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Re: Proposed Regulations under Section 951A [REG-104390-18]

Dear Sirs and Madame:

On behalf of the National Foreign Trade Council ("NFTC"), I would like to express our appreciation to the U.S. Department of the Treasury ("Treasury") and the Internal Revenue Service ("Service") for your efforts in developing the recently issued Proposed Section 951A regulations (the "Proposed Section 951A Regulations").

The NFTC, organized in 1914, is an association of approximately 250 U.S. business enterprises engaged in all aspects of international trade and investment. Our membership covers the full spectrum of industrial, commercial, financial and service activities and the NFTC therefore seeks to foster an environment in which U.S. companies can be dynamic and effective competitors in the international business arena. The NFTC's emphasis is to encourage policies that will expand U.S. exports and enhance the competitiveness of U.S. companies by eliminating major tax inequities in the treatment of U.S. companies operating abroad. To achieve this goal, American businesses must be able to participate fully in business activities throughout the world, through the export of goods, services, technology, and entertainment and through direct investment in facilities abroad. Foreign trade is fundamental to the economic growth of U.S. companies.

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The Proposed section 951A Regulations are highly complex and would have a very significant impact on U.S. income tax administration and compliance. In light of that complexity, and the significant number of issues that we have with the Proposed Section 951A Regulations, we urge the Treasury and the Service to revise the regulations as discussed below.

Inclusion of High-Taxed Income in GILTI

Issue:

The Proposed Section 951A Regulations "clarify" that the statutory language of section 951A excludes from tested income only high-taxed income if such high-taxed income would otherwise be subpart F income. As discussed below, the narrow scope of this interpretation leads to counterintuitive results and causes far more income to be taxed under the GILTI rules than Congress had intended.

When GILTI includes high-taxed foreign income, such as active business income, the overall tax rate on such income can significantly exceed 21%, once the expense allocation rules and the Base Erosion Anti-abuse Tax (the "BEAT") of Section 59A are taken into account. Allocating deductions and expenses to GILTI disproportionately punishes taxpayers with income subject to high foreign taxes. The higher the foreign taxes paid with respect to income included in GILTI, the more likely that allocating deductions and expenses to that income prevents the taxpayer from offsetting its U.S. tax liability with the full amount of the foreign taxes paid on such income. This loss of foreign tax credits is especially unfair with respect to interest expense deductions that are already limited by the new section 163(j) limitation. To make matters worse, GILTI subject to high foreign taxes is more likely to be taxed a second time under the BEAT because the BEAT rules take into account a gross-up for the full amount of foreign taxes paid on the GILTI while ignoring foreign tax credits.

These increases in the effective tax rate on high-taxed foreign income were clearly not intended by Congress. The Committee reports, and even the name of the provision (global intangible low-taxed income), are clear reflections that Congress intended for GILTI to target only low-taxed income. In fact, the Conference Report states: "At foreign tax rates greater than or equal to 13.125 percent, there is no residual US tax owed on GILTI, so that the combined foreign and US tax rate on GILTI equals the foreign tax rate."

Further, the Proposed Section 951A Regulations unfairly target active business operations in high-tax jurisdictions, contrary to the longstanding presumption of good business purposes for active business income in high-tax jurisdictions. Oddly, under the proposed regulations, a U.S. shareholder of a company with income in a high-tax foreign country would not have GILTI if the company's income were passive subpart F income, but would have GILTI if the company engaged in an active business in that same country.

To properly implement the policy behind GILTI and to prevent unintended increases in the effective tax rate on high-taxed foreign income, we urge Treasury and the Service to consider a

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GILTI high-tax exception (analogous to the subpart F high-tax exception), that would allow taxpayers to elect to exclude from income high-taxed GILTI. Treasury and the Service would be well within their regulatory authority to write such a GILTI high-tax exception for the following reasons: (i) it would be a clarification of the statutory ambiguity ("clarif[ied]" by the Proposed Regulations) in favor of a more general high-tax exception; (ii) GILTI is, in fact, often treated in the same manner as subpart F income pursuant to section 951A(f)(1)(B); and (iii) "needful" regulations to "effect the will of Congress" are written pursuant to section 7805(a). Absent a GILTI high-tax exception, taxpayers' only recourse will be to restructure their activities to convert high-taxed GILTI to subpart F income for which a subpart F high-tax exception election can be made, a result that would be inconsistent with the intent of the subpart F rules as an anti-abuse regime.

