CFR 1.1503(d)-6(h)(4)(i).

(2) **Exception to presumptive rule.** The recapture amount included in gross income may be offset and absorbed by that portion of a taxpayer's NOL carryover that is attributable to the DRC or separate unit that incurred the DCL being recaptured.

Note: The taxpayer must demonstrate to the satisfaction of the IRS the amount of NOL carryover that may absorb any part of the recapture amount. The taxpayer must prepare a computation demonstrating this and attach it to the timely filed income tax return for the taxable year in which the triggering event occurs.

(3) The recapture income will be treated as ordinary income. For additional rules on the character and source of recapture income, see 26 CFR 1.1503(d)-6(h)(5).

4.61.13.6
(07-23-2020)
Report Writing

(1) This section provides guidance for issue teams regarding report writing for proposed adjustments related to DCLs.

4.61.13.6.1
(07-23-2020)
Report Writing for Disallowing the Use of a DCL

(1) If the issue team determines that the taxpayer used all or a part of a DCL to offset income of a domestic affiliate in the year the DCL was incurred, and no exception to the domestic use limitation applies, the issue team may propose to disallow that use of the DCL. The issue team should use a Form 5701, Notice of Proposed Adjustment, to propose the disallowance.

Note: The disallowed DCL is subject to the domestic use limitation rule of 26 CFR 1.1503(d)-4 and treated as a SRLY loss, as modified by the DCL rules for the DRC or separate unit which incurred the DCL.

(2) The issue team should prepare a Form 886-A, Explanation of Items, in addition to the Form 5701. The Form 886–A should:

- Identify the DRC or separate unit that incurred the DCL.
- List the tax year in which the DCL was incurred.
- Specify the amount of the DCL being disallowed.
- Provide the reasons for the disallowance (e.g., the domestic use limitation applies with exception, including no domestic use election made) with proper citations to the DCL regulations.

Note: The taxpayer may request reasonable cause relief for failure to timely make a domestic use election. See IRM 4.61.13.7, Requests for Reasonable Cause Relief.

4.61.13.6.2
(07-23-2020)
Report Writing for Recapturing a DCL

(1) If the issue team determines that a taxpayer must recapture a DCL because of the occurrence of one or more triggering events and no exception applies, the issue team may propose the recapture of the presumptive full amount of the DCL. The issue team should use a Form 5701 to propose the recapture.

Note: The taxpayer may attach to a timely filed tax return for the taxable year in which an event described as a triggering event occurred, or provide in a request for reasonable cause relief, a statement rebutting that the event is a triggering event. See IRM 4.61.13.4.2.2, Rebuttal of Triggering Events.

Note: The taxpayer may attach to a timely filed tax return for the taxable year in which a triggering event occurred, or provide in a request for reasonable cause relief, a separate accounting showing that the recapture amount is less than the full amount of the DCL. See IRM 4.61.13.5.2, Rebuttal of the Presumptive Rule of Full Recapture Amount. If the taxpayer properly demonstrates a lesser recapture amount, the recapture amount will be the lesser amount so demonstrated.

(2) The issue team should prepare a Form 886–A in addition to the Form 5701. The Form 886–A should:

a. Identify the DRC or separate unit which incurred the DCL.
b. List the tax year of the DCL.
c. Identify the domestic use election covering the DCL.
d. Specify the amount of the DCL being recaptured.
e. List the triggering events for the recapture.

f. Compute the additional tax resulting from the recapture.
g. Compute the interest charge.
h. Explain the proposed recapture and interest charge with proper citations to the DCL regulations.

Note: See IRM 4.61.13.6.2.1, Report Writing for the Interest Charge Upon Recapture, for additional guidance on the report writing for the interest charge upon recapture.

4.61.13.6.2.1
(07-23-2020)
Report Writing for the Interest Charge Upon Recapture

(1) The issue team should include on the Form 5701 that proposes the recapture a separate line item for the amount of the interest charge that results from the recapture. The line item should be labeled "Interest Charge – Due to Dual Consolidated Loss Recapture." See IRM 4.61.13.5.1, Interest Charge, for computation of the interest charge.

(2) The following explanation of the interest charge should be included on the Form 5701:

"An interest charge on the recapture is due under 26 CFR 1.1503(d)-6(h). The interest charge is computed under the rules of IRC 6601(a) by treating the additional tax resulting from the recapture as though it had been due and unpaid as of the date for payment of the tax for the taxable year in which the taxpayer received a tax benefit from the dual consolidated loss. The interest is computed to the due date of the tax return for the year of recapture (or if payment of the additional tax is made on an earlier date, to that earlier date) and the interest thus computed becomes a part of the tax liability for that taxable year. In this case, the interest is computed on $ *(insert the amount of the additional tax resulting from the recapture of the DCL)* for the period beginning *(insert the due date of payment of the tax for the taxable year in which the taxpayer received a tax benefit from the DCL being recaptured)* and ending *(insert the due date of the tax return for the year of recapture)* and will be part of the tax liability for the taxable year ending *(insert ending date of the taxable year of recapture)*."

