UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS

September 17, 2019

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

RE: IRS REG-101828-19 - Guidance Under Section 958 (Rules for Determining Stock Ownership) and 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 rules for determining stock ownership and Global Intangible Low-Taxed Income or "GILTI" under section 951A (IRS REG-101828-19).

Summary

USCIB supports the proposed rules on stock ownership and believes the proposed rules on the high-taxed exception to the GILTI rules are a well-intentioned and positive step. The proposed stock ownership rules will ease compliance for both taxpayers and the IRS. The high-tax exception will improve the GILTI provision, but changes are needed to better align the GILTI regulations with the intent of Congress. The legislative history is very clear that Congress intended that GILTI apply to low-taxed income. The Tax Cuts and Jobs Act (TCJA) conference report states "[at] foreign tax rates greater than or equal to 13.125 percent, there is no residual U.S. tax owed on GILTI, so that the combined foreign and U.S. tax rate on GILTI equals the foreign tax rate." [2]

The mechanics of the TCJA do not actually result in a maximum rate of 13.125%, but the intention of Congress should be kept in mind in interpreting the provisions of the Act. Interpretations that tend to achieve the goal of only taxing low-tax income – income subject to an effective rate below 13.125% -- should be preferred over interpretations that increase the effective rate beyond that level. Treasury and the IRS have concluded that the language of section 951A(c)(2)(A)(i)(III), commonly referred to as the "GILTI high-tax exclusion", could not be interpreted in a way that would achieve that goal.[3] Particularly in light of that conclusion, we commend Treasury and IRS for proposing to further Congress' intent by exercising its regulatory authority to create an elective high-tax exception from GILTI. We recommend

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[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.

[2] TCJA, Conference Report, at 627.

[3] Treas. Reg. §1.951A-2(c)(1)(iii).

below certain changes to the proposed exception that would align it more closely with Congress' intent and the policy objectives cited by Treasury and IRS in the preamble.

USCIB does suggest several changes to the proposed rules:

- Consistent with Congressional intent, the election should apply for income taxed at or above 13.125% rather than above 18.9%.
- If the election is to be based on the subpart F high-tax election, it should be conformed in several respects to that regime.
    - The election should be made annually rather than every 5 years.
    - The election should be made separately with respect to each CFC.
    - The determination should be made on a CFC-by-CFC basis rather than on a QBU-by-QBU basis.
    - It should be clear that all foreign taxes paid should be taken into account in determining the effective rate.
- Finally, the election should be permitted retroactively to tax years beginning on or after January 1, 2018. The logic of the election – that Congress intended not to tax highly-taxed foreign income – applies equally to all GILTI years and not merely to years following finalization of the rules.

Detailed Comments

Proposed §1.951A-2 (c)(6) provides that an item of gross tested income qualifies for the high tax exception if an election is effective for the inclusion year and the gross tested income is subject to foreign tax at an effective rate that is greater than 90 percent of the maximum rate provided in section 11 (currently 18.9%). Both legs of this test should be modified to improve the operation of the high-tax exception.

<u>Income subject to foreign tax at a rate greater than 13.125% should be considered high-taxed</u>

While USCIB appreciates the proposed adoption of the high-tax exception, we believe that income should be considered high-taxed if it subject to foreign tax at a rate greater than 13.125%. That was the clearly expressed intent of Congress and the regulations should implement that intent. Thus, USCIB recommends that the foreign effective tax rate threshold at which the election applies should be reduced in the final regulation.

<u>Conformity with section 954(b)(4)</u>

The proposed regulations are based upon an application of section 954(b)(4) to any item of income received by a foreign corporation; the 90% test is contained in section 954(b)(4). If the government rejects arguments to reduce the rate based on the theory that the GILTI high-tax exception must conform to section 954(b)(4), then, consistent with that theory, the government should adopt other parts of section 954(b)(4).

Consistency with section 954(b)(4) would require the following changes:

- The election should be made annually, consistent with §1.954-1(d)(1)(i);
- The high-tax test should be applied on a CFC-by-CFC basis at the CFC level consistent with §1.954-1(d)(2);

- All foreign taxes paid on the income should be taken into account consistent with §1.954-1(d)(3)(i).

The high-tax election should be made annually

Instead of following the rule of §1.954-1(d)(1)(i), the proposed regulations require a one-time election that may be revoked, but after revocation there is a 60-month waiting period before a new election may be made. While these rules are clearly laid out in the preamble and the proposed regulations, there is no indication why this method was chosen and why these proposed rules deviate from the existing regulations under §1.954-1(d)(1)(i). The GILTI calculation is determined on an annual basis and so the high-tax election should also be made on an annual basis.

