UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS

Charles P. Rettig
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20044

RE: IRS REG-104390-18 - Guidance Related to Section 951A (Global Intangible Low-Taxed Income)

Dear Commissioner Rettig:

USCIB[1] is pleased to provide comments on the proposed regulations regarding guidance related to Global Intangible Low-Taxed Income or "GILTI" under section 951A (REG-104390-18). Detailed comments are below.

1. **Application of section 245A to CFC dividend income**
    a. Regulation language (preamble): "Comments are requested as to whether these rules (subpart F income, tested income, and tested loss rules) 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." (Parenthetical added.)
    b. Issues:
        i. The reform of the international tax provisions essentially constructed three classes of foreign income: income that would be subject to tax currently at the full U.S. corporate rate (section 952 subpart F income); income that would be exempt from U.S. tax permanently (the net deemed tangible return income); and income taxed currently at a reduced rate of tax (section 951A income). Restricting section 245A's applicability exclusively to domestic corporations would potentially cause taxpayers to incur tax on income that Congress intended to exempt from U.S. corporate income tax. This would occur in two cases.
        ii. First, dividends paid by related CFCs would be subject to U.S. tax if the look-through rules of section 954(c)(6) expire as they are currently scheduled to do under section 954(c)(6)(C). Providing that section 245A applies at the CFC level would remove the risk that section 954(c)(6) is not extended because the DRD would eliminate any U.S. tax on that income.

[1] USCIB promotes open markets, competitiveness and innovation, sustainable development and corporate responsibility, supported by international engagement and prudent regulation. Its members include top U.S.-based global companies and professional services firms from every sector of our economy, with operations in every region of the world. With a unique global network encompassing leading international business organizations, USCIB provides business views to policy makers and regulatory authorities worldwide and works to facilitate international trade and investment.

iii. Second, a dividend from a lower-tier unrelated[2] entity to a CFC would trigger section 954(c)(1)(A) foreign personal holding company income that would be subject to U.S. tax unless the section 245A dividend received deduction is available to the CFC. Congress intended that the section 245A dividends received deduction should apply to section 952 subpart-F dividend income in that case. The Conference Report[3] provides that the 245A should be "available to a controlled foreign corporation treated as a domestic corporation for purposes of computing the taxable income thereof under Treas. Reg. sec. 1.952-2(b)(1). Therefore, a CFC receiving a dividend from a 10-percent owned foreign corporation that constitutes subpart F income may be eligible for the DRD with respect to such income."

iv. These results are exacerbated by the unavailability of foreign tax credits to offset the subpart F inclusion. The TCJA removed section 902 providing for deemed paid foreign tax credits on dividend distributions since dividends out of non-previously taxed income would generally qualify for the section 245A DRD, therefore foreign tax credits would not be necessary to eliminate double taxation. If, however, neither the DRD nor the deemed paid foreign tax credit are available, significant double taxation may occur. In the cases, identified above, there may be foreign taxes paid on these earnings, none of which would be credible.

c. Proposed solution:

i. Treasury and the IRS should clarify that the section 245A DRD is applicable to section 954 subpart F dividends received by section 957 controlled foreign corporations.

2. Basis reduction for net used tested loss included in consolidated GILTI calculation

a. Prop. Reg. § 1.951A-6(e): The proposed regulations require a mandatory decrease in the stock basis of a controlled foreign corporation ("CFC") immediately before the "disposition" of the stock. 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. Reg. § 1.1502-51(c) addresses stock basis adjustments for members of consolidated groups.

b. Issues:

i. It will be administratively burdensome 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.

ii. It will be administratively burdensome on the Service to review/substantiate the taxpayer's records on audit to confirm the NUTLA.

iii. The proposed regulation can lead to inequitable results for taxpayers because they may apply in circumstances in which a taxpayer does not receive any U.S. tax benefit from its pro rata share of "used tested losses".

