

Summer 2010

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Recommended Citation

Robert H. Dilworth, *President's Economic Recovery Advisory Board: Suggested Considerations in Fundamental Reform of the United States Tax Treatment of Income from Cross Border Trade and Investment*, 30 *Nw. J. Int'l L. & Bus.* 551 (2010)

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President's Economic Recovery Advisory Board: Suggested Considerations in Fundamental Reform of the United States Tax Treatment of Income from Cross Border Trade and Investment

*Robert H. Dilworth**

The President's Economic Recovery Advisory Board ("PERAB") has as part of its mandated inquiry the reform of the U.S. tax treatment of income from cross border trade and investment. This paper sets forth a short set of recommendations as to tax reform methodology and some substantive proposals.¹ Tax reform should not "start over," or undertake significant changes, without a fairly detailed understanding of what the present regime actually does, or does not do, and identifying the relationship (if any) between the various existing provisions and whatever "the problem" is perceived to be. The present architecture results from the

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¹ In August 2010, after this article had been submitted for publication, the President's Economic Recovery Advisory Board issued its "Report on Tax Options." The Report consisted of a brief description of alternative approaches and options rather than recommendations as to how best to integrate the competing aspirations of our society with respect to global business activity. The National Commission on Fiscal Responsibility and Reform is addressing the same issues, with the assistance of many of the same tax policy advisers who advised the PERAB. The Fiscal Commission report with its recommendations is scheduled to be issued on or before December 1, 2010. The recommendations in this article may be useful to the Fiscal Commission in its deliberations.

striking of balances and the making of compromises between competing good ideas (and no doubt a few bad ones).

The discussion of international tax reform sometimes suffers from an acute information gap. For example, the “deferral privilege” is routinely described as a subsidy for foreign direct investment, and a subsidy that leads to job migration out of the United States. The description is routinely uttered by experts with apparently little or even no involvement or exposure to the decision making process actually followed by businesses that make the decisions.

If job migration out of the United States is an important concern for the PERAB, the PERAB should first try to ascertain why investment-location decision makers make the decisions they do with respect to direct investment. The notion that tax motivation is the dominant consideration, and that real business factors only “may” also form part of the decision making process, is simply wrong.

As stated before the Senate Finance Committee at a hearing in June 2008, I have never met a business decision maker (who was actually a decision maker about where to locate a business that actually employs people) who would agree that his multi-national company (MNC) employer acted to invest somewhere because of an interest free loan of residual U.S. corporate tax if the company invested in a foreign country rather than the United States. Although such anecdotal evidence may be suspect, the Tax Reform Subcommittee might find it profitable to meet with business decision makers to determine the extent to which they think investment location decisions are made based on deferral of residual U.S. corporate tax compared to factors such as labor costs, environmental and other non-tax regulations, proximity to customers, access to materials and components, educated work force, and domestic tranquility. If there is a variance between the reasons business decision makers think they make decisions and the algorithms on which the deferral-subsidy thesis is sometimes based, it might be worth re-examining the simplifying assumptions used in the algorithms.

The Tax Reform Subcommittee should keep in mind the difference between the location of direct investment and the location of ownership of intangible property. Direct investment is often dependent on intangible property, but ownership-location considerations may be quite different than investment location considerations.

The Tax Reform Subcommittee should also seek to measure the extent to which financial accounting for deferred U.S. tax may affect, or perhaps even distort, business decision making. There appears to be an asymmetry under GAAP between FAS 94² (including foreign subsidiary earnings in

² Consolidation of All Majority-Owned Subsidiaries, Statement of Fin. Accounting Standards No. 94 (Fin. Accounting Standards Bd. 1987), *available at* <http://www.fasb.org/pdf/fas94.pdf>.

consolidated earnings based on availability of such earnings to the parent and to the parent's shareholders) and FAS 109³ (particularly APB 23) (excluding from the consolidated tax provision any amount of residual U.S. tax on earnings intended to be indefinitely reinvested by the foreign subsidiary). As a first step, the Tax Reform Subcommittee should meet with members of the Financial Accounting Standards Board to determine the bases for such asymmetry (if there are any). Earnings per share likely have a much greater impact on investment location decisions than either "cash on cash taxes" or even an economist's present value calculation of cash on cash taxes to be paid in the future.