To best implement Congressional intent, the GILTI high-tax exception should exclude from GILTI all income subject to a foreign tax rate greater than 13.125%, consistent with the explicit intent stated in the Conference Report. Alternatively, the GILTI high-tax exception could apply a threshold of 18.9% to mirror the existing subpart F high-tax exception's threshold of 90% of the maximum applicable U.S. corporate tax rate. The GILTI high-tax exception should not apply to the same limited categories of income excluded from the subpart F high-tax exception (international boycott income, illegal bribes, and income derived from certain listed countries).

In order to determine what income should be excluded, the GILTI high-tax exception should be calculated on either a CFC-by-CFC basis or an item of income by-item of income basis. A CFC-by-CFC calculation would be consistent with the subpart F high-tax exception, but an item of income-by-item of income calculation would also preserve the Congressional intent by including in GILTI only items of income subject to a low rate of tax. In either case, the GILTI high-tax exception could be calculated either (x) at the tested income level by allocating QBAI, as appropriate, to items of income excluded as high-taxed tested income or (y) after the calculation of a United States shareholder's total GILTI by allocating the total GILTI among CFCs with tested income and then exempting the high-taxed GILTI.

Proposal:

We understand new Treasury Regulations are forthcoming that could change the mechanics for the subpart F high-tax exception. If the existing mechanics should continue to apply, it would make sense to apply the same approach for a GILTI high-tax exception. If new Treasury regulations, instead, implement a pure item of income-by-item of income calculation for the subpart F high-tax exception, a GILTI high-tax exception could be similarly determined. Either mechanic would be within Treasury's regulatory authority and consistent with the policy behind the GILTI rules.

As such, for the reasons discussed above, when finalized, the section 951A regulations should include a GILTI high-tax exception for income subject to a foreign tax rate of at least 13.125%, determined on either a CFC-by-CFC or item of income-by-item of income basis. A GILTI high-tax exception would ensure GILTI is implemented consistent with Congressional intent to target

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low-taxed income, without unfairly increasing the effective tax rate on income already subject to high foreign taxes.

<u>Application of Section 245A to CFC Dividend Income</u>

<u>Issue</u>:

The preamble to the Proposed Section 951A Regulations provides, *inter alia*, as follows: "Comments are requested as to whether these rules [Sub F income, tested income, tested loss] should allow a CFC a deduction, or require a CFC to take into account income, that is expressly limited to domestic corporations under the Code. For example, *questions have arisen as to whether a CFC could be entitled to a dividends received deduction under section 245A, even though section 245A by its terms applies only to dividends received by a domestic corporation*. See Conf. Rep. at 599, fn. 1486." [Emphasis added.]

As illustrated in Conf. Rep. at 599, fn. 1486, Congressional intent indicates that the section 245A DRD should apply to subpart-F dividend income received by domestic corporations as well as CFCs (see Treas. Reg. Sec. 1.952-2). If section 245A DRD does not apply to subpart F dividend income, U.S. multinational firms will be disadvantaged vis-à-vis their foreign competitors.

First-tier CFC dividend income includes income received from:

100% owned lower-tier CFCs: considered subpart F income (GL-NOGI) and taxed at 21% if CFC look-through not extended;

10/50 foreign corporations: considered subpart F income (NOGI under section 954(b)(4)) and taxed at 21%; and

No consequences to <10% owned foreign corporations.