The election should be made separately with respect to each CFC

Instead of following the rule of §1.954-1(d)(5) which allows the high-tax election to be made by the controlling US shareholder separately with respect to each CFC, the proposed regulations require an "all or nothing" election. The preamble to the proposed regulations does not provide a rationale for such an outcome.

As currently drafted the language of proposed §1.951A-2(c)(6)(E)(1) requires the election to apply to all CFC's of a controlling domestic shareholder. This is inconsistent with the application of the high-tax election under §1.954-1(d)(5) and is counter to sound tax policy that would call for consistency among related provisions of the tax code, particularly when the basis for the applying the high-tax exception at 18.9 percent, is consistency with the section 954. USCIB recommends that the language in the proposed regulations be changed to provide parity with section 954(b)(4) and allow taxpayers to make the election separately with respect to each CFC.

The high-tax election should be determined on a CFC-by-CFC basis

Instead of following the rule of §1.954-1(d)(2) which requires the high-tax test be determined on a CFC-by-CFC basis, the proposed regulations require a QBU-by-QBU determination. The preamble to the proposed regulations requests comments on "whether additional rules are needed to properly account for other instances in the which the income base upon which foreign tax is imposed does not match the items of income reflected on the books and records of the QBU determined under Federal income tax principles" and "whether all of a CFC's QBUs located within a single foreign country or possession should be combined for purposes of performing the effective rate test in proposed §1.951A-2(c)(6)(iii)".

The foreign tax credit is not, and as a practical matter cannot be, an item-by-item calculation that conforms US and foreign tax principles to achieve a match between income subject to foreign tax and the credit granted by the US against foreign source income. Rather, Congress has explicitly countenanced "blending" of foreign taxes within the contours of the relevant separate limitations. This "blending" – within the limits set out by the Internal Revenue Code – can take many forms. Perhaps the most obvious example is the blending of taxes imposed by different foreign countries. Congress repealed the country-by-country limitation as part of the Tax Reform Act of 1976.[4] The Treasury and the IRS should not further

[4] Pub. L. 94–455, title X, § 1031; http://www.jct.gov/s-31-76.pdf The Tax Reform of 1976 eliminated the per-country limitation and adopted an overall limitation. The foreign tax credit has been reformed multiple times over

restrict the "blending" of foreign taxes against income within the same limitation category given the extensive consideration that has been given to the contours of these limitations. In particular, the Treasury and the IRS should not impose what is essentially a country-by-country limitation by adopting the QBU-by-QBU approach for purposes of the elective high-tax exception. Even the proposed expansion to QBU's within a single foreign country would effectively adopt a per-country limitation, contrary to the expressed will of Congress.

As a more recent example, the QBU-by-QBU approach was also explicitly rejected by Congress in section 904(d)(1)(B) and section 904(d)(2)(J). Section 904(d)(1)(B) creates a separate limitation for foreign branch income. Section 904(d)(2)(J) defines the income in that separate limitation as "the business profits of such United States person which **are attributable to one or more qualified business units … in one or more foreign countries."** (Emphasis added.) So, the proposed regulations are attempting to prevent blending at the CFC level that is considered appropriate at the level of a US person. That is, high-taxed QBU income in one country may be blended with low-taxed QBU income from another country at the level of the US person.[5] It is, therefore, not clear why this is objectionable at the level of the CFC.

In determining the scope of the GILTI high-tax exception, the government should consider the structure of the GILTI rules more generally. GILTI does not follow the CFC-by-CFC structure of subpart F foreign base company income because Congress wanted to allow more aggregation than a CFC-by-CFC approach allows. The government may feel compelled to adopt a more limited approach (the determination cannot be made at the US shareholder level), but it should not adopt an approach that permits less aggregation than the foreign base company rules.

Further, USCIB believes that if the government does not adopt the 13.125% rate as the test for determining whether income is high-taxed, then more blending is appropriate. If GILTI is intended to function as a minimum tax, it does not need to be imposed on a per-country basis to be effective. Rather, an overall limitation can achieve the same impact depending on the rate that is considered to be the floor. For example, a minimum tax at a lower rate and with a per-country limitation might achieve similar results to a minimum tax imposed at higher rate and on an overall basis and while achieving the simplicity results of an overall limitation.[6] Thus, if the government retains the 18.9% rate in the final regulations, then the higher rate should not be combined with a narrow definition of income against which this rate is tested.[7]

USCIB believes that a CFC-by-CFC determination is appropriate for the reasons expressed above. If, however, the government does not adopt a CFC-by-CFC determination, then, at minimum, taxpayers should be permitted to combine QBUs with a country. If the government's concern is blending between high and low-tax jurisdictions, this concern does not exist with respect to QBUs in the same country.