1. Tested losses create, at most, a 10.5% tax benefit for taxpayers with excess GILTI limitation. Conversely, tested losses may provide no tax benefit if

[2] A specified 10% owned foreign corporation that is not a related person per section 954(d).
[3] TCJA Conference Report, at 599, fn. 1486.

either tested income is less than net deemed tangible return income or the taxpayer is in a excess GILTI credit position. 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, are required to reduce the stock basis of the CFC at disposition and are taxed on the corresponding gain at 21%.

2. A reduction in the stock basis of a first-tier CFC immediately prior to a deemed exchange pursuant to a § 165(g) prevents the taxpayer from enjoying the benefit of a 21% U.S. source loss on worthless CFC stock. The taxpayer's benefit is reduced to, at most, a 10.5% tax benefit from the tested loss and, as previously mentioned, taxpayers with excess GILTI credit enjoyed no benefit from a tested loss.

c. Proposed alternative solutions:
   i. The IRS/Treasury should withdraw the proposed regulation. There is no authority provided in the statute for stock basis reductions as a result of use of a tested loss in the GILTI calculation.
   ii. In the alternative, the use of tested losses to offset tested income should be elective. The taxpayer could elect to either use or exclude the tested loss in the consolidated GILTI. To the extent that a tested loss is not used in the consolidated 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 adjustment should be reduced by 50% to reflect the rate differential between GILTI and capital gains taxation.
   iii. Limit the term "disposition" to transactions involving an actual transfer of stock, and clarify that distributions described in sections 301(c)(1) and (c)(2) do not constitute "dispositions", even when deemed to occur pursuant to section 304(a)(1). The proposed regulations effectively take a "wait-and-see" approach with respect to taxable stock transactions that do not involve an actual transfer of stock ownership (i.e., indirect dispositions), such as distributions described in sections 301(c)(1) or (c)(2). We believe this approach is appropriate because a CFC that produces tested loss in one year may produce tested income in a later year as the CFC's business matures. Duplicative loss safeguards should not apply prior to a meaningful change in CFC ownership because future tested income may eliminate the benefits of any prior tested losses. Accelerating the imposition of U.S. tax on distributions described in sections 301(c)(1) and (c)(2) will, in many cases, cause double taxation rather than prevent a duplicative loss. For this reason, the term "disposition" should be limited to transactions involving an actual transfer of stock.

3. Subpart-F anti-abuse rule

a. Prop. Reg. § 1.951-1(e)(6): provides that for purposes of determining a US shareholder's pro rata share of a CFC's (1) subpart F income and (2) tested income, tested loss, QBAI, and tested interest, a plan a principal purpose of which is the avoidance of Federal income taxation, including, but not limited to, a transaction or arrangement to reduce a US shareholder's pro rata share of these items is disregarded in determining these items.

b. Issues:
   i. The proposed regulation is too broad and may implicate many transactions that have historically not been considered abusive.
   ii. Traditionally, check-the-box ("CTB") elections have not been considered abusive. Generally, taxpayers can make a CTB 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 future Subpart-F income, it may be that the CTB election can be disregarded under the proposed regulation. Query how the "tax avoidance purpose" of a CTB election be evaluated when the only effect of the CTB election is its tax consequences? Taxpayers are unlikely to make elections that only have tax effects in order to increase their taxes. The proposed rule would curtail the certainty otherwise offered by the check-the-box entity classification regime.
   iii. Similarly, a section 338(g) election, which allows taxpayers to increase the value of an offshore acquisition's up to current fair market value could also be susceptible to this anti-abuse rule. If the future cost recovery generated by this election reduces future section 952 income, it is possible that the section 338(g) election may fall within the scope of the anti-abuse rule as well.

c. Proposed solutions:
   i. The Treasury/IRS should clarify and narrow the language in Prop. Reg. Sec. 1.951-1(e)(6) to disregard transactions or arrangements that are part of plan to reduce a U.S. shareholder's pro rata share of the subpart F income of a CFC. This provision should not apply, however, to disregard any other transactions or arrangements. It would also be helpful if Treasury and the IRS could clarify that this proposed regulation does not prevent taxpayers from restructuring operations into either a branch or the GILTI basket. The regulations should also make clear that tax elections cannot be tested under this rule, since there will never be a business purpose for a tax election and therefore a tax election is likely to be motivated by reducing one's taxes.