Applying section 245A to non-subpart F dividend income (Section 954(c)(6) look-through, same country dividends, HTKO election) can result in U.S. tax on income otherwise contemplated as exempt in the TCJA territorial system. See Section 1059(a) and the following example:

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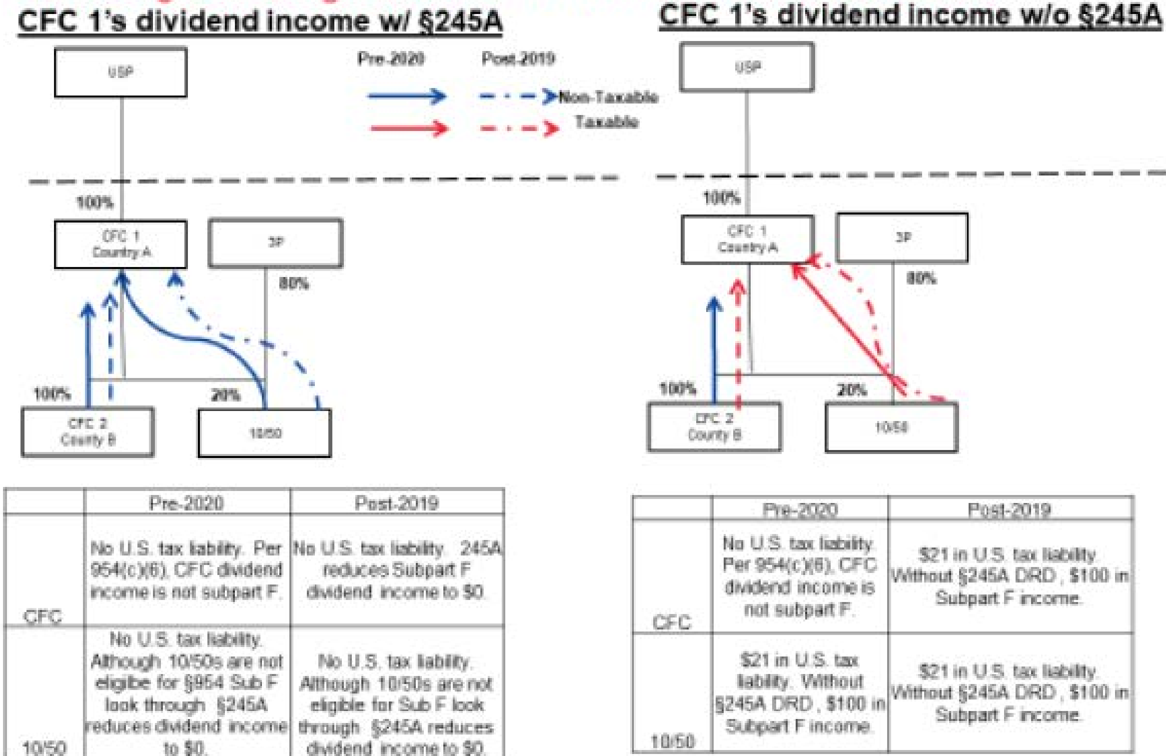

	Pre-2020	Post-2019
CFC	No U.S. tax liability. Per 954(c)(6), CFC dividend income is not subpart F.	No U.S. tax liability. 245A reduces Subpart F dividend income to $0.
10/50	No U.S. tax liability. Although 10/50s are not eligibe for §954 Sub F look through. §245A reduces dividend income to $0.	No U.S. tax liability. Although 10/50s are not eligible for Sub F look through. §245A reduces dividend income to $0.

	Pre-2020	Post-2019
CFC	No U.S. tax liability. Per 954(c)(6), CFC dividend income is not subpart F.	$21 in U.S. tax liability. Without §245A DRD, $100 in Subpart F income.
10/50	$21 in U.S. tax liability. Without §245A DRD, $100 in Subpart F income.	$21 in U.S. tax liability. Without §245A DRD, $100 in Subpart F income.

Proposal:

When finalized, the section 951A regulations should clarify that section 245A applies exclusively to subpart F dividend income received by domestic corporation as well as CFCs.