4.61.13.6.3
(07-23-2020)
Report Writing for Interest Charge on Properly Reported DCL Recapture Amount

(1) If the taxpayer properly reports the correct amount of recapture of a DCL on its income tax return and pays the correct amount of additional tax on the recapture amount but fails to report and pay the interest charge, the issue team should propose an adjustment for the interest charge. The issue team should use a Form 5701 to propose this adjustment.

(2) The issue team should include on the Form 5701 a separate line item for the amount of the interest charge that results from the recapture. The line item should be labeled "Interest Charge – Due to Dual Consolidated Loss Recapture." See IRM 4.61.13.5.1, Interest Charge, for computation of the interest charge.

(3) The following explanation of the interest charge should be included on the Form 5701:

"An interest charge on the recapture is due under 26 CFR 1.1503(d)-6(h). The interest charge is computed under the rules of IRC 6601(a) by treating the additional tax resulting from the recapture as though it had been due and unpaid as of the date for payment of the tax for the taxable year in which the taxpayer received a tax benefit from the dual consolidated loss. The interest is computed to the due

date of the tax return for the year of recapture (or if payment of the additional tax is made on an earlier date, to that earlier date) and the interest thus computed becomes a part of the tax liability for that taxable year. In this case, the interest is computed on $ *(insert the amount of the additional tax resulting from the recapture of the DCL)* for the period beginning *(insert the due date of payment of the tax for the taxable year in which the taxpayer received a tax benefit from the DCL being recaptured)* and ending *(insert the due date of the tax return for the year of recapture)* and will be part of the tax liability for the taxable year ending *(insert ending date of the taxable year of recapture)*."

(4) The issue team should prepare a Form 886–A in addition to the Form 5701. The Form 886–A attached to the Form 5701 should:

a. Reference the recapture of the DCL as reported on the return.
b. Compute the interest charge.
c. Explain the interest charge with proper citations to the DCL regulations.

4.61.13.6.3.1
(07-23-2020)
Interest Charge on Computer Generated Examination Report

(1) If an interest charge adjustment is required, the issue team must include this amount as part of the tax liability for the taxable year of the triggering event.

(2) A manual calculation of the interest charge must be made. See IRM 4.61.13.5.1, Interest Charge, for guidance on the interest charge calculation.

(3) For LB&I cases utilizing software to generate the examination report, the manually computed interest charge amount should be input under "Miscellaneous Taxes/Recapture" under "Other" on the main worksheet. The miscellaneous tax description for the interest charge should be input as "DCL Recapture Interest Charge" with the appropriate interest charge amount included in the amount field.

(4) For SB/SE cases, to generate the examination report, the interest charge amount should be input and identified under "Other Taxes."

4.61.13.7
(07-23-2020)
Requests for Reasonable Cause Relief

(1) A taxpayer may fail to timely file a document relating to a DCL. For example, a taxpayer may fail to timely file a domestic use election or annual certification.

(2) The regulations provide a procedure by which a taxpayer may cure a failure to timely file documents related to DCLs. See 26 CFR 1.1503(d)-1(d)(1). This procedure may be referred to as a "request for reasonable cause relief."

(3) In a request for reasonable cause relief, the taxpayer must demonstrate that the failure to timely file a document relating to a DCL was due to reasonable cause and not willful neglect.

(4) The review, development and determination of the taxpayer's request for reasonable cause relief does **not** constitute or initiate an examination of any taxable year of the taxpayer.

4.61.13.7.1
(07-23-2020)
Filing the Request for Reasonable Cause Relief

(1) To make a request for reasonable cause relief, the taxpayer must file an amended return which amends the return to which the document(s) should have been attached. The amended return must include:

- The documents that should have been attached to the original return.
- A written statement setting forth the reasons for the failure to timely comply.

(2) The taxpayer must file the original amended return referred to in this section with the applicable IRS Service Center with which the taxpayer filed its original return to which the documents should have been attached.

(3) In addition to filing the amended return referred to in this section with the IRS Service Center, the taxpayer must provide a copy of the amended return and all required attachments to the director (see paragraph (4) of this section for the definition of "director") as follows:

a. If the taxpayer is under examination for any taxable year when the taxpayer requests relief, the taxpayer must provide a copy of the amended return and attachments to the issue team conducting the examination.
b. If the taxpayer is not under examination for any taxable year when the taxpayer requests relief, the taxpayer must provide a copy of the amended return and attachments to the director having jurisdiction of the taxpayer's return.

Note: For purposes of this section, "any taxable year" means any taxable year and is not limited to a taxable year for which an amended return is filed to request reasonable cause relief. See 26 CFR 1.1503(d)-1(d)(1).

Note: The issue team should confirm with the taxpayer that the original amended return was filed with the IRS Service Center.