4. **GILTI calculated without regard subpart-F recapture**.
   a. Prop. Reg. 1.951A-2(c)(4): The proposed regulation calculates a CFC's tested income or tested loss without regard to subpart-F recapture under section 952(c).
   b. Issue:
      i. GILTI is defined to exclude income "taken into account in determining the subpart-F income of such corporation."[4] In Year 2, the example on pages 99-100 of the proposed regulations treats the same $100 as both subpart-F income and gross tested income for purposes of the GILTI calculation. This result is inconsistent with the policy of the exclusions from tested income – which generally exclude other items of income that are subject to tax without regard to section 951(A). This is so, because applying the recapture rules and the GILTI rules to the same earnings, could result in double

[4] I.R.C. § 951A(c)(2)(A)(ii).

taxation. This may also create questionable foreign tax credit results. If the same earnings are subject to tax twice, should the same foreign taxes be creditable twice? It is certainly anomalous to grant multiple credits for the same taxes, but if the earnings are double counted, credits ought to double counted as well.

   c. Proposed solutions:
      i. Earnings recaptured under section 952(c)(2) should be excluded from tested income. This is more consistent with subpart F income taking priority of the determination of the GILTI amount.
      ii. Alternatively, gross tested income could be excluded from earnings and profits available for recapture.
      iii. Section 951A(c)(2)(B)(ii) provides that the earnings and profits of a tested loss corporation should be increased by the amount of the tested loss. Without additional guidance, this rule would apply whether or not the tested loss was utilized to decrease tested Income. The proposed regulations should clarify that the increase in E&P of the tested loss company required by Section 951A(c)(2)(B)(ii) is limited to the amount of tested income reduced by the tested loss.

5. **Anti-abuse rule for certain specified tangible property held for a short term**
   a. Prop. Reg. 1.951A-3(h)(1): provides an anti-abuse rule for certain specified tangible property that is held for a short-term. The anti-abuse rule would, effectively, treat as abusive any holding that is held over at least one quarter end, but for less than 12 months.
      i. Issue: This rule will capture non-abusive, ordinary course transactions and inappropriately reduce the basis of eligible property. The proposed regulation assumes that specified tangible property held (i.e., acquired and disposed of) for less than 12 months was acquired to artificially inflate QBAI. However, specified tangible property may be held by CFCs for less than 12 months for many valid business reasons, especially in the context of transfers occurring between members of a U.S. corporation's global group. Such transfers can occur, for example, to meet intra-group property needs, allocate tangible property obtained to receive bulk purchase discounts, and for temporary storage. An exemption for transfers occurring between related CFCs is consistent with regulation's approach to calculating GILTI on an aggregate US shareholder basis, rather than on a CFC-by-CFC basis.
      ii. Proposed Solutions: USCIB recommends that transfers of specified tangible property occurring between related CFCs be exempt from this paragraph. Further, the rule should permit such transfers to result in a "tacked" holding period to the transferee CFC. Alternatively, the Treasury and the IRS should clarify that only specified tangible property disposed of to a third party is subject to this paragraph.
   b. Prop. Reg. 1.951A-3(h)(1): requires asset tracking by taxpayers that may be disproportionate in complexity to the underlying policy concerns.
      i. Issue: We believe the purpose of this paragraph is to avoid meaningful distortions of QBAI. However, taxpayers may, in the ordinary course of business, temporarily hold small amounts of specified tangible property. For example, damage to specified tangible property may lead to a disposal within 12 months of its acquisition. Such

dispositions should represent a small percentage of the U.S. corporation's global group's QBAI. However, the effort required to quantify such inadvertent dispositions is large and has no material effect upon the GILTI inclusion amount. For property acquired late in the taxable year, a taxpayer simply will not know whether it has been held for 12 months before filing its return. Taxpayer's should be able to reasonably approximate whether such dispositions exceed five percent of the prior year's aggregate QBAI. Such an approach would preserve the purpose of the paragraph without placing unnecessary burden upon taxpayers.

