NATIONAL ASSOCIATION OF Manufacturers

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Internal Revenue Service
Attn: CC:PA:LPD:PR (REG-101828-19)
Room 5203
Post Office Box 7604
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Washington, DC 20044

RE: Comments Related to the Elective High-Tax Exception for Global Intangible Low-Taxed Income

On behalf of the 12.8 million men and women who make things in America, the National Association of Manufacturers welcomes the opportunity to comment on the Treasury Department's proposed regulations implementing an elective high-tax exception for Global Intangible Low-Taxed Income.[1] The NAM is the largest industrial association in the United States representing manufacturers in every sector and in all 50 states, and our comments are intended to ensure that the *Tax Cuts and Jobs Act* (TCJA)[2] has the intended effect of spurring economic growth and innovation.

The Need for an Elective High-Tax Exception

As part of the TCJA's move toward a territorial system whereby taxpayers can repatriate foreign earnings without an additional layer of U.S. tax, Congress enacted Section 951A.[3] Under this anti-base erosion measure, a U.S. shareholder of a controlled foreign corporation (CFC) must include in its gross income the excess (if any) of the shareholder's net CFC tested income over the shareholder's net deemed tangible income return. Once the Global Intangible Low-Taxed Income inclusion has been calculated, it is included as part of the U.S. shareholder's taxable income and taxed at the corporate tax rate of 21 percent. The TCJA does provide for a 50 percent deduction of the Global Intangible Low-Taxed Income coupled with the ability to use 80 percent of foreign tax credits (FTCs), resulting in a minimum tax of 13.125 percent on foreign income.[4]

[1] *See* Letter from the National Association of Manufacturers to the Honorable Steven Mnuchin. Secretary of the Treasury and the Honorable David Kautter, Assistant Secretary for Tax Policy (September 11, 2018) and Letter from the National Association of Manufacturers in response to REG-104390-18 (November 26, 2018).
[2] Pub. L. No. 115-97.
[3] References herein to "Sections" are to sections of the Internal Revenue Code of 1986, as amended (the "Code"), and the Treasury regulations ("Treasury Regulations" or "Treas. Regs."), including Proposed Regulations, promulgated thereunder.
[4] After 2025, the deduction for the Global Intangible Low-Taxed Income is 37.5 percent resulting in a minimum tax of 16.4 percent.

However, taxpayers with high-taxed foreign income can face an additional U.S. tax on income that is subject to a foreign rate of tax well beyond 13.125 percent. This occurs due to the interaction of the Global Intangible Low-Taxed Income provision with existing rules for taxing international income. Specifically, FTCs are affected by Section 861 (the expense allocation rules), which was unchanged by the TCJA and requires deductions to be allocated to income to which they relate. This FTC limit is based on the ratio of foreign source income to worldwide taxable income, multiplied by a taxpayer's U.S. tax liability. This limit declines as expenses are allocated to foreign income, creating the potential for high-taxed foreign income to be subject to a Section 951A inclusion.[5]

The legislative history of Section 951A indicates that Congress intended to limit the scope of this provision to exempt from additional U.S. taxation foreign earnings that are taxed beyond a threshold rate in the local country. As the TCJA conference committee report states, "The minimum foreign tax rate, with respect to [Global Intangible Low Tax Income], at which no U.S. residual tax is owed by a domestic corporation is 13.125 percent."[6]

Last year, we urged Treasury to provide an election to exclude high-taxed income from Section 951A, and we want to thank Treasury for its support on this issue, and for ultimately providing a high-tax exception in proposed form.[7] We appreciate Treasury's efforts to mitigate this issue for the most adversely affected taxpayers by providing an election to exclude highly-taxed foreign income from the Section 951A regime. The proposed regulations provide taxpayers the option of excluding foreign income with an effective tax rate higher than 90 percent of the U.S. corporate tax rate of 21 percent from the scope of Global Intangible Low-Taxed Income. In other words, taxpayers do not need to include in income under Section 951A foreign earnings that have an effective tax rate of more than 18.9 percent (90 percent of the corporate tax rate). To that end, the comments offered below with respect to the mechanics of the high-tax exception are intended to ensure that the proposed high-tax exception operates as intended.

The proposed exception is a step in the right direction in that it can, at a taxpayer's election, limit the scope of the Global Intangible Low-Taxed Income regime. However, as we have previously noted, modifying the application of the expense allocation rules with respect to Section 951A, in addition to the high-tax exception, would provide a result that is more consistent with congressional intent.[8]

Treasury Should Make the High-Tax Exception Retroactive

As proposed, the high-tax exception would take effect after final regulations are published in the Federal Register. Delaying the effective date of this relief provision to a time many months after the enactment of Section 951A would harm manufacturers and be inconsistent with Treasury's stated

[5]*See, e.g.,* Michael Caballero and Isaac Wood, *Restoring a 'Not GILTI' Verdict for High-Taxed Income*, Tax Notes (Oct. 8, 2018). We would note that Section 251A also adversely impacts taxpayers with a current or carryforward net operating loss (NOL). Both the Section 250 deduction and the FTC are applied to taxable income determined after utilization of any current or carried forward losses, and the FTCs related to Section 251A may not be carried forward. The practical impact of these rules is that U.S. companies operating in cyclical industries are at a competitive disadvantage to their foreign competitors.