(4) For purposes of this section "director" is, as appropriate, the Area Director, Field Examination, SB/SE or the Director of Field Operations (DFO), LB&I having jurisdiction over the taxpayer's return for the taxable year.

a. The authority of the director to determine whether the taxpayer has established reasonable cause has been formally delegated to LB&I team managers. See Delegation Order LB&I-193-6.
b. The authority of the director to determine whether the taxpayer has established reasonable cause has been formally delegated to specific examination management personnel in SB/SE pursuant to Delegation Order SB/SE 1-23-57. See IRM 1.2.65.4.33, SB/SE 1-23-57, Determination of Reasonable Cause for Failure to File Dual Consolidated Loss Documents.
c. Therefore, any reference under IRM 4.61.13.7 to "director" may also include any of these delegates.

(5) The taxpayer must file a separate amended return for each year it requests reasonable cause relief.

(6) It may not be appropriate to consider a request for reasonable cause relief if the period of limitations on assessment under IRC 6501(a) has expired for the tax year in which the DCL was incurred, or the tax year in which the DCL should have been recaptured as a result of a failure to file an annual certification.

Note: See IRS AM 2008-001 (January 22, 2008) in which IRS Office of Chief Counsel addresses, under several scenarios, whether it is appropriate for

examination to consider a request for reasonable cause relief where the period of limitations on assessment has expired for the tax year in which the underlying DCL was incurred, or the tax year for which an annual certification was required.

4.61.13.7.1.1
(07-23-2020)
Timeliness of Request for Reasonable Cause Relief

(1) The IRS will consider a request for reasonable cause relief only if the taxpayer submits the request for relief "once [the taxpayer] becomes aware of the failure" to timely file the DCL document(s). See 26 CFR 1.1503(d)-1(d)(2)(i).

(2) If the taxpayer does not submit the request for relief once it becomes aware of the failure to timely file the DCL document(s), the IRS should not consider the request.

a. In this situation, it is recommended that the IRS notify the taxpayer in writing that its request for relief cannot be considered because the taxpayer failed to submit the request in a timely manner.

(3) Whether the taxpayer has submitted a request for relief in a timely manner is an issue separate from whether the taxpayer has demonstrated that the failure to file the DCL document(s) was due to reasonable cause and not willful neglect.

4.61.13.7.2
(07-23-2020)
Processing the Receipt of a Request for Reasonable Cause

(1) Processing the receipt of a request for reasonable cause relief will depend on whether the taxpayer is under examination.

a. If the taxpayer is under examination for any taxable year, the issue team conducting the examination will receive a copy of the amended return and attachments. In this situation, it is recommended that the issue team assigned to the examination should review and develop the issue of whether the taxpayer has demonstrated reasonable cause. In developing the issue, the issue team should follow the procedures set forth in the regulations and this IRM section.

b. If the taxpayer is not under examination for any taxable year at the time of the taxpayer's request for reasonable cause, the director having jurisdiction of the taxpayer's return will receive a copy of the taxpayer's original amended return and attachments through which the reasonable cause relief is requested. See IRM 4.61.13.7.1, Filing the Request for Reasonable Cause Relief. The director may assign the review and development of whether the taxpayer has demonstrated reasonable cause to IRS personnel, as appropriate. See IRM 4.61.13.7.4, Determining Whether Reasonable Cause Has Been Demonstrated, for guidance on developing the issue of reasonable cause.

Note: The IRS Service Center with which the original amended return was filed does not provide the original or any copy of the amended return to IRS field personnel. The taxpayer provides a copy of the original amended return to the appropriate IRS personnel in the field.

(2) The review, development and determination of the taxpayer's request for reasonable cause relief does not constitute or initiate an examination of any taxable year of the taxpayer.

4.61.13.7.2.1
(07-23-2020)
Written Notification of Receipt and Assignment of Request for Reasonable Cause

(1) The director must notify the taxpayer in writing that the taxpayer's request for reasonable cause relief has been received and assigned for review.

(2) The director should provide the written notification of receipt and assignment by issuing Letter 4291, Notification of Receipt and Assignment Letter for a Dual Consolidated Loss Reasonable Cause Request.

Note: While the regulations do not provide a date by which the written notification of receipt and assignment must be provided to the taxpayer, the director should strive to assign the request and provide the written notification to the taxpayer as soon as reasonably possible.

(3) The director should provide a separate Letter 4291 for each taxable year for which the taxpayer filed an amended return.

4.61.13.7.2.2
(07-23-2020)
The 120-Day Determination Period

(1) On the date the taxpayer is notified in writing of the receipt and assignment, a 120-day determination period prescribed by the regulations commences. See IRM 4.61.13.7.2.1, Written Notification of Receipt and Assignment of Request for Reasonable Cause, and 26 CFR 1.1503(d)-1(d)(1). The director must notify the taxpayer in writing during this 120-day period if either of the following applies:

a. It has been determined that the failure to comply was not due to reasonable cause or was due to willful neglect (or both)
b. Additional time is needed to determine whether the taxpayer has demonstrated reasonable cause

(2) If the taxpayer is not provided written notification of the information set forth in this section (1)(a) or (b) during the 120-day period, the taxpayer will be deemed to have established reasonable cause.