ii. Proposed Solution: The temporarily held property rules should apply only if more than five percent of the prior year's aggregate QBAI would be affected.

c. Prop. Reg. 1.951A-3(h)(1): may cause taxpayers to file an amended tax return.

i. Issue: We understand the intention of this paragraph is too prevent "window dressing" of QBAI—acquiring specified tangible property with a principal purpose of artificially increasing QBAI. Mid- or late-year purchases of specified tangible property have, under this rule, a 12-month holding period that straddles more than one taxable year. Dispositions occurring after the first-year tax return is filed would require an amended tax that would place undue burden on the taxpayer and IRS' already limited resources. Making required basis adjustments in the year of disposition and subject to a de minimis (e.g., less than five percent of the prior year's aggregate QBAI) rule would lessen this burden while addressing the policy concern.

ii. Proposed Solution: Permit required QBAI adjustments to be made in the taxable year of disposition and subject to a de minimis rule.

d. Prop. Reg. 1.951A-3(h)(2) and Prop. Reg. 1.951A-2(c)(5), which cross-references Prop. Reg. 1.951A-3(h)(2): The Disqualified Period Rule exceeds Treasury's rule-making authority.

i. Issue: The Disqualified Period Rule exceeds Treasury's grant of authority to promulgate regulations because (1) the effective date for the law is stated in the statute and Treasury cannot make regulations to enforce a law that is not effective yet, (2) there is no ambiguity or gap in the statute that Treasury needs to clarify since (a) the effective date for the GILTI provisions is clear and (b) the anti-abuse provision clearly applies to determination of QBAI, and (3) Congress expressed no intention, whether in the statute or legislative history, that any GILTI anti-abuse rules should apply strict liability to taxpayers.

ii. Proposed Solution: Treasury should withdraw the Disqualified Period Rule. The Disqualified Period Rule is not necessary because there are statutory provisions or judicial doctrines to prevent taxpayers from abusing the Code, e.g., the Economic Substance Doctrine disregards a transaction for Federal income tax purposes if the transaction has no economic substance beyond the creation of Federal income tax effects and the taxpayer has no non-tax business purpose for engaging in the transaction. Therefore, any valid anti-abuse rule promulgated under section 951A would be superfluous. However, if Treasury insists on issuing an anti-abuse provision, then Treasury should consider modifying the Disqualified Period Rule so that it applies only to transactions that do not have a business purpose, have the principal purpose of avoiding the purposes of section 951A, and do not have any economic effect. Treasury should permit affected taxpayers and other stakeholders an opportunity to provide comments on the modified rule.

6. Increase of Earnings and Profits of Tested Loss CFC

a. Prop. Reg. 1.951A-6(d): provides: "for purposes of section 952(c)(1)(A) with respect to a CFC inclusion year, the earnings and profits of a tested loss CFC are increased by an amount equal to the tested loss of the tested loss CFC for the CFC inclusion year."

i. Issue: It is clear that Congress intended this rule to prevent the double benefit from a single loss – it is the very title of the subsection. However, as recognized by the IRS in crafting the -6(e) basis adjustments rules, the possibility for a double benefit crystallizes only to the extent a loss is "used." A tested loss would not be used, in full, to the extent that a US shareholder's allocable share of tested loss exceeds its allocable share of tested income. Guidance should be drafted to this effect.

ii. Proposed Solution: Limit the amount of tested loss added back for section 952(c) purposes to the amount of tested loss actually "used."

USCIB is available to discuss these comments further, if that would be helpful to the Treasury and the IRS.

Sincerely,

William J. Sample
Chair, Taxation Committee
United States Council for International Business (USCIB)

Washington Office
1400 K Street, N.W., Suite 525
Washington, DC 20005
202.371.1316 tel
202.371.8249 fax
www.uscib.org

Global Business Leadership as the U.S. Affiliate of:
International Chamber of Commerce (ICC)
International Organization of Employers (IOE)
Business and Industry Advisory Committee (BIAC) to the OECD
ATA Carnet System