The goal of simplification should not be an overriding consideration. Simplification is desirable at this stage in the development of the U.S. international tax regime primarily for two reasons: (1) to enable a reasonably well-informed citizenry and electorate to understand the rules of the road, and (2) to minimize the risk that future tax policy makers will act in ignorance of how the rules actually work and why they work the way they do. Simplification should not be pursued on the facile notion that special interests account for the present complexity of the international provisions of the federal income tax, or that somewhere out there a grand guiding principle exists comparable to $E=mc^2$. The international tax architecture is complicated because we are a complicated national economy (and society) in a larger universe of a global economy with which we must come to grips.

The Administration's 2010 and 2011 Budgets propose a "pooling" approach to the foreign tax credit. All foreign taxes on all distributed and undistributed foreign subsidiary earnings, and foreign taxes thereon, would be pooled. A foreign tax credit would be allowed only with respect to the average rate of foreign tax on the pool. The foreign tax credit would not be determined on the basis of the actual foreign taxes on the earnings of the foreign corporation that pays the dividend. Whatever the political or economic benefits of the proposal, the proposal appears to be in conflict with each of a large number of bilateral tax treaties.⁴ In the end, the issue may be resolved by consultation with important treaty partners. Any changes in the framework of our global tax posture need to be vetted with careful attention to the treaties into which we have encouraged other countries to enter and to the potential impact on other countries' perception of the United States as a reliable treaty partner. I do not advocate *pacta*

³ Accounting for Income Taxes, Statement of Financial Accounting Standards No. 109 (Fin. Accounting Standards Bd. 1992), available at <http://www.fasb.org/pdf/fas109.pdf>.

⁴ Robert H. Dilworth, *Proposed Multilateral FTC Pooling and U.S. Bilateral Tax Treaties*, 124 TAX NOTES 1227 (2009). The GAAP references have been changed since submission of the letter to PERAB by the Financial Accounting Standards Board's adoption of the *Codification of Accounting Standards*. The substantive content has not changed, however. References to particular financial accounting standards have not been changed herein from the traditional citations.

sunt servanda, but I do advocate being courteous and diplomatic in American foreign policy (even in tax matters).

The following suggestions are the points on the lines of choices where I would strike the balance among competing goals. There is more than one wrong answer and it is important to keep the importance of all this in perspective. American business may be injured by bad choices, but it is unlikely to be brought to its knees. The U.S. job market is unlikely to be favorably affected by increasing the tax on U.S. MNCs (as proposed in the Administration's 2010 and 2011 Budget with respect to international business income), but popular perception that someone is trying to do something may encourage domestic tranquility even if domestic jobs do not materialize as a result of a tax penalty on foreign business activity.

RETAIN EXISTING CORE ARCHITECTURE

The United States should tax all business income, domestic or foreign, derived by businesses with a prescribed minimum nexus to the United States and should allow a foreign tax credit. Business income would consist of items realized by a U.S. taxpayer under general U.S. tax accrual principles.

U.S. tax should not be imposed on a U.S. shareholder's unrealized income consisting of undistributed foreign business income of foreign corporations. U.S. tax should be imposed on a U.S. shareholder when it receives a distribution of such income. This would maintain the general global division of taxing jurisdiction between source countries (where the business activity occurs) and the residence countries (where the shareholder-investors reside). The United States should tax U.S. shareholders on their pro rata share of undistributed foreign personal holding company income to the extent attributable to portfolio investment made by a controlled foreign corporation. A PFIC-type⁵ interest charge should be applied to passive income (undistributed foreign personal holding company income) attributable to a U.S. shareholder's interest in a non-controlled foreign corporation (10/50 company), when the income is included upon distribution to such U.S. shareholder.

