AICPA®

July 17, 2017

The Honorable Orrin G. Hatch, Chairman
Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510

RE: AICPA Tax Reform Suggestions on the International Tax System

Dear Chairman Hatch:

The American Institute of CPAs (AICPA) applauds the leadership taken by the Senate Committee on Finance on comprehensive tax reform. We recognize the tremendous effort required to analyze the current complexities in the tax law, examine policy trade-offs, and consider the various reform options. This letter on the international tax system is submitted in response to your request of June 16, 2017, for comments and recommendations from stakeholders, regarding comprehensive tax reform. In addition to this letter, we are submitting separate letters on the following areas of tax:

- Individuals, Families, and Tax Administration
- Business Income Tax
- Taxation on Savings and Investments

The AICPA is a long-time advocate for an efficient and effective tax system based on principles of good tax policy.[1] We need a tax system that is administrable, stimulates economic growth, has minimal compliance costs, and allows taxpayers to understand their tax obligations. These features of a tax system are achievable if principles of good tax policy are considered in the design of the system.

In the interest of good tax policy and effective tax administration, we respectfully submit the following comments for your consideration in updating our international tax system:

1. Transition to a Territorial Tax System for Corporate Business Income
2. Develop Effective Anti-Base Erosion Provisions
3. Retain and Strengthen the Subpart F Provisions
4. Establish Fair, Equitable and Administrable Deemed Repatriation Procedures
5. Consolidate and Simplify Foreign Information Reporting Requirements
6. Provide Parity in the Treatment of Similar Foreign and Domestic Tax-Deferred Savings Accounts

[1] AICPA, "Guiding Principles for Good Tax Policy: A Framework for Evaluating Tax Proposals," January 2017.

1. Transition to a Territorial Tax System for Corporate Business Income

The AICPA thinks that transitioning to a territorial tax system is generally considered good tax policy. Under a territorial system, earnings generated from foreign subsidiaries of United States (U.S.) multinational businesses are taxed in the country where earned; earnings outside the U.S. are not taxable in the U.S. An incremental U.S. tax is not imposed upon repatriation of the foreign earnings to the U.S.

Switching to a territorial system could significantly reduce the complexity of the current income tax system. Compared to our current worldwide deferral system, a territorial system should require less tracking of earnings, taxes, and types of current year income. The need for a robust foreign tax credit regime is significantly reduced under a territorial system. In addition, U.S. taxpayers would not have to maintain as many different tax accounts or perform as many calculations to compute their taxable income and tax liability.

However, some complexity would remain under a territorial system. For example, transfer pricing would continue as an area of significant importance, and likely would receive an enhanced emphasis from the Internal Revenue Service (IRS) in enforcing a territorial system. Differences in the way the IRS and foreign countries approach transfer pricing risks and valuations would exist. For example, the Organization for Economic Co-operation and Development's (OECD) Base Erosion and Profit Shifting (BEPS) approach to the valuation of intangible assets would likely result in U.S. taxpayers facing enhanced scrutiny and controversy with both the IRS and foreign tax authorities. This disparate treatment, in turn, would increase the likelihood of double taxation on those earnings apart from any relief provided under our double taxation treaties.

2. Develop Effective Anti-Base Erosion Provisions

Territorial international tax systems are used by most developed countries; however, the territorial systems adopted by these countries generally provide comprehensive anti-abuse measures. Imposing similarly strong and effective anti-base erosion provisions as part of a territorial tax system is essential in developing a fair and equitable U.S. tax regime for international business income. Provisions similar to the existing rules under sections[2] 367 and 956 are essential anti-abuse tools. Ensuring that businesses are unable to avoid U.S. tax on appreciation of assets developed in the U.S. is a basic issue of fairness and is an essential anti-abuse tool.

3. Retain and Strengthen the Subpart F Provisions

An additional important anti-abuse element is the retention and strengthening of rules similar to the existing Subpart F income tax regime. Under a territorial system, foreign source income is exempt, not merely deferred, from U.S. taxation. The incentive for multinationals to arbitrarily direct the sourcing of highly mobile and passive income without a business purpose other than tax

[2] All section references in this paper are to the Internal Revenue Code of 1986, as amended, or the Treasury regulations promulgated thereunder.

avoidance is potentially greater under a territorial system. Clearly defined rules designed to prevent potential abuse are an essential component of any new international tax system. As Congress develops these rules, we suggest they consider ways of simplifying the administration and implementation of them for both taxpayers and the IRS.