Note: The director may, but is not required to, notify the taxpayer in writing during the 120-day period that it has been determined that the failure to comply was due to reasonable cause and not willful neglect. For the administrative convenience of the IRS and the taxpayer and as a best practice, it is recommended in all cases in which it is determined that the taxpayer has established reasonable cause that written notification be provided to the taxpayer. See IRM 4.61.13.7.4.1, Determining Whether Reasonable Cause Has Been Demonstrated.

Note: The 120-day period should be carefully monitored to ensure that reasonable cause is properly reviewed and developed and not inadvertently deemed established.

(3) If the taxpayer, prior to the expiration of the 120-day period, is notified in writing that additional time is needed, the 120-day period is no longer applicable. See IRM 4.61.13.7.5, Determination That Additional Time is Needed.

(4) See IRM 4.61.13.7.6, Requests for Additional Information, for requests by the issue team for additional information to develop the issue of reasonable cause. If a request for additional information is made without notification that additional time is needed, the 120-day period continues to apply. See IRM 4.61.13.7.6(3).

4.61.13.7.3
(07-23-2020)
Authority to Determine Reasonable Cause

(1) The director has the authority to determine whether the taxpayer has established reasonable cause.

(2) The authority of the director to determine whether the taxpayer has established reasonable cause has been delegated to LB&I team managers. See Delegation Order LB&I-193-6.

(3) The authority of the director to determine whether the taxpayer has established reasonable cause has been formally delegated to specific examination management personnel in SB/SE pursuant to Delegation Order SB/SE 1-23-57. See IRM 1.2.65.4.33, SB/SE 1-23-57, Determination of Reasonable Cause for Failure to File Dual Consolidated Loss Documents.

(4) Any reference made to the director determining reasonable cause in this IRM includes any person who has been delegated such authority.

(5) While the director has the authority to determine reasonable cause, any appropriately assigned issue team may develop the issue. See IRM 4.61.13.7.4, Guidance on Developing the Issue of Reasonable Cause.

4.61.13.7.4
(07-23-2020)
Guidance on Developing the Issue of Reasonable Cause

(1) This section provides the issue team with guidance on developing whether the taxpayer has demonstrated reasonable cause.

4.61.13.7.4.1
(07-23-2020)
Determining Whether Reasonable Cause Has Been Demonstrated

(1) The issue team charged with reviewing and developing the request for reasonable cause relief must develop whether the taxpayer has demonstrated that the failure to timely file was both:

a. Due to reasonable cause
b. Not due to willful neglect

Note: The taxpayer has the burden of demonstrating that the failure to timely file was both (1) due to reasonable cause and (2) not due to willful neglect.

(2) See IRM 4.61.13.7.4.2, Reasonable Cause Criteria, for guidance to assist the issue team in developing whether the taxpayer has met its burden.

(3) The issue team should initially review the copy of the amended return to confirm that the amended return contains a statement setting forth the reasons for the failure to timely file.

a. If the amended return does not include a written statement setting forth the reasons for the failure to timely file, the director should notify the taxpayer in writing that its purported request is incomplete and does not conform to the requirements of 26 CFR 1.1503(d)-1(d)(2)(i) and its purported request will not be considered by the IRS.

Note: The review, development and determination of the taxpayer's request for reasonable cause relief does not constitute or initiate an examination of any taxable year of the taxpayer.

(4) If assistance is needed in making the factual determination whether the taxpayer has demonstrated that the failure to timely file was due to reasonable cause and not willful neglect, the issue team should first contact local field counsel.

4.61.13.7.4.2 (07-23-2020)
Reasonable Cause Criteria

(1) The provisions of the Penalty Handbook which may be relevant to reasonable cause determinations under 26 CFR 1.1503(d)-1(d)(1) are discussed in this section. However, this section is not intended to be an exhaustive discussion of reasonable cause as contained in the Penalty Handbook at IRM 20.1.1.3.2, Reasonable Cause, or any other Penalty Handbook section.

(2) The Penalty Handbook sets forth, in part, general guidelines and criteria for determining whether a taxpayer has established reasonable cause for relief from penalties. See IRM 20.1.1.3.2, Reasonable Cause. The Penalty Handbook at IRM 20.1.1.3.2, Reasonable Cause, also provides guidance on determining whether penalties imposed by the IRC apply to a given case. See IRM 20.1.1.1.2, Authority.

(3) The Penalty Handbook provides a convenient and adequate starting point for developing the issue of reasonable cause under 26 CFR 1.1503(d)-1(d)(1) since it includes criteria and suggested inquiries which are relevant generally in determining whether reasonable cause exists.

(4) Numerous published court cases address the issue of reasonable cause under various IRC sections, however none under IRC 1503(d) and 26 CFR 1.1503(d)-1(d)(1).