Basis Adjustments for the Use of Tested Losses

Issue:

The Proposed Section 951A Regulations require a mandatory decrease in the stock basis of a CFC immediately before the "disposition" of its stock. Specifically, the stock basis is reduced by the "net used tested loss amount," ("NUTLA"), which is the cumulative net tested loss generated by the CFC and included in the consolidated GILTI calculation over the life of the CFC. A "disposition" is defined broadly to include any sale, contribution, or deemed transfer of the CFC stock that creates a taxable event in whole or in part. Prop. Treas. Reg. Sec. 1.1502-51(c) addresses stock basis adjustments for members of consolidated groups.

There are a number of issues with this basis adjustment rule. First, it will be administratively burdensome for taxpayers to maintain a rolling account of tested loss/tested income, by CFC, by year, to determine if there is a NUTLA at the time of a disposition. Likewise, it will be administratively burdensome for the Service to review/substantiate the taxpayer's records on audit to confirm the NUTLA. Finally, the basis adjustment rule can lead to inequitable results.

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A tested loss generates, at most, a 10.5% tax benefit, or for a taxpayer with excess GILTI limitation, a 0% tax benefit. If the taxpayer later sells the stock of the CFC generating a NUTLA to a third party, and the CFC has no earnings and profits, the gain is subpart F, passive gain taxed at 21%. Consequently, there will be taxpayers that recognize no benefit from the tested loss, but nevertheless, these taxpayers are required to reduce the stock basis of the CFC at disposition, and are taxed on the corresponding gain at 21%.

Proposal:

When the section 951A regulations are finalized, the basis adjustment rule should be eliminated. There is no authority provided in the statute for stock basis reductions as a result of the use of a tested loss in the GILTI calculation.

In the alternative, the use of tested losses to offset tested income should be elective. The taxpayer should be allowed to elect to either use or exclude the tested loss in its GILTI calculation. To the extent that a tested loss is not used in the taxpayer's GILTI calculation, the tested loss would not be considered a "used tested loss." To the extent a taxpayer elected to use a tested loss, the corresponding basis would be reduced by 50% to reflect the rate differential between GILTI and capital gains taxation.

The Subpart-F Anti-Abuse Rule

Prop. Treas. Reg. Sec. 1.951-1(e)(6) provides that "any transaction or arrangement" can be disregarded that reduces subpart F income and "avoids Federal income taxation".

This rule is too broad and could implicate a myriad of transactions that historically have not been treated as abusive.

For example, check-the-box elections. Generally, Treas. Reg. Sec. 301.7701-3 provides taxpayers with an election to classify a foreign entity as either a CFC or a disregarded entity ("DRE"). If a taxpayer elects to classify a foreign entity as a DRE, and this classification avoids the recognition of subpart F income, query whether the election to be classified as a DRE can be disregarded by Prop. Treas. Reg. Sec. 1.951-1(e)(6)? The rule eliminates the certainty and simplicity created by Treas. Reg. Sec. 301.7701-3.

Another example, is a section 338(g) election to increase the value of a foreign target's assets to fair market value (the "step-up"). If the future depreciation or amortization created by the step-up is recovered against subpart F income, query whether the section 338(g) election can be disregarded by Prop. Treas. Reg. Sec. 1.951-1(e)(6)?

As yet another example, a plain reading of Prop. Treas. Reg. Sec. 1.951-1(e)(6) would disregard a CFC's sale of assets if the sale was structured to close by the end of a particular year to allow an unrelated buyer more favorable depreciation treatment than the next year. Disregarding such transaction could impact a United States shareholder's pro rata share of completely unrelated subpart F income in a completely unrelated manner.

Furthermore, Prop. Treas. Reg. Sec. 1.951-1(e)(6) does not provide any guidance on how transactions or arrangements should be disregarded. In the CFC asset sale example above, it is unclear if the selling CFC should still be treated as owning the asset for all taxable years going forward forever. As another example, if a CFC ownership structure with both preferred

and common shares were disregarded, it is unclear whether the structure should be disregarded by treating all the shares as common shares, by ignoring the existence of whichever shares were created by the transaction (and potentially also any property contributed to the CFC in exchange for such shares), or by some other mechanism.

