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December 4, 2009

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Re: Report on Certain Administration International Tax Proposals

Dear Sirs:

We write to comment on three of the international tax provisions in the Administration's fiscal year 2010 revenue proposals (the "Green Book"). The first of these proposals (the "Deduction Deferral Proposal") would require the deferral of deductions attributable to deferred foreign source income. The second proposal (the "Foreign Tax Credit Pooling Proposal") would require U.S. taxpayers to determine foreign tax credits for taxes paid by their foreign subsidiaries based on the blended tax rate of all the subsidiaries; taxpayer could no longer maximize their foreign tax credits by selectively repatriating income from high-tax foreign subsidiaries while continuing to defer U.S. tax on income of low-tax foreign subsidiaries. The third proposal (the "Entity Classification Proposal") would prevent treatment of a foreign entity with a single owner

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as a disregarded entity for U.S. tax purposes under the “check-the-box” rules, subject to exceptions for foreign entities organized in the same jurisdiction as their owners and foreign entities owned by U.S. persons.


All three of these proposals raise basic policy questions about their effect on U.S. businesses and the U.S. economy. Our report does not express views on the underlying policies of the Green Book proposals, but is focused instead on whether the proposals are an effective means of achieving their apparent objectives.

The Deduction Deferral Proposal and Foreign Tax Credit Pooling Proposal are similar to provisions of H.R. 3970, the Tax Reduction and Reform Act of 2007, which was introduced by House Ways and Means Committee Chairman Rangel in October 2007 and on which we submitted a report last year. Our comments on these provisions are largely directed toward the differences between the Green Book proposals and the analogous provisions of H.R. 3970. As a general matter, we prefer the Green Book proposals’ approach of limiting the scope of the proposed changes to deductions attributable to income earned by, and credits for foreign taxes paid by, foreign subsidiaries as opposed to foreign branches of U.S. taxpayers. We continue to believe that it is not appropriate to repeal section 864(f) (permitting an allocation of interest expense that takes worldwide interest expense into account), and we observe that the distortion under current law resulting from the overallocation of interest expense to foreign subsidiaries’ income will be magnified if the Deduction Deferral Proposal is enacted, because the allocation of interest expense will affect the timing of deductions in addition to foreign tax credits. The report also addresses technical issues with respect to the determination of the amount of deductions that are attributable to deferred foreign source income, the timing of later allowance of deferred deductions, and the effect of changes in ownership of foreign subsidiaries.

With respect to the Entity Classification Proposal, the report discusses the potential impact on both U.S. and foreign taxpayers of adoption of the proposal, which may be broader in some respects than intended. We believe that the primary intent of the Entity Classification Proposal is to prevent taxpayers from reducing foreign taxes on income earned by foreign subsidiaries by means of interest, royalty, and other payments between disregarded entities and their owners or related parties that are deductible for foreign tax purposes without triggering current taxation of income in the U.S. under subpart F of the Internal Revenue Code. The report expresses our view that the objectives of the Entity Classification Proposal could be achieved more effectively by changing subpart F and other substantive tax rules rather than by changing the classification of foreign entities for U.S. tax purposes. We believe that our suggested approach would avoid negative tax consequences associated with changes in entity status that are not germane to the purposes of the proposal and at the same time deter avoidance of the proposal’s objectives through use of partnerships and other devices. The report also comments on technical aspects of the Entity Classification Proposal, including the scope of the same country and first-tier entity exceptions, issues relating to partnerships, and issues relating to the consequences of deemed incorporation of foreign entities upon the proposal becoming effective.

We appreciate your consideration of our comments. Please let us know if you would like to discuss these matters further or if we can assist you in any other way.

Respectfully submitted,

  
Erika W. Nijenhuis  
Chair

Enclosure

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