4.61.13.7.4.2.1 (07-23-2020)
Reasonable Cause - General Guidelines

(1) The taxpayer bears the burden of demonstrating to the satisfaction of the director that the failure to timely file was due to reasonable cause and not willful neglect.

(2) Reasonable cause is based on all the facts and circumstances in each situation and is generally granted when the taxpayer exercises ordinary business care and prudence in determining its tax obligations. See IRM 20.1.1.3.2, Reasonable Cause.

(3) Reasonable cause should never be presumed. See IRM 20.1.1.3.2.2.6, Ignorance of the Law.

4.61.13.7.4.2.2 (07-23-2020)
Reasonable Cause - Common Inquiries

(1) Each request for reasonable cause relief must be judged individually based on the facts and circumstances. See IRM 20.1.1.3.2(1). The following is a list of general inquiries that the issue team should consider when developing whether the taxpayer has demonstrated reasonable cause for its failure to timely file:

a. What happened and when did it happen?
b. During what period of time was the taxpayer non-compliant and what facts and circumstances prevented the taxpayer from timely filing?
c. How did the facts and circumstances prevent the taxpayer from complying with the filing requirements under the DCL regulations?
d. What attempts did the taxpayer make to comply? See IRM 20.1.1.3.2(5).

4.61.13.7.4.2.3
(07-23-2020)
Ordinary Care and Prudence

(1) 26 CFR 1.1503(d)-1(d)(1) provides that in determining reasonable cause, the issue team considers whether the taxpayer acted reasonably and in good faith.

(2) 26 CFR 1.1503(d)-1(d)(1) provides that reasonable cause is based on all the facts and circumstances in each situation and is generally determined to exist when the taxpayer demonstrates that it exercised ordinary care and prudence in meeting its tax obligations but nonetheless did not comply with the prescribed duty within the prescribed time.

(3) In determining whether a taxpayer exercised ordinary care and prudence, the issue team should secure and review information which details:

a. The taxpayer's reason(s) for the non-compliance (including the reasons set forth in the written statement accompanying the taxpayer's amended return).
b. The taxpayer's history of compliance (or non-compliance) with regards to filings related to DCLs. A first-time occurrence of non-compliance does not by itself demonstrate reasonable cause.
c. Whether circumstances beyond the taxpayer's control caused the taxpayer's non-compliance. See IRM 20.1.1.3.2.2, Ordinary Business Case and Prudence.

(4) The Penalty Handbook sets forth various reasons a taxpayer may assert to justify its non-compliance. See IRM 20.1.1.3.2.1, Standards and Authorities. The following are more likely to be asserted by a taxpayer in a request for reasonable cause relief under 26 CFR 1.1503(d)-1(d)(1):

a. Ignorance of the law. See IRM 20.1.1.3.2.2.6, Ignorance of the Law.
b. Mistake, forgetfulness or oversight. See IRM 20.1.1.3.2.2.4, Mistake Was Made, and IRM 20.1.1.3.2.2.7, Forgetfulness.
c. Reliance on advice from a tax advisor. See IRM 20.1.1.3.3.4.3, Advice From a Tax Advisor.

4.61.13.7.4.2.4
(07-23-2020)
Willful Neglect

(1) In addition to demonstrating reasonable cause, the taxpayer must demonstrate that its failure to comply was not due to willful neglect.

(2) The Penalty Handbook defines "willful neglect" as "conscious, intentional failure to comply with the provisions of the IRC, or reckless indifference to such provisions." See IRM Exhibit 20.1.1-8, Dictionary of Key Terms.

(3) With the exception of IRM 4.61.13.7.4.2 above, any reference in this IRM section (or reference to a form letter) to demonstrating or determining reasonable cause also includes demonstrating or determining "willful neglect."

4.61.13.7.5
(07-23-2020)
Determination that Additional Time is Needed

(1) During the 120-day period set forth in 26 CFR 1.1503(d)-1(d)(1) and in the course of reviewing the copy of the taxpayer's amended return including the written statement setting forth the reasons for reasonable cause relief, the issue team may conclude that additional time is needed to develop whether the taxpayer has demonstrated reasonable cause. In such a case, the director should notify the taxpayer that additional time is needed. This will make the 120-day period inapplicable.

(2) The director should use Letter 4294, Additional Time Notification Letter for Final Determination of the Dual Consolidated Loss Reasonable Cause, to notify the taxpayer that additional time is needed.

Note: If additional information is also needed, the director should use Letter 4296, Request for Additional Time and Information on Dual Consolidated Loss Reasonable Cause Determination, to request such additional information as well as provide written notification that additional time is needed.

(3) The issuance of Letter 4294 or Letter 4296 will make the 120-day determination period inapplicable. See IRM 4.61.13.7.2.2, The 120-Day Determination Period.