The United States should not extend a territorial exemption to any U.S. shareholder's interest in any income of a foreign corporation. All return-on-capital investment should eventually be taxable in the hands of the U.S. taxpayer investor, no later than upon actual or constructive receipt as determined by general U.S. tax principles.

ELIMINATE SEPARATE REGIMES FOR FOREIGN BUSINESS CONDUCTED VIA FOREIGN CORPORATIONS VERSUS BRANCHES

⁵ A "PFIC" is a passive foreign investment company as defined in I.R.C. § 1297. Section 1291 imposes an interest charge on the "deferred tax amount" when a distribution is made by a PFIC (or with respect to certain gains on disposition of an interest in a PFIC).

AND OTHER PASS-THROUGH ENTITIES

The United States should treat all foreign business activities, in which a U.S. corporation has more than a ten percent voting equity interest, as a separate entity (corporation) rather than variously as a corporation, branch, or other pass-through entity based on the legal form of the business vehicle. This will eliminate electivity of tax regime for foreign business activities of U.S. MNCs, particularly loss pass-through and disregarded transactions between a legal entity and its branch.⁶

MATCH FOREIGN-RELATED EXPENSES AND FOREIGN-RELATED INCOME

Existing law should be modified to apply a matching principle for deductible expenses incurred to produce “foreign-related income.” All “foreign-related income” should, in the aggregate, pay for itself. Expenses attributable to “foreign-related income,” to the extent in excess of aggregate “foreign-related income,” should not offset otherwise taxable domestic income.

The present law approach should also be extended to matching of expenses, used for purposes of limiting the maximum foreign tax credit, to include not only taxpayers that are affected by the foreign tax credit limitation (based on expense allocations) but also to include taxpayers that do not have foreign tax credits in any particular year sufficient to have an economic effect equivalent to matching. Without such matching, expenses incurred to produce foreign-related income can offset U.S. corporate tax on the corporation’s purely domestic income (if any).

The principal items affected would be interest expense, general and administrative expense, and research and experimentation expense. Allocable interest expense should be calculated by taking into account controlled foreign corporation indebtedness. The class of income to which such expenses are to be allocated should be drafted broadly (in contrast to the Administration’s 2010 and 2011 Budget Proposals that would match only expenses and foreign income attributable to dividend-producing assets).⁷

A broadly drafted class would consist of all *foreign-related* income attributable to cross border business activities, including: (1) undistributed direct investment income; (2) direct investment dividends, and related party interest, rents and royalties from direct investment foreign affiliates; (3) active business royalties from third parties; and (4) export sales income (but

⁶ See Robert H. Dilworth, *Tax Reform: International Tax Issues and Some Proposals*, 35 INT’L TAX J. 5, 21–22, 86–87, 92 (2009).

⁷ The Administration’s 2011 Budget Proposal would apply the same principle but would allocate and apportion only interest expense and would not allocate and apportion general and administrative expense. The difference is quantitative rather than qualitative.

see resourcing proposal for export sales and intangible property royalties). Using a broadly drafted class, deferrable expenses incurred for the production of a broad class of deferred income would be initially larger, but would be more readily restored to deductibility if the class includes items normally remitted currently, such as related party interest and royalties, as well as other foreign-related items taken into account on a current basis such as export sales income and royalties for U.S.-origin intangible property. Direct investment income would include not only distributions on equity, but also interest, rents and royalties from foreign direct investment and active foreign business.

Interest and royalties received from foreign-related business would restore deductions for expenses that might have been incurred to generate earnings to be derived by dividends not yet taken into income. The core premise is that if foreign-related business activity pays for itself, on a current basis, the United States should count its blessings. Any deferred expenses not restored as deductions in any taxable year would be added to basis in the U.S. shareholder's investment in assets intended to produce foreign-related income. If that investment is disposed of, or abandoned, the tax benefit of deferred and capitalized deductions would be available subject to any limits on loss deductions generally.