[6] H. Rept. No. 115-466 at p. 626 (December 15, 2017). Also see Joint Committee on Taxation, General Explanation of Public Law 115-97 at 382 (December 2018).

[7]*See* Letter from the National Association of Manufacturers to the Honorable Steven Mnuchin. Secretary of the Treasury and the Honorable David Kautter, Assistant Secretary for Tax Policy (September 11, 2018).

[8]*See* Letter from the National Association of Manufacturers in response to REG- REG-105600-18 (February 5, 2019) and Multi-Trade Letter to Treasury Secretary Steven Mnuchin Regarding Expense Allocation and Section 251A.

purpose in proposing the exception. Accordingly, we respectfully request that Treasury make the high-tax exception retroactive to all years for which Section 951A has been in effect.

Section 951A took effect for tax years beginning after December 31, 2017. The Treasury Department should not attempt to provide solely prospective relief from the application of a provision that, as noted above, may be applied in a manner inconsistent with congressional intent when interactions with the expense allocation rules are taken into account. A prospective effective date for the high-tax exception would necessarily mean that taxpayers with high-tax foreign income would face a Global Intangible Low-Taxed Income inclusion for at least one taxable year. Moreover, such a result is inconsistent with the Treasury Department's rationale for the Section 951A high-tax exception. As noted in the preamble to the proposed regulations, high-taxed income should not be subject to the Global Intangible Low-Taxed Income regime:

> The legislative history evidences an intent to exclude high-taxed income from gross tested income. The proposed regulations, which permit taxpayers to electively exclude a CFC's high-taxed income from gross tested income, are consistent, therefore, with this legislative history. Furthermore, an election to exclude a CFC's high-taxed income from gross tested income allows a U.S. shareholder to ensure that its high-taxed non-subpart F income is eligible for the same treatment as its high-taxed FBCI and insurance income, and thus eliminates an incentive for taxpayers to restructure their CFC operations in order to convert gross tested income into FBCI for the sole purpose of availing themselves of section 954(b)(4) and, thus, the GILTI high-tax exclusion.[9]

The Duration of and Entities to Which the Exception Applies Should be Modified

A. Duration

If a taxpayer were to elect relief under the proposed high-tax exception, such election would be immediately effective and bind the U.S. shareholders of a CFC for all subsequent years. While Treasury would allow taxpayers to revoke the election, the proposed regulations deny taxpayers the use of the high-tax exception for the same CFC for five years following the revocation. Moreover, once a taxpayer makes a new election for the same CFC it cannot revoke that election for five years.[10] While we appreciate that Treasury provides an exception to the five-year period when a CFC has a change of control, the length of the revocation and election periods pose a serious challenge to the ability of taxpayers to use the high-tax exception.[11]

Manufacturers operating in a global environment can face a significant amount of medium-term uncertainty, which makes a binding five-year election with respect to future income impractical. For example, taxpayers would need to undertake modelling that factors in such hard-to-predict variables as the future business environment and foreign tax law changes.

Accordingly, we respectfully request that Treasury provide taxpayers with an annual election. Such a modification would allow Treasury to achieve its intent. As noted in the preamble to the proposed regulations, the high-tax exception "eliminates an incentive for taxpayers to restructure their CFC operations in order to convert gross tested income into" subpart F income.[12] However, the reality could very well be the opposite due to the lack of an annual election. Faced with high-taxed income and the inability to predict with the necessary certainty beyond a year, taxpayers could quite

[9] GILTI High-Tax Exception, 84 Fed. Reg. 29120, June 21, 2019.
[10] Prop. Treas. Reg. § 1.951A-2(c)(6)(v)(D)(*2*)(*i*).
[11] Prop. Treas. Reg. § 1.951A-2(c)(6)(v)(D)(*2*)(*ii*).
[12] GILTI High-Tax Exception, 84 Fed. Reg. 29120, June 21, 2019.

conceivably restructure their operations in order to plan into subpart F to avail themselves of the longstanding exception for high-taxed subpart F income of Section 954(b)(4), on which the proposed Section 951A exception appears to be modeled – in part because the subpart F high-tax exception is applied on an annual basis.[13]

B. Entities Bound by the Election

As proposed, the election to apply the Section 951A high-tax exception is binding on any and all CFCs within the same controlling domestic shareholder group.[14] As noted above, taxpayers must determine the potential changes in the business environment and local law in the jurisdiction in which an entity operates in order to determine the efficacy of such an election. For taxpayers with operations in many jurisdictions, this challenge is compounded by the sheer number of assumptions that must be made in order to accurately predict whether an election is beneficial for all entities in a shareholder group. Accordingly, we respectfully ask Treasury to reconsider the all-or-nothing rule.