Note: The issuance of Letter 4295, Request for Additional Information on Dual Consolidated Loss Reasonable Cause, does **not** suspend the 120-day determination period. See IRM 4.61.13.7.6, Request for Additional Information.

(4) A manager with authority under Delegation Order LMSB 193-6 or Delegation Order SB/SE 1-23-57, as applicable, should sign and issue to the taxpayer the appropriate Letter 4294 or Letter 4296 to notify the taxpayer that additional time is needed. See IRM 4.61.13.7.3, Authority to Determine Reasonable Cause, for delegation of authority.

(5) A separate additional time notification letter is issued as needed for each amended return.

4.61.13.7.6
(07-23-2020)
Request for Additional Information

(1) During the course of developing whether the taxpayer has demonstrated reasonable cause, the issue team may determine that additional information is needed from the taxpayer.

(2) The issue team should use Letter 4295, Request for Additional Information on Dual Consolidated Loss Reasonable Cause Determination, to request additional information.

(3) The additional information sought should be included in the body of the letter provided to the taxpayer. See Letter 4295.

Note: A request for additional information via Letter 4295 during the 120-day period will not by itself render the 120-day period inapplicable. The Director must notify the taxpayer in writing that additional time is needed in order for the 120 days to be rendered inapplicable. See IRM 4.61.13.7.5, Determination that Additional Time is Needed.

(4) To avoid confusion, the issue team should not use Information Documents Requests (IDRs) to request additional information because the review, development and determination of the taxpayer's request for reasonable cause relief is not an examination of any taxable year of taxpayer.

4.61.13.7.7
(07-23-2020)
Determination that the Taxpayer Has Demonstrated Reasonable Cause - Acceptance of Reasonable Cause

(1) If the 120-day period is applicable and the director determines that the taxpayer has demonstrated that its failure to comply was due to reasonable cause (and not willful neglect) it is recommended that the director provide written notification of the determination to the taxpayer.

a. Letter 4293, Acceptance of Taxpayer's Request for a Dual Consolidated Loss Reasonable Cause, should be used to notify the taxpayer that its request for reasonable cause relief has been accepted.

Note: If no written notification at all is provided to the taxpayer during the 120-day period, the taxpayer will be deemed to have established reasonable cause. See IRM 4.61.13.7.2.2, The 120-Day Determination Period. The director may notify the taxpayer in writing during the 120-day period that it has been determined that the failure to comply was due to reasonable cause. However, the director is not required to provide this in writing since the taxpayer will be deemed to have established reasonable cause upon the expiration of the 120 days in the event no written notification is provided.

Note: For the administrative convenience of the IRS and the taxpayer and as a best practice, it is recommended in all cases in which it is determined that the taxpayer has established reasonable cause that written notification be provided to the taxpayer.

(2) If the 120-day period is not applicable (i.e., a Letter 4294 or Letter 4296 has been issued) and the director determines that the taxpayer has demonstrated reasonable cause, the director should provide written notification of the determination to the taxpayer.

a. Letter 4293, Acceptance of Taxpayer's Request for a Dual Consolidated Loss Reasonable Cause, should be used to notify the taxpayer that its request for reasonable cause relief has been accepted.

(3) In any event, the director is the only IRS personnel who provides the written notification of determination to the taxpayer.

Note: The authority of the director to determine reasonable cause has been delegated to certain managers but not to revenue agents. See IRM 4.61.13.7.3, Authority to Determine Reasonable Cause. As a result, revenue agents may not sign Letter 4293.

(4) A separate written notification of the IRS's determination should be provided for each taxable year for which the taxpayer filed an amended return requesting reasonable cause relief.

Note: Letter 4293 is the only documentation that the taxpayer will receive from the IRS that its request for reasonable cause relief was accepted.

(5) If the taxpayer is currently under examination for any taxable year, the issue team should charge time spent working the request for reasonable cause relief to the current examination cycle of the taxpayer or the examination of the taxable year for which the amended return was filed.

(6) If the taxpayer is under the Large Corporate Compliance (LCC) program (which replaced the Coordinated Industry Case (CIC) program), a copy of the acceptance letter should be incorporated into the planning file for future reference.

(7) If the taxpayer is not currently under examination, the examiner should charge the time spent working the request for reasonable cause relief to the Miscellaneous Examination Activity Code 514 - Specialist Consultations or Informal Assistance (in IMS, use code 514000). The review, development and determination of the taxpayer's request for reasonable cause relief is not an examination of any taxable year of the taxpayer.

(8) The IRS Service Center with which the original amended return was filed does not provide the original or any copy of the amended return to IRS field personnel. The taxpayer provides a copy of the original amended return to the appropriate IRS personnel in the field. See IRM 4.61.13.7.9, Administrative Procedures on Reasonable Cause Determination Workpapers, for the recommended administrative procedures for the retention of the determination letter sent to the taxpayer and/or any related documents/workpapers.

