NATIONAL FOREIGN TRADE COUNCIL, INC.

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NFTC Position Paper on the Extenders Legislation H.R. 4213
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The NFTC, organized in 1914, is an association of some 300 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 we seek to foster an environment in which U.S. companies can be dynamic and effective competitors in the international business arena.

We support the inclusion in the extender legislation the following provisions that expired at the end of last year:

- An extension of the look-through rules for payments between related foreign corporations, and
- An extension of the exception from subpart F for active financing income

However, we have grave concerns about the revenue offset provisions included in the "American Jobs and Closing Tax Loopholes Act of 2010" (H.R. 4213). The revenue offsets included in the extender legislation were developed in closed door meetings without input from the affected taxpayers. The U.S. international tax rules are complex and increasingly out of step with the rest of the world. These new revenue proposals will make American businesses less able to compete in foreign markets, will subject them to double taxation, and as a result may have significant negative consequences on worldwide American businesses and their U.S. employees. As such, these proposals should be thoughtfully considered only in the context of international tax reform rather than be quickly enacted as permanent revenue offsets for short term extensions of expiring tax provisions. In addition, the provisions are retroactive and will affect taxpayers who have relied on long standing rules in the tax code in doing their tax planning. Taxpayers need to be able to rely on certainty of tax rules when making business decisions, and the retroactive application of adverse tax changes is unfair and will make it more difficult for American worldwide companies to compete in the global marketplace.

Foreign Tax Credit Splitter Provision

The retroactive effective date for the foreign tax credit splitter proposal that is designed to prevent the so-called splitting of foreign taxes and foreign income is both inappropriate and unfair. The proposed effective date means that the changes to the foreign tax credit rules would apply to foreign taxes that were paid by taxpayers long before the legislation was under consideration (much less enacted). Taxpayers should be entitled to rely on the foreign tax credit rules that were in place when they paid the foreign taxes.

The potential for foreign taxes and foreign income to be separated or "split" from each other was created by the U.S. tax law. U.S. tax rules determine which entity in a corporate group is treated as the taxpayer with respect to foreign taxes paid; U.S. tax rules also determine which entity is treated as earning the foreign income with respect to which such taxes were paid. The proposal would change these established rules and would impose those changes on a retroactive basis. The proposed retroactive effective date means that the changes to the foreign tax credit rules would apply to different taxpayers differently. The proposal thus would have an uneven effect.

Treasury and the IRS in 2007 communicated to taxpayers that any changes in this aspect of the foreign tax credit rules would be prospective only. Treasury and the IRS in 2006 issued proposed regulations aimed at requiring the matching of foreign taxes and foreign income. When originally issued in 2006, those proposed regulations were proposed to be effective for foreign taxes paid in taxable years beginning on or after 2007. When the government had not finalized the regulations by late in 2007, they recognized that retaining this effective date would make the regulations effectively retroactive. So in November 2007, Treasury and the IRS issued a Notice stating that the regulations when finalized would be effective only for taxable years beginning after the date they are published in final form. It would be completely inconsistent with this history for legislation now to apply on a retroactive basis. And it would be particularly surprising for a statutory change to apply retroactively when the proposed regulatory guidance in this area would have been effective only prospectively.

Retroactive application of the provision also would be extremely difficult, if not impossible, for taxpayers to apply. Consider a taxpayer that has a group of business affiliates in a foreign country that file their tax returns in that country on t a consolidated basis. If the provision applies retroactively, the taxpayer would have to try to figure out the separate income and foreign taxes associated with each of the entities for many past years. It would be very difficult, if not impossible, to obtain the necessary information and make the determinations that are required so many years after the year when such taxes were paid.

Section 338 Covered Asset Acquisitions

American taxpayers utilize Section 338 in acquiring foreign companies to help level the playing field against foreign competitors. It is not a loophole and is a well recognized practice. The primary foreign competitors of many American worldwide companies are located in jurisdictions with territorial tax systems. The ability to make a Section 338 election on a foreign target helps American companies compete with those foreign competitors with respect to those targeted companies. The Section 338 election allows American companies to pay US tax on repatriations from those foreign targets on a more competitive basis, putting American companies on a more even playing field with their foreign competitors. From a policy perspective, American companies should be allowed depreciation and amortization deductions for the amounts paid to acquire a target in calculating E&P. The effects of a Section 338 election should not be changed except as part of comprehensive international tax reform that makes American companies more competitive with their foreign competitors. Retroactive application of this provision will make it even more difficult for taxpayers who are in the process of acquiring a foreign company, notwithstanding the limited transition relief provided in some (but not all) of these situations.

Limitation on the Use of Section 956

The IRS has ruled in unpublished guidance that bona fide loans that permit taxpayers to use

Subpart F (specifically sec. 956), rather than a regular dividend, are permitted under current law. Thus, these transactions are hardly abusive. In FSA 950823 the IRS described a U.S. parent company that received a loan from its Japanese subsidiary. The FSA states that it is the position of the IRS that the affirmative use of section 956 should not be challenged as long as the loan between the U.S. parent company and the Japanese subsidiary is a bona fide loan.

In FSA 961121a CFC guaranteed the debt of its US parent in order to affirmatively trigger Section 956. In the FSA the IRS stated that if the loan guarantee is bona fide, the IRS will not challenge its validity for section 956 purposes even if the only purpose for the guarantee was to cause an inclusion in current income under subpart F. The CFC could decide to declare a dividend to give the U.S. shareholder the deemed paid foreign tax credit under section 902. Thus, if the parties decide to achieve the same result by causing a deemed inclusion under subpart F, the transaction is not considered abusive. Generally, the FSA states that the taxpayer will decide to use subpart F, rather than declare a dividend, to avoid the withholding tax that would be imposed on the dividend in the CFC's country of incorporation. However, that the taxpayer planned the transaction at issue in a manner that will avoid foreign tax is not a factor that affects whether the transaction is valid for U.S. tax purposes.

These FSAs show that the IRS has long been aware of and indeed has blessed the affirmative use of Section 956. The bill would make this significant change in the law rather abruptly having been only released shortly before final floor action. This is not a change that is limited to "abusive" or "aggressive" transactions. At a minimum, the change should be applied to Section 956 investments made in tax years beginning after December 31, 2010. Companies that have plans that may be undertaken in their current tax years should not be penalized with a retroactive effective date.

Conclusion

The international tax revenue raisers included in H.R. 4213 were never the subject of Congressional hearings. Many of them were never even included in any previous bill or budget proposal. They deal with complex international tax rules that can have significant inadvertent consequences on worldwide American businesses and U.S. employees. In many cases, the proposals target well-known planning techniques that the government has never suggested were abusive, and yet the proposals carry immediate or retroactive effective dates of the king usually reserved for provisions that target clear abuses. These international tax revenue raisers should be thoughtfully considered only in the context of tax reform rather than as piecemeal permanent revenue raiser for short term extensions of expiring tax provisions. For taxpayers, the date of introduction of the legislation was the first time most of these provisions came to light. The effective dates included in the legislation penalize taxpayers who have acted in good faith and who have relied on the current tax code in planning their transactions. If Congress inadvisedly enacts these proposals without careful deliberation of the long term ramifications, it should at the very minimum make the effective date of these proposals prospective for taxable years beginning on or after December 31, 2010. Otherwise, American companies would unfairly face retroactive tax increases that would break long-standing tax policy that strongly favors making tax increases prospective only.