"GUIDANCE RELATED TO SECTION 951A (GLOBAL INTANGIBLE LOW-TAXED INCOME)"

UNITED STATES DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE

PUBLIC HEARING ON PROPOSED REGULATIONS

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PROCEEDINGS

(10:02 a. m.)

MS. HARVEY: Good morning. Welcome to the Public Hearing on Proposed Regulations. Reg-1043901-18. Guidance Related to Section 951(A) Global Intangible Low-Taxed Income. My name is Melinda Harvey. With me on the panel are Jeff Mitchell and John Merrick. We are from the office of Associate Chief Counsel International. We also have Kevin Jacobs from the office of Associate Chief Counsel Corporate and Gary Scanlon from the office of International Tax Counsel at Treasury. We have two speakers on the agenda today. Speakers are allotted ten minutes. There is a timer. After the ten minutes are up, the panel may or may not have questions. The first speaker is Stewart Lipeles with Baker & McKenzie.

MR. LIPELES: Why don't we get going. Ladies and Gentleman, thank you for inviting me here to speak with you today about the proposed GILTI regulations. I'm here to discuss the anti-abuse rule that disallows basis step-up transactions between December 31, 2017 and the beginning of the taxpayers next fiscal year. This rule is invalid. In fact, all of the commentators who have commented on this rule have all said that it's invalid. Roughly, a little over a half of dozen of them, I think eight, maybe 9, they've all said it's invalid.

It's invalid for at least three reasons. To begin with, Congress wanted a facts and circumstances rule that took into account taxpayers own individual facts and circumstances, why they entered into the transaction, and what was the economic substance. That's not what Congress got. Treasury wrote a per se rule, upright line test, that this allows all basis step-up transactions during the disqualified period without any regard to why the taxpayer entered into the transaction or whether there was any economic substance to the transaction. Section 951A D4 requires any anti-abuse rule to target transactions to prevent the avoidance of the purposes of this subsection. This language implies, if it doesn't just come out and say, that the rule has to be an anti-abuse rule that takes into account whether the transaction was truly abusive and why the taxpayer did it.

To the extent there's ambiguity about whether the rule should be facts and circumstances or not, the conference report makes it clear. The conference report states that Congress intends that non-economic transactions, I want to repeat that, non-economic transactions intended to minimize tax under this provision be disregarded. Taking the statute and the legislative history together, it indicates that any anti-abuse rule, at a minimum, would have to have at least two elements before a taxpayer would fail it.

First, the transaction would have to be non-economic lacking in all economic substance and second of all, the taxpayer would have to have an intent to avoid the statute. You can't tell whether a taxpayer has an intent to avoid the statute without getting into their facts circumstances, and it's the same with economic and substance. You have to actually look at the facts. It's Congress that decides whether a rule should facts and circumstances and not the administrative agency. In fact, this very issue was just litigated by Treasury in Good Fortune Shipping. Good Fortune Shipping was a case involving an exemption for foreign shippers under Section 883 of the internal revenue. In that case, Treasury wrote a rule that was a bright line test that did not allow taxpayers to present evidence and the DC circuit, a circuit well-versed in these issues, found the rule to be invalid and they did so within the last 12 months. The mandate for that case came out in September of last year. It's a very recent case.

There are many other cases that reach the same conclusion. I think a good one that illustrates it is Northwestern Environmental Advocates. Northwestern Environmental Advocates involved the Clean Water Act and in that case, Congress actually did write a per se rule with a bright line test. And then the EPA came out and issued a rule that had exceptions and the 9th Circuit found the rule to be invalid.

The rule is also invalid because it goes [missing text] the scope of congressional authority. Congress granted Treasury authority to issues regulations in 951A D4. 951A D4 allows Treasury to issues regulations to prevent the avoidance of the purposes of this subsection. This subsection is 951A D. 951A D involves the calculation of a taxpayers qualified business asset investment or a q-buy. Q-buy is limited under the terms of the code to tangible personal property. It simply does not include other assets. The proposed anti-abuse rule is not so limited. In fact, it's unlimited. It includes all possible assets so it goes well beyond the scope of the statute.

Section 7805A doesn't give Treasury the authority to exceed what's in the actual code. 7805A provides that the secretary shall provide all needful rules and regulations for the enforcement of this title, to enforce the rules Congress wrote. Not to change them, not to alter them, not to issue a new rule.

In plain English, Congress wrote an anti-abuse rule. It's all there for us to see. Treasury looked at it and thought, no, we can do better. We don't like that anti-abuse rule. We'll put in a different anti-abuse rule and that's what they seem to have done.

The anti-abuse rule is invalid for a third reason. It is inconsistent with the effective for the statute 951A. The effective date for 951A is the beginning of the taxpayers first taxable year beginning on or after 1-01-2018. The is not an ambiguous date. It's not a date that we could get confused about. Every taxpayer knows when their first taxable on or after 1-01-2018 begins and virtually every provision in the TCJA Congress wrote an effective date. They went provision-by-provision and selected effective dates. They chose an effective date of 1-01-2018 for numerous provisions in the statute including 367, 91, 245A, just to name a few. They didn't choose that effective for the GILTI provisions. They just didn't. They chose the taxpayers first taxable year beginning on our after 1-01-2018.

Again, as I say, this is ambiguous date and 7805A just doesn't give Treasury the authority to go write a different effective date. If Congress writes an unambiguous rule, Treasury has to follow the rule that the Congress wrote. For all of these reasons, we would recommend that Treasury withdraw the rule. The rule isn't really necessary. We already have 77010, the Economic Substance Doctrine, to the extent that Treasury wants to have a rule. It should issue a rule that follows congressional intent in the statute. The rule should be within the scope of the statute so it should be limited to tangible personal property. The rule should be limited to transactions that lack economic substance and the rule should be limited to transactions that have an intent to avoid the statute. And I am going to end almost exactly on time. Apparently, I have practiced, but before I end, I do want to thank you all for listening to me. You haven't asked any questions.