It is likely that no other country applies a comparable matching of otherwise deductible expense to foreign-related income, even broadly defined.⁸ To this extent, the proposal may decrease "competitiveness" of U.S. MNCs with similarly situated foreign MNCs. It would be much less exceptional than matching only against returns on equity.⁹

TRANSFER PRICING: EXCLUDE RELATED PARTY RISK BASED ALLOCATIONS OF INCOME TO CFCS, EXCEPT BY TREATY

Section 482 should be amended to exclude allocation of income away from a U.S. affiliate to a foreign affiliate based on the *risk borne by that foreign affiliate's capital*. Such risk-based allocations under bilateral tax treaties should be retained (in order to maintain appropriate apportionment of taxing jurisdiction between the source country and the shareholder investor's residence country). The affiliate's capital that bears the risk represents the related shareholder's "risk" as the provider of the capital that

⁸ If this matching proposal were to be adopted, the United States should repeal foreign base company sales income and foreign base company services income provisions now in Subpart F. Dilworth, *Tax Reform, supra* note 6, at 26–39, 93. Further, the United States should retain the Related Party Look-Through Rule that excludes from Subpart F income related party interest, rents and royalties paid by foreign affiliates to other foreign affiliates. This would recognize that cross border business is, more often than not, conducted across national boundaries. It would update the U.S. tax view to take into account the emergence of the European Union and the North American Free Trade Agreement in the years since enactment of Subpart F in 1962. *Id.* at 5, 15–16, 86–87, 94.

⁹ *Id.* at 46–54, 57–60, 92–93.

bears the risk. This proposal would require adjustment to accommodate any significant cross border trade and investment by U.S. MNCs in countries with which the United States does not have treaties, such as Argentina, Brazil, Hong Kong, Singapore, Taiwan, and the Persian Gulf states. Such countries could be identified by an appropriate euphemism for non-tax-havens.¹⁰

ELIMINATE REPATRIATION TAX ON ARM'S LENGTH
TRANSACTIONS BETWEEN A CFC AND U.S. AFFILIATES

Some proponents of ending deferral base the suggestion on the existence of a tax barrier to repatriation of deferred income. The tax barrier is the residual U.S. tax on the amount to be repatriated. Ending deferral to solve this problem is reminiscent of Jonathan Swift's proposed solution to the famine in Ireland. If the so-called "repatriation tax" is a real problem, it can be solved without completely repealing deferral and without completely exempting a piece of such income.

The more measured step would be to *repeal* section 956 (Investment in United States property). If section 956 were to be repealed, the kind of taxable deemed-distributions that would end deferral would be limited to transactions on non-arm's length terms that would be treated as constructive dividends under general tax principles. CFC acquisition of related party stock or debt should be treated as a dividend, or not a dividend, under generally applicable tax rules rather than pursuant to a special rule for controlled foreign corporations only. Forcing external leverage is probably less sensible in 2009 than before the current financial crisis.¹¹

RETAIN CREDITING OF FOREIGN TAXES AGAINST U.S. TAX ON
EXPORT SALES INCOME (FOREIGN-RELATED INCOME)

Section 863(b) (*deemed* foreign source rule with respect to export sales) should be retained. Such income is foreign-related without regard to the passage of title, and foreign income taxes on some parts of the overall pool of foreign-related income should be allowed as a credit against U.S. corporate income tax on the overall pool.¹²

MAKE INTANGIBLE PROPERTY ROYALTY SOURCING
SYMMETRICAL WITH INCOME FROM EXPORT SALE OF
INVENTORY PROPERTY, EXCEPT TO THE EXTENT OTHERWISE
PROVIDED BY TREATY

All things being equal, there should be no distinction in treatment as "foreign-related income" of any income derived from an intangible when it

¹⁰ *Id.* at 68–73, 94.

¹¹ *Id.* at 39–46, 94–95.