4.61.13.7.7.1
(03-27-2009)
Consequences of Reasonable Cause

(1) If the director determines that the taxpayer has demonstrated reasonable cause, or the taxpayer is deemed to have established reasonable cause, the only consequence is that the DCL filing at issue will be considered to have been timely filed.

(2) A determination by the director that the taxpayer has demonstrated reasonable cause, or a situation in which reasonable cause has been deemed to have been established, is not a finding that the taxpayer was eligible to file the DCL filing (e.g., domestic use election) at issue. It is also not a finding that any amount, date, representation, etc., contained on the DCL filing at issue is correct. These issues may be addressed, as appropriate, during an examination.

Note: Reasonable cause relief is not a finding on any substantive issue involving the DCL. The information contained in the DCL filing at issue should only be considered in an examination of the DCL after, and only if, the taxpayer's request for reasonable cause has been demonstrated or deemed established.

4.61.13.7.8
(07-23-2020)
Determination that the Taxpayer Has Not Demonstrated Reasonable Cause - Denial Of Reasonable Cause

(1) If the director determines that the taxpayer has not demonstrated reasonable cause, the director provides written notification of this determination to the taxpayer.

a. The director should use Letter 4292, Denial of Taxpayer's Request for a Dual Consolidated Loss Reasonable Cause, to notify the taxpayer that its request for reasonable cause relief has been denied.

(2) The director is the only IRS employee who may provide written notification of the determination to the taxpayer.

Note: The authority of the director to determine reasonable cause has been delegated to certain managers but not to revenue agents. See IRM 4.61.13.7.3, Authority to Determine Reasonable Cause. As a result, revenue agents may not sign Letter 4292.

(3) A separate written notification of the IRS's determination should be provided for each taxable year for which the taxpayer filed an amended return requesting reasonable cause relief.

Note: Letter 4292 is the only documentation that the taxpayer will receive from the IRS that its request for reasonable cause relief was denied.

(4) If the taxpayer is currently under examination for any taxable year, the issue team should charge time working the request for reasonable cause relief to the current examination cycle of the taxpayer or the examination of the taxable year for which the amended return was filed.

(5) If the taxpayer is under the LCC Program, a copy of the denial letter should be retained in the planning file for future reference.

(6) If the taxpayer is not currently under examination, the examination should charge the time spent working the request for reasonable cause relief to the Miscellaneous Examination Activity Code 514 - Specialist Consultations or Informal Assistance. The review, development and determination of the taxpayer's request for reasonable cause relief is not an examination of any taxable year of the taxpayer.

(7) The IRS Service Center with which the original amended return was filed does not provide the original or any copy of the amended return to IRS field personnel. The taxpayer provides a copy of the original amended return to the appropriate IRS personnel in the field. See IRM 4.61.13.7.9, Administrative Procedures on Reasonable Cause Determination Workpapers, for the recommended administrative procedures for the retention of the determination letter sent to the taxpayer and/or any related documents/workpapers.

4.61.13.7.8.1
(07-23-2020)
Consequences of No Reasonable Cause

(1) If the IRS determines that the taxpayer has not demonstrated reasonable cause, the DCL filing at issue will be considered to have not been timely filed.

Note: As a result, the DCL filing should not be considered in the examination of the DCL issue.

(2) The denial of reasonable cause is not a determination of any substantive tax issue.

(3) The denial of reasonable cause by itself does not result in an adjustment to the taxpayer's income or any other adjustment.

(4) The IRS should independently consider the substantive tax consequences of the failure to file in order to determine whether to propose any adjustments on an examination.

a. For example, if the IRS denies a taxpayer's request for reasonable cause relief to file a domestic use election for a DCL, the taxpayer would have no valid domestic use election for that DCL. Generally, the taxpayer would be prohibited from using the DCL to offset income of a domestic affiliate in the taxable year the DCL was incurred. For the IRS to propose the disallowance of the full amount of the DCL as an adjustment to the taxpayer's income for the year in which the DCL was incurred and used on the U.S. return and assess tax for that taxable year, the taxpayer would need to be under examination for that taxable year. As a result of

the adjustment, the disallowed DCL amount would be subject to the domestic use limitation rule and be treated as a SRLY loss of the DRC or separate unit that incurred the loss. See IRM 4.61.13.6.1, Report Writing for Disallowing the Use of a DCL, for report writing on the disallowance of the DCL in the year the DCL was incurred.

b. For example, if the IRS denies a taxpayer's request for reasonable cause relief to file an annual certification, the lack of a timely filed annual certification would be a triggering event. Generally, the taxpayer would be required to recapture the full amount of the DCL in gross income in the taxable year of the triggering event. For the IRS to propose to include the full amount of the DCL recapture as an adjustment to the taxpayer's income and assess tax for the taxable year of the triggering event, the taxpayer would need to be under examination for that taxable year. See IRM 4.61.13.6.2, Report Writing for Recapturing a DCL.