Treasury Should Provide More Flexibility in Applying the High-Tax Exception

In general, the proposed Section 951A high-tax exception is made with respect to a qualified business unit (QBU) of a CFC.[15] However, not all companies have sufficient systems in place to accurately track items at the QBU level. In fact, the agency implicitly acknowledges this issue in the preamble to the proposed regulations, when it states "the Treasury Department and the IRS do not have readily available data on activities at the QBU level."[16] This may be because the major, related international provisions of the Internal Revenue Code generally require taxpayers to track items at the CFC level, rather than the QBU level. Requiring taxpayers to adopt new systems in order to determine whether to avail themselves of the high-tax exception is an unreasonable administrative burden.[17]

On the other hand, some taxpayers do in fact track items at the QBU level, and applying the election at this level would satisfy Treasury's desire for granularity without imposing an additional burden. Among NAM members, it is clear that there is significant variability in the complexity of taxpayers' foreign structures and reporting systems. For this reason, we urge Treasury to provide taxpayers additional flexibility in applying the Section 951A high-tax exception election.

In particular, Treasury should allow taxpayers the ability to apply the election at other levels, in addition to a QBU-by-QBU basis. Ideally, Treasury would allow taxpayers to calculate the high-tax exclusion on an aggregate basis, which would comport with legislative intent.[18] Alternatively, we believe Treasury should allow taxpayers to choose whether to apply the election at the QBU or CFC level.

There are several factors weighing in favor of adopting an elective CFC-by-CFC approach for the Section 951A high-tax exception. First, for taxpayers that do not currently track items on a QBU basis, the administrative burden associated with a QBU-by-QBU approach would be unreasonable. Second, while a desire to avoid blending was one of Treasury's stated objectives in adopting a

[13] See Treas. Reg. §1.954-1(d).
[14] Prop. Treas. Reg. §1.951A-2(c)(6)(v)(E)(*1*).
[15] Prop. Treas. Reg. §1.951A-2(c)(6)(ii)(A)(*1*).
[16] GILTI High-Tax Exception, 84 Fed. Reg. 29123, June 21, 2019.
[17] *See, e.g.,* the foreign tax credit regime described in Sections 901 and 960.
[18] According to the Senate explanation of the TCJA, the Global Intangible Low-Taxed "is treated as subpart F income, and the aggregate nature of the [Global Intangible Low-Taxed Income] calculation is a departure from present law, under which subpart F income is calculated at the CFC level." S. Rpt. No. 115-20 at p. 373.

QBU approach, we do not believe there is significant risk of taxpayers' blending income from low and high-tax jurisdictions in a single CFC to take advantage of the high-tax exception due to unpredictable fluctuations in effective tax rates on tested income.[19] The uncertainty in year-over-year tested income and foreign taxes (given differences in U.S. and foreign tax and accounting principles) provides a natural check on high-tax exception planning.

Further, there are strong policy reasons for more consistency with the subpart F high-tax exception, which would permit a CFC approach. For example, maintaining a QBU-by-QBU approach, which is far more administratively complex than a CFC approach, could provide an incentive for tax-motivated restructurings. Rather than incur an annual compliance burden, taxpayers could restructure their foreign operations, either to reduce the number of entities for which a separate calculation must be made or to plan into subpart F. For the aforementioned reasons an elective CFC-by-CFC approach is appropriate and consistent with the subpart F authority and congressional intent.

However, if Treasury will not consider a CFC-by-CFC approach, Treasury should allow companies to elect to group QBUs by country in order to reduce the administrative burden of the QBU approach. While we strongly urge Treasury to provide an elective CFC approach, we believe a strict QBU approach would render the high-tax exception unworkable for many companies. Accordingly, at a minimum, taxpayers should have an ability to aggregate QBUs located in the same country.

Thank you for the opportunity to comment. If you have questions or would like to discuss this matter further, please contact me at 202-637-3077.

Sincerely,

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[19] While Treasury acknowledges in the preamble that a QBU-by-QBU approach versus a CFC-by-CFC approach "may be more complex and administratively burdensome under certain circumstances" it nonetheless contends that a QBU-by-QBU approach would best identify "income subject to a high rate of foreign tax" whereas a CFC-by-CFC could result in "the blending of different rates." GILTI High-Tax Exception, 84 Fed. Reg. 29125, June 21, 2019.