¹² *Id.* at 63–65, 95.

is licensed rather than embedded in exported tangible property. If a careful examination (in which MNC decision makers are at least consulted) confirms that research and development activities will not be likely to migrate as a result of such a change, symmetry with export property sourcing would be a desirable result. Such examination should consider the extent to which alternative locations for research and development are, or are not, parties to tax treaties with the United States. If migration of the research and development activity is a serious risk, the existing system should be retained: U.S.-situs research and development is worth more than symmetry with export sales.¹³

INTEREST FROM RELATED PARTIES SHOULD CONTINUE TO BE FOREIGN SOURCE INCOME ELIGIBLE FOR CROSS CREDITING

All interest from foreign enterprises in which the interest recipient (or any person that controls, is controlled by, or is under common control with the recipient) is a greater than or is exactly a ten percent shareholder would be foreign source income against the U.S. tax on which excess foreign taxes from other foreign direct business investment could be credited. All foreign source income should also be foreign-related income.¹⁴

CONTRIBUTIONS OF APPRECIATED PROPERTY TO FOREIGN AFFILIATES SHOULD TRIGGER TAX ON THE VALUE OF PRIOR DEDUCTIONS AGAINST U.S. TAXABLE INCOME

This recommendation is prompted by two distinct considerations. First, the treatment of valuation in the case of outbound transfers of income-producing property in exchange for stock should be symmetrical in economic consequences with similar transactions when the consideration is money or other property. Second, simplification gains would be desirable if available without doing violence to the first consideration.

Income-producing property will often have been purchased or developed with tax deductible expenditures. If such property is shifted to a foreign affiliate without recovering the deductions, there would be an asymmetry between the recommendation that current expenses allocable to foreign-related income be deferred to the extent they exceed foreign-related income. At present, the basic approach is to capture the fair market value when and if an exit tax is due. Although the present system may be appropriate for some items of property, the search for fair market value of items that are not normally disposed of in a market is a difficult

¹³ *Id.* at 65–68, 95.

¹⁴ Dilworth, *Tax Reform*, *supra* note 6, at 54–57, 60–63, 95. In addition, dividends, interest, rents and royalties from portfolio investment should be ineligible for cross crediting any foreign income tax imposed on foreign direct investment income for purposes of the expense matching proposal. Expenses related to foreign-related business income would not be eligible to offset foreign-related portfolio income. *Id.* at 84–85, 95.

undertaking. Simplification gains could be achieved by seeking to recapture only prior unrecovered deductions.

In the case of high-value intangible property, expense recapture may be simpler but it may also be asymmetrical with the valuation approach suggested for cost sharing in the development of high value intangible property. In addition, tracking and allocating costs of developing successful high-value intangible property, and determining how much of the costs of developing *unsuccessful* intangible property should be borne by the successful intangible property, is likely to erode any simplification gains otherwise available when dealing with property that is unlikely to generate premium returns.

If, notwithstanding the undesirable complexity inherent in expense recapture, a regime requiring current recapture of previously deducted costs is adopted, and if it is also important that there be symmetry between the treatment of inframarginal (premium returns) on transferred intangible property transferred for stock and the treatment of such returns by means of a cost sharing arrangement (with buy-in payments when applicable), the transfer of intangibles for stock should trigger a recovery of previous deductions of expense incurred in the development, *plus* a current return for the cost of capital previously incurred to develop the property. The treatment of the value (if any) in excess of the development-cost recovery could then be treated in a manner consistent with the approach that would apply in a cost-sharing arrangement. The premium return could be realized by the U.S. MNC (capital provider) when it realizes a return on capital investment (dividends) from the transferee controlled foreign corporation. Alternatively, the premium return could be realized over the life of the intangible by relying on a deemed running royalty that is commensurate with income (i.e., comparable to the current law treatment under section 367(d)).