The lack of clarity described above only increases over time, as taxpayers change their organizational structures or enter into transactions in response to commercial pressures, regulatory requirements, or other non-tax needs but where tax considerations play a role in the structure or timing. Clarity on how taxpayers should apply Prop. Treas. Reg. Sec. 1.951-1(e)(6) is crucial to allow taxpayers to keep accurate books and records and to continue running business operations smoothly.

Proposal:

When finalized, the anti-abuse rule of Prop. Treas. Reg. Sec. 1.951-1(e)(6) should be significantly narrowed so that it clearly does not apply to transactions that historically have not been treated as abusive, *e.g.*, check-the-box elections and section 338(g) elections, and so that the duration for which the rule should be applied is limited.

Pro Rata Share

Issue:

Section 951(a) requires U.S. shareholders of CFCs to include in income their pro rata share of such foreign corporations' subpart F income. Treas. Reg. Sec. 1.951-1(e) generally allocates the subpart F income of a controlled foreign corporation with multiple classes of stock based on a deemed distribution of the corporation's current year E&P. For a controlled foreign corporation with multiple classes of stock with "discretionary distribution rights," these regulations allocate E&P based on the relative fair market value of each class of stock (the "fair market value method"). Prop. Treas. Reg. Sec.1.951-1(e), applicable to taxable years of U.S. shareholders ending on or after October 3, 2018, would amend these allocation rules to instead generally allocate E&P among multiple classes of stock based on all relevant facts and circumstances related to the economic rights and interests of each class of stock in the current E&P of the corporation (the "facts and circumstances method").

Section 965 generally requires U.S. shareholders that own a 10 percent voting interest in a foreign corporation to increase their subpart F income based on their share of the undistributed post-1986 E&P of the foreign corporation, as specially determined (these increases in subpart F income, the "965(a) inclusion amounts"). U.S. shareholders include a foreign corporation's 965(a) inclusion amount in the last taxable year of such foreign corporation that begins before January 1, 2018. As a result, a U.S. shareholder with a taxable year ending December 31 would be required to include the 965(a) inclusion amounts of its foreign subsidiaries: (i) in its 2017 tax year with respect to foreign subsidiaries with a taxable year ending December 31 (*i.e.*, "calendar year" foreign subsidiaries) and (ii) in its 2018 tax year with respect to foreign subsidiaries with a taxable year ending November 30 (*i.e.*, "fiscal year" foreign subsidiaries). Such a U.S. shareholder would be required to apply the fair market value method to allocate the 965(a) inclusion amounts with respect to some subsidiaries while applying the facts and circumstances method with respect to others.

Proposal:

For the following reasons, the effective date of Prop. Treas. Reg. Sec. 1.951-1(e) should be amended to permit, but not require, U.S. shareholders to apply the facts and circumstances method to taxable years ending on or after December 31, 2017 and before October 3, 2018:

1. Allowing U.S. shareholders to allocate their pro rata share of subpart F income under the facts and circumstances method enables taxpayers to apply a uniform method for allocating the 965(a) inclusion amounts of all relevant foreign subsidiaries.
2. The facts and circumstances method may provide more certainty regarding the allocation of subpart F income, and determining the fair market value of multiple classes of stock is administratively burdensome.
3. Applying the facts and circumstances method should not result in improper allocations of subpart F income, because the facts and circumstances method allocates subpart F income in a manner that is consistent with each shareholder's economic rights and interests.

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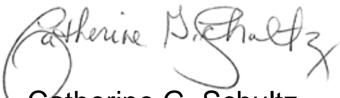
Again, thank you very much for the opportunity to provide these comments. Please do not hesitate to contact me should you have any questions on the above. We would be glad to meet with you to discuss these comments more fully and hereby formally request a public hearing to present our oral comments on the Proposed Section 951A Regulations.

Sincerely,



Catherine G. Schultz
Vice President for Tax Policy

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