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Ladies and Gentlemen:

The enclosed NYSBA Report No. 1003, prepared by the Committee on Foreign Activities of U.S. Taxpayers (the "Committee") and approved by the Tax Section Executive Committee, comments on the Treasury Department's "Subpart F Study." The Study explores whether the subpart F rules, enacted in 1962 to curtail deferral of tax on foreign income of U.S. taxpayers earned through controlled foreign corporations, should be modified in light of modern realities and changes in the Code since 1962.

The Treasury's Study provides an extremely helpful and thorough history of subpart F and the policies that underlie it. However, as others have already noted, the Study is disappointing in many respects. Nothing therein truly broke new ground, and much of the Study was given over to a restatement of the policies and principles of "capital export neutrality" that have been thoroughly debated by others for many years. Perhaps the most remarked-upon shortcoming of the Study was its failure to make any concrete suggestions as to how subpart F might be modified – either expanded or limited – to adapt to modern global realities.

The enclosed report, like the Study itself, does not make substantive recommendations relating to the modification or amendment of subpart F. Instead, the report focuses on a few areas the Committee believes might have been given more attention in the Study. In general, the Committee believes the Study went too far in the direction of justifying the current subpart F rules and was not evenhanded in evaluating alternative policy choices.

The report suggests the Study should have devoted more attention to alternative systems for taxing foreign income, such as the territorial regimes that have long been in use in several foreign countries. We note that there have been several recent proposals floated by members of Congress to adopt a territorial system. There is very little in the Study from which even a rudimentary understanding of the strengths and weaknesses of such a system might be

gleaned, and no attempt to compare the potential revenue impact of adopting a territorial system to what is currently in place.

The Study also might have incorporated a discussion of the manner in which the anti-deferral regimes of other countries, including those that have generally adopted territorial systems and those, like the United States, that apply a worldwide system with foreign tax credits, operate. Many of these regimes apply only to controlled foreign corporations formed in low-tax or "blacklisted" countries, and tax only passive income, whereas subpart F extends to all controlled foreign corporations, even those operating in high-tax countries, and generally extends to active income that is "deflected" from one country to another.

One obvious purpose of the Study was to restate the policies that underlie these active income deflection, or "foreign base company," rules of subpart F. Although the Study did provide a solid background and rationale for the foreign base company rules, it did not seriously explore the arguments for their repeal. Given that repeal of these rules would simplify the taxation of foreign income and offer an alternative to adoption of a wholly new and untested territorial system of taxation, the Committee believes the effects of repealing the foreign base company rules should have been addressed more thoroughly.

The report notes that the Study did not fairly or fully address the often-raised concern that subpart F, particularly in combination with other tax rules applicable to international operations, inhibits the ability of U.S.-based multinationals to compete with their foreign competitors. It may be that complaints about competitiveness are routinely overstated. Without further study, however, it is difficult to counter the anecdotal evidence to the contrary.

A related point made in the report is that subpart F should be reviewed not in isolation, but as an important element of a complex and multi-faceted approach to taxing international operations of U.S. taxpayers. In particular, the Code's complex foreign tax credit limitations may contribute more to the Treasury, and to the complaints of U.S. multinationals, than anything contained in subpart F. By placing subpart F in context, we feel that the Study might have served as a useful tool for those in Congress who would seek to repeal or to expand the Subpart F regime.

Respectfully Submitted,

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