4. Establish Fair, Equitable and Administrable Deemed Repatriation Procedures

One of the key transition issues in moving to a territorial system is the treatment of deferred foreign earnings held by U.S. corporations. The AICPA suggests permitting payment of the applicable tax over an extended period of years. Imposing two distinct tax rates is a reasonable approach to apportion the tax burden among taxpayers on their deemed repatriation of deferred foreign earnings. This method recognizes a taxpayer's ability to pay based on the liquidity of the foreign investments i.e. whether they are currently held as cash (and other liquid-type assets) or previously invested in physical or illiquid assets (such as land, factories, equipment and certain intangibles). An appropriate cut-off date for determining the amount and applicable category of deferred foreign earnings is an important element for inclusion in any legislation.

It is important that the legislative language contains clear, specific and administrable rules for the repatriation procedures along with any other transition provisions. We are concerned that the normal extended regulatory process to address transition related provisions will result in confusion and uncertainty for taxpayers. This situation, in turn, might provide unanticipated opportunities for certain taxpayers to take unfair advantage of the transition regime.

An additional consideration for any deemed repatriation procedure is the availability of foreign tax credits to offset a taxpayer's calculated liability, such as applied under the 2004 temporary repatriation procedures in section 965. Clear and effective rules regarding the status of a taxpayer's existing foreign tax credit accounts are essential to a fair and equitable transition.

5. Consolidate and Simplify Foreign Information Reporting Requirements

In its efforts to ensure that U.S. taxpayers are properly reporting their income from and ownership of foreign assets, as well as ensuring foreign taxpayers properly report their income from within the U.S., Congress and the IRS have imposed a series of new requirements, including the Foreign Account Tax Compliance Act (FATCA) in recent years. This patchwork of laws and regulations has imposed duplicative and, in some cases, unnecessarily burdensome reporting obligations on taxpayers.

As Congress develops tax reform proposals, the AICPA recommends that it remains cognizant of opportunities to eliminate or reduce duplicative reporting and reduce the administrative reporting burdens on both taxpayers and the IRS.

The AICPA has previously provided suggestions in this area relating to Passive Foreign Investment Companies (PFICs).[3] The AICPA has also submitted recommendations relating to reducing unnecessary foreign asset reporting.[4]

6. Provide Parity in the Treatment of Similar Foreign and Domestic Tax-Deferred Savings Accounts

The AICPA recommends providing tax and filing relief for certain foreign savings accounts considered equivalent to specified U.S. tax-exempt and tax-deferred savings accounts. Such relief would involve providing tax-deferred or tax-exempt treatment for approved foreign plans identical to the equivalent U.S. plans. In addition, this proposal would exempt approved foreign plans from classification as grantor trusts, and exempt U.S. citizens and residents from various onerous statutory filing requirements for foreign trusts and PFICs which currently exist for these plans.

The U.S. tax code currently does not provide relief for these foreign plans. Furthermore, while many of the income tax conventions that the U.S. has entered into with various foreign governments provide bilateral deferral of tax or inclusion in income for various qualified or registered pension or retirement plans, these conventions do not provide relief from double taxation or current inclusion in income for other plans and accounts. Among the types of plans are education savings plans which are similar to Qualified Tuition Program (529) Plans, disability savings plans that are similar to Achieve a Better Life Experience (ABLE) Plans, and tax-exempt savings accounts that are similar to Roth Individual Retirement Accounts (IRAs). The AICPA has previously submitted specific recommendations in this area regarding the Canadian equivalents of these plans.[5]

* * * * *

The AICPA is the world's largest member association representing the accounting profession with more than 418,000 members in 143 countries and a history of serving the public interest since 1887. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

We appreciate the opportunity to provide comments on these issues related to international tax reform. If you have any questions, please contact me at (408) 924-3508 or annette.nellen@sjsu.edu; or Jonathan Horn, Senior Manager – AICPA Tax Policy & Advocacy, at (202) 434-9204, or jonathan.horn@aicpa-cima.com.

---

[3] AICPA letter "Treatment of Shareholders of Certain Passive Foreign Investment Companies", May 12, 2014 and AICPA letter " 2017 Compendium of Tax Legislative Proposals – Simplification and Technical Proposals", December 14, 2016.
[4] AICPA letter "Simplification of Tax Filing Requirements for Americans Residing Abroad", August