MS. HARVEY: Yes, thank you. I will see if the panel has any questions. No.

MR. LIPELES: Okay. Well, listen.

Thank you very much for inviting me here today and listening to me. I appreciate the opportunity.

MS. HARVEY: Thank you. Our next speaker is Catherine Schultz with the National Foreign Trade Council. Just begin whenever you're ready.

MS. SCHULTZ: Okay, thanks. I appreciate the opportunity to present the views of the National Foreign Trace Counsil on GILTI regulations. Our number one priority and the problem with this is the high tax income provision in GILTI. The proposed Section 951A regulations clarifies that the statutory language of Section 951A excludes from tested income only high tax income if such tax income would otherwise be subpart F income. This narrow interpretation leads to counterintuitive results and caused far more income to be taxed under GILTI then Congress had intended.

For example, when GILTI includes high tax foreign income, such as active business income, the overall tax rate on such income can significantly exceed 21 percent once the expense allocation rules and the beat 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 pay with respect to income included in GILTI, the more likely that allocating deductions and expenses to that income prevents that taxpayer from offsetting its U. S. tax liability with the full amount of foreign taxes paid on such income.

The loss of foreign tax credits is especially unfair with respect to interest expense deductions that are already limited by the new Section 163J limitations. 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 paid on a GILTI while ignoring the foreign tax credits. These increases in the effective rate in high tax foreign income were not intended by Congress. The committee reports and even the name provision Global and Tangible Low-Tax Income are clearly reflections that Congress intended for GILTI to target only low-tax income. In fact, the 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 rates on GILTI equals the foreign tax rate.

Further, to propose GILTI regulations unfairly target active business operations in high-tax jurisdictions contrary to the longstanding presumption of good business purpose 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 past the sub-part 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 increase in the effective tax rate on high-tax foreign income, we urge Treasury and the service to consider a GILTI high-tax exception and now I guess to the sub-part F high-tax exception that will taxpayers to elect to exclude from income high-tax GILTI. Treasury and the service will do well within their regulatory authority to write such GILTI high-tax exception for the following reasons.

It would be a clarification of the statutory ambiguity clarified by the proposed regulations in favor of a more general high-tax exception. GILTI is, in fact, often treated in the same manners at subpart F income pursuant to Section 951A F 1B and needful regulations to the effect the will of Congress are written pursuant to section 7801A. Absent of GILTI high-tax exception, taxpayers only recourse will be restructure their activity to convert high-tax GILTI to subpart F income for which the 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 regiment.

When finalized, the GILTI regulations should include a high-tax exception for income subject to foreign tax of at least 13. 125 percent determined on either a CFC-by-CFC or an item of income-by-item of income basis. GILTI high-tax exception would ensure GILTI is implemented consistent with congressional intent to target low-taxed income without unfairly increasing the effective tax rate of income already subject to high foreign taxes.

The second issue I want to talk about is the application of 245A to subpart F dividend income. The preamble to the GILTI regs provides that comments are requested as to whether these rules subpart F income, tested income, tested loss, should follow a CFC deduction or require a CFC to take into account income that expressly limited to domestic corporations under the code. If Section 245 A DRD does not apply to subpart F dividend income, U. S. multi-national firms will be disadvantaged versus their foreign competitors. When finalized, the GILTI regulations should clarify that Section 245 A DRD applies to sub F and income received by CFC's as well as domestic corporations.

The last issue I'd like to talk about in the basis adjustment concerns. GILTI regulations require a mandatory decrease in the stock basis of a CFC immediately before the disposition of stock. Specifically, the stock basis is reduced by the net used tax tested loss amount, which is the cumulative net tested generated by a CFC, which includes in the consolidate GILTI calculation over the life of the CFC. Disposition is defined broadly to include any sale, contribution, or deemed transfer of a CFC stock that creates a tax event in whole or in part.

There are a number of issues with the 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 net used tested loss amount at the time of the disposition.

Second, a tested loss generates at most a 10. 5 percent tax benefit or for a taxpayer with excess GILTI limitation a 0 tax benefit. If a taxpayer later sells the stock of a CFC generating a net used tested loss amount to a third party and the CFC has not earnings and profits the gain is subpart F passive gain taxed at 21 percent. Consequently, there will be taxpayers who benefit from their tested losses, but nevertheless, these taxpayers are required to reduce the stock basis of a CFC at disposition on the corresponding gain at 21 percent.

The NFTC recommends that when finalized the basis adjustment rule be eliminated. There is no authority in the statute for stock basis reduction as a result of the use of the tested loss in the GILTI calculation. And that's all I have. I made it within my ten minutes.

MS. HARVEY: Thank you, Catherine. Are there any questions? No.

MS. SCHULTZ: Thank you very much.

MS. HARVEY: Thank you. We only had two speakers today. Thank you for coming.

(Whereupon, at 10:22 a. m. , the HEARING was adjourned.)

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CERTIFICATE OF NOTARY PUBLIC
DISTRICT OF COLUMBIA

I, Carleton J. Anderson, III, notary public in and for the District of Columbia, do hereby certify that the forgoing PROCEEDING was duly recorded and thereafter reduced to print under my direction; that the witnesses were sworn to tell the truth under penalty of perjury; that said transcript is a true record of the testimony given by witnesses; that I am neither counsel for, related to, nor employed by any of the parties to the action in which this proceeding was called; and, furthermore, that I am not a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

(Signature and Seal on File)

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