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the decades to refine the operation of various separate limitations, but Congress has never returned to a per-country limitation.

[5] The same base erosion concerns would exist at the US person level. A US person with significant excess foreign taxes earned through a QBU would have an incentive to move assets and income to a low-taxed QBU to reduce that excess credit position.

[6] Fixing the System: An Analysis of Alternative Proposals for the Reform of International Tax, Grubert and Altschuler, National Tax Journal, September 2013, 66(3), 671-712, at 697.

[7] USCIB is also concerned about the potential impact of the proposed regulations on the ongoing negotiations at the OECD. USCIB believes that any global minimum tax should be computed on an overall basis, adoption of contrary regulations by the US government may make that more difficult.

Determination of foreign taxes paid or accrued

The proposed regulations are particularly obscure with respect to the determination of the foreign taxes paid or accrued. Section 1.954-1(d)(3)(ii) is clear that foreign income taxes include taxes imposed by a country or countries on the net item of income. The final regulations should clarify that this continues to be the rule. This is not a case of "blending" income and taxes, but rather this is a case of two foreign countries taxing the same income. All of these taxes should be taken into account in determining the effective rate of tax on the net item of income.

Applicability date

The regulation is proposed to be applicable to taxable years of foreign corporations **beginning on or after** the date of publication of the Treasury decision adopting the **rules as final regulations is published** in the Federal Register. It is not clear why the government would choose this extremely delayed effective date and the preamble to the proposed regulations does not offer any explanation. Section 7805(b)(1)(B) provides that in the case of a final regulation the earliest effective date (unless an exception applies) is any taxable period ending after the date of filing with the Federal Register of **the proposed regulations** to which the final regulation relates. So, the application date is significantly later than section 7805(b)(1)(B) general rule. More to the point, the exception for "promptly issued" regulations in section 7805(b)(2) reflects that Congress desired for regulations interpreting new legislation to generally take effect coincident with the underlying Code provision (so long as such regulations are issued without a delay that would unfairly prejudice taxpayers, a concern not relevant to a regulatory election). A delayed effective date is thus both unnecessary and harmful.

Section 7805(b)(7) provides that the Secretary may permit taxpayers to elect to apply regulations retroactively. The Secretary should exercise this authority and allow taxpayers to elect retroactive application to CFC taxable years beginning after December 31, 2017, and US shareholder taxable years with or within which such CFC taxable years end. Retroactive application may require taxpayers to file amended returns for some years, a potentially burdensome undertaking, but it is reasonable and appropriate to allow taxpayers to conduct their own cost-benefit analysis in this regard. Indeed, we can identify no reason not to permit an election to apply the regulations retroactively.

In fact, there are several reasons why retroactive application should be permitted. We summarize two here. First, in the preamble to the proposed regulations, Treasury and the IRS offer various rationales for the proposed election, each of which is equally compelling with respect to prior GILTI years. For example, if section 954(b)(4) can be read to embrace all high-taxed income, as the preamble suggests, then it should be so interpreted for all periods. Similarly, if, as the preamble asserts, Congress intended to exclude high-taxed income from tested income—an assertion with which USCIB wholeheartedly agrees—then this intention applied from the first GILTI year.

Second, deferring the effective date will disadvantage certain U.S. shareholders as compared with others. For example, a delayed effective date inappropriately disadvantages taxpayers with CFCs in high-tax jurisdictions as compared with taxpayers with CFCs in no- or low-tax jurisdictions. Allocation of U.S. group expenses against GILTI increases U.S. tax on domestic income for taxpayers in both groups. Only for taxpayers with CFCs in no- or low-tax jurisdictions, however, does it have the corresponding benefit of reducing residual U.S. tax on GILTI. Taxpayers with CFCs in high-tax jurisdictions realize no such benefit because the foreign tax credit makes high-tax GILTI effectively exempt.

USCIB respectfully recommends that the final regulations make the election available to taxpayers for their taxable years beginning in 2018. At a minimum, the regulations should adopt the rule of section 7805(b)(1)(B) and apply to taxable years ending after June 21, 2019, the date of filing with the Federal Register. Returns for 2019 will generally not be due for some time and taxpayers may gather the information and prepare to apply those rules now. USCIB also hopes that the government will finalize the rules promptly so that electing the high-tax exception for 2019 tax years would not require an amended return.

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

Sincerely,

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