(5) If the taxpayer is not under examination, the IRS should consider whether to initiate an examination of the taxpayer in order to propose any adjustments and assess tax resulting from the failure to timely file. In addition to factors generally considered in deciding whether to initiate an examination, the IRS should consider:

- Periods of limitations on assessment
- Assessment of risk on the proposed adjustment

(6) The disallowance of a DCL in a tax year for which the period for assessment of tax has expired may impact the amount of a net operating loss carryover to a tax year for which the period for assessment of tax has not expired. See IRS AM 2008-001.

(7) If the decision is made to initiate an examination, Master File controls should be secured under normal case procedures and the DCL issue should be raised. See IRM 4.61.13.6, Report Writing, for report writing guidance on DCL audit adjustments.

(8) If the IRS proposes an adjustment to income which relates to a DCL document for which reasonable cause relief has been denied, the issue team should in its audit report explain the request for reasonable cause relief and the director's decision to deny the relief.

(9) The taxpayer cannot protest to Appeals a denial of a request for reasonable cause relief by itself. The taxpayer may submit a protest of a proposed adjustment to income made as a result of an examination that relates to a DCL document for which reasonable cause relief was denied. In this protest, the taxpayer may raise issues regarding the denial of its request for reasonable cause relief.

(10) The determination of a request for reasonable cause relief, including the review and development of reasonable cause, is not by itself an examination and therefore no Master File controls are established. See IRM 4.61.13.7.9, Administrative Procedures on Reasonable Cause Determination Workpapers, for the recommended procedures for the retention of the determination letter sent to the taxpayer and/or any related documents/workpapers.

4.61.13.7.9
(03-27-2009)
Administrative Procedures on Reasonable Cause Determination Workpapers

(1) The determination of a request for reasonable cause relief, including the review and development of reasonable cause, is not by itself an examination.

(2) Once the determination of the request for reasonable cause relief is made (or deemed), this section should be followed to administratively process the determination letter sent to the taxpayer ("determination letter") and/or related documents and workpapers.

(3) As discussed below, the administrative procedure differs depending on whether the taxable year for which the request was made is under examination.

4.61.13.7.9.1
(03-27-2009)
Administrative Procedures for Reasonable Cause Determination for Tax Year Not Currently Under Examination

(1) This section provides the administrative procedures that should be followed where the taxable year for which the request for reasonable cause relief was made is not under examination and will not be examined.

(2) The following steps should be taken to associate a copy of the determination letter and any other related documents with the amended return filed by the taxpayer with the Service Center:

a. Secure a Master File transcript for the tax year for which the request for reasonable cause relief was filed.
b. Locate the Transaction Code (TC) 290 that represents the posting of the amended return filed by the taxpayer with the Service Center. The Document Locator Number (DLN) for the TC 290 represents the "controlling DLN" of the amended return with which the determination letter and/or any related document and workpapers should be associated.

Note: If the tax year was previously examined, the DLN associated with TC 300 or TC 301 should be used as the "controlling DLN" for purposes of associating the determination letter and/or any related document and workpapers.

c. Prepare a Form 9856, Attachment Alert, and attach thereto a copy of the determination letter and/or any related documents and workpapers.

Note: The following fields/sections of the Form 9856 should be completed: Controlling DLN, Employee IDRS Number, Date Prepared, Stop Number and Alpha, EIN/SSN, Name Control, Form, and Period Ending.

Note: The controlling DLN associated with the TC 290 posting on the Master File Transcript (or the TC 300 or 301 DLN, if appropriate) should be used on the Form 9856.

d. Submit the Form 9856 through proper administrative channels to the appropriate Service Center Campus for refiling.

(3) A separate Form 9856 should be prepared for each taxable year for which the taxpayer has made a request for reasonable cause relief. The steps outlined above under (2) should be followed for each Form 9856.

Note: If the taxpayer is deemed to have established reasonable cause pursuant to 26 CFR 1.1503(d)-1(d)(1), the issue team should prepare a memorandum that states this and include the memo in workpapers.

4.61.13.7.9.2
(07-23-2020)
Administrative Procedures for Reasonable Cause Determination for Tax Year Currently Under Examination or Will Be Under Examination Due to the Reasonable Cause Determination

(1) This section provides the administrative procedures which should be followed where the taxable year for which the request for reasonable cause relief was made is:

a. Under examination at the time of the filing.
b. Becomes under examination after the filing.

Note: This includes where the taxable year becomes under examination solely because of a denial of the request for reasonable cause relief.

(2) A copy of the determination letter and/or any related documents and workpapers should be incorporated into the audit workpapers for the taxable year for which the request for reasonable cause relief was made.

(3) If reasonable cause is denied, the disallowed DCL amount is subject to the domestic use limitation rule and is treated as a SRLY loss of the DRC or separate unit that incurred the loss. See IRM 4.61.13.6.1, Report Writing for Disallowing the Use of a DCL, for report writing on the disallowance of the DCL in the year the DCL was incurred. The audit report should explain the request for reasonable cause relief and the director's decision to deny the relief.