As with the ongoing discussion of cost sharing, tax policy makers should be very cautious in moving to a regime in which U.S.-situs research and development is treated less favorably than foreign situs research and development. The relevant comparison will include foreign situs research and development by the U.S. MNC as well as foreign or U.S. situs research and development by a “foreign” MNC. If the same intangible will have a higher value when owned by a foreign MNC than by a U.S. MNC, there is always the risk that portfolio investment capital will follow such a comparative advantage. Today there are 600,000 foreign students in the United States and 200,000 U.S. students in foreign countries. The opportunity for ideas and capital to come together outside the United States should be taken into account. The notion that intellectual property is inherently American and cannot “get away” is unlikely to be true in the future. It is something tax policy makers may want to consider and investigate.

JOINT VENTURES (10/50 COMPANIES)

The guiding principle with joint ventures should be to treat direct investment in controlled foreign corporations the same as direct investment in non-controlled foreign direct investment (i.e., 10/50 companies). Certain modifications must be made with respect to portfolio investment income of a 10/50 company.

Matching

Expenses incurred by a U.S. corporate taxpayer attributable to direct investments (greater than or exactly ten percent) in non-controlled foreign corporations should be nondeductible unless and until foreign related income is included in income by the U.S. shareholder. Any deferred expense attributable to the joint venture investment would, in effect, be capitalized and added to basis of the U.S. shareholder's investment.

The amount of allocable interest expense would be the amount of deferrable interest incurred by the U.S. shareholder allocable to the joint venture investment. If and to the extent the U.S. shareholder could provide information to support an adequate measurement of foreign affiliate interest expense, the amount of U.S. shareholder allocable interest expense could be reduced in the same manner that U.S. shareholder interest is reduced by interest expense of a controlled foreign corporation. The excess or net allocable interests in any year would then be added to the pool of potentially deductible expenses associated with all foreign-related income.

Foreign Tax Credit

All foreign taxes on foreign source business income would be taken into account and allowed to offset all U.S. tax otherwise due with respect to foreign source business income. As with controlled foreign corporations, deferred expenses, when restored and deductible, would be subject to limitations comparable to present law that would prevent offsetting foreign income tax on foreign income against U.S. tax on U.S. income (section 904(d)). There should be no separate "10/50 basket."

Foreign Personal Holding Company Income

U.S. shareholders would not be taxed on undistributed foreign personal holding company income of a non-controlled foreign corporation. Deferred expenses associated with the investment in the 10/50 company would be available as a deduction taxable if and to the extent of foreign-related income. Deferred expenses would not be "grossed up" (from time incurred and deferred until restored) by the foregone financial rate of return on disallowed deductions. The PFIC regime should be retained. If a 10/50 company derives certain minimum proportions of portfolio investment income, it would be a "PFIC" and shareholders would be subject to an interest-like charge on the tax then imposed upon receipt of a distribution.

Relief from the interest charge regime would be available to shareholders able to make an effective “qualified electing fund” (“QEF”) election to be taxed currently on undistributed income. Absent PFIC treatment, there would be no special treatment of income derived in respect of a direct investment in a 10/50 company: all income received by a U.S. shareholder should be taken into account and taxed when actually or constructively received under general U.S. tax principles.

Foreign Base Company Sales Income

No special treatment would be necessary with respect to related party sales and services income. The repeal generally of foreign base company sales income and foreign base company services income represents a policy decision that is equally applicable to 10/50 companies.

Foreign Personal Holding Company Exclusion: Look-Through Rules Should Apply to Interest, Rents, and Royalties

No special rules would be necessary, except to distinguish related party interest, rents and royalties from portfolio asset income. Such rules would be relevant with respect to PFIC treatment of a 10/50 company.

Any such items of income received by a foreign corporation from a payer in which the recipient (or any person that controls, is controlled by, or is under common control with the recipient), holds more than a ten percent equity interest, would not be treated as portfolio income.¹⁵

FOREIGN DIRECT INVESTMENT IN THE UNITED STATES SHOULD CONTINUE TO BE TAXED ON EFFECTIVELY CONNECTED INCOME

Branch rules should be replaced by a separate entity rule that would treat all domestic branches as separate corporations. Interbranch transactions should be treated as intercompany transactions and related party royalties for domestic use of foreign-origin intangible property should be foreign source to the same extent that royalties for use of U.S.-origin intangible property would be domestic. Further, dividends and interest from domestic corporations should remain a U.S. source to the same extent as present law allows and subject to U.S. withholding tax except to the extent otherwise provided by treaty. This is present law and should not change under the logic of this proposal.¹⁶

¹⁵ *Id.* at 87–90, 96.

¹⁶ Similarly, present law should be retained with regard to foreign portfolio investment in U.S. business entities. Dividends, interest, rents and royalties should be taxable based on gross income at appropriate withholding tax rate, subject to treaty relief. Portfolio interest taxation should eventually be made symmetrical with taxation of dividends paid to nonresident aliens and foreign corporations. The present regime favors foreign portfolio debt investment over foreign portfolio equity investment in domestic business enterprises.

FINANCIAL INSTITUTIONS

Domestic: Present Law Temporary Exclusion from Subpart F Should Be Made Permanent

Assuming that Subpart F is amended for industrial and services corporations as recommended above, U.S.-parented MNCs engaged in the active conduct of a banking, financing or similar business should be symmetrically excluded from the regime taxing U.S. shareholders currently on undistributed foreign personal holding company income (income that is not otherwise excluded from foreign personal holding income on the basis of a related party payer). However, any income deferred from tax would result in a corresponding deferral of deductions for interest, general and administrative expense and other expenses incurred to produce such deferred foreign financing business income. Simplifying conventions should be applied to accommodate differences in currencies and other terms (maturities, interest rate basis) applicable to borrowing by such financial institutions and lending by such institutions.

Branches and subsidiaries would be treated as separate entities (corporations) for this purpose. Interbranch transactions should therefore be treated as cognizable intercompany transactions.

Foreign Parent Financial Institutions: Domestic Branches Should Be Treated as Separate Corporations

Foreign-parented MNCs engaged in the active conduct of a banking, financing or similar business that generates U.S. source income effectively connected should be subject to corporate tax on net income. Branches should be treated as separate corporations. Interbranch transactions should be treated as transactions with tax effect. The Branch Profits tax should be repealed because a branch would be treated as a separate corporation.

TAX-EXEMPT INVESTORS

Distributions from foreign MNCs should be made a class of unrelated business taxable income (“UBTI”)¹⁷ (subject to a contrary provision in a U.S. tax treaty with the country from which a tax-exempt investor receives a dividend). All income from investments in domestic and foreign corporations should be taxed once to the extent attributable to a U.S. tax-exempt investor’s interest therein. If a tax-exempt U.S. investor invests in a foreign corporation that is exempt from U.S. corporate income tax, there may be a marginal investment incentive to invest uniquely “American” capital outside the United States. Treaties could provide otherwise, because

¹⁷ An organization otherwise exempt from income tax pursuant to I.R.C. § 501(a) is subject to income tax with respect to its “unrelated business taxable income” (“UBTI”) as defined in I.R.C. § 512.

treaties are generally concluded with countries with a “meaningful” tax system.¹⁸

BILATERAL VS. MULTILATERAL FOREIGN TAX CREDIT.

If a tax increase on MNCs with multijurisdictional business is thought necessary, the “pooling basis” proposal should be deferred, and a more direct limitation of cross crediting should be pursued instead. A multilateral foreign tax credit regime will not work without a multilateral consensus among the United States and concerned treaty partners. The daunting complexity of the 1986 Act “basketing” to eliminate cross crediting between baskets is, of course, at odds with any simplification goals, but probably less so than the proposed pooling basis foreign tax credit proposal. Whatever “solution” is pursued should not be based on Humpty Dumpty’s argument that the words of the treaties mean only what the Treasury Department wants them to mean at any point in time.¹⁹

¹⁸ Dilworth, *Tax Reform*, *supra* note 6, at 90–91.

¹⁹ Dilworth, *Proposed Multilateral FTC Pooling and U.S. Bilateral Tax Treaties*, *supra* note 4, at 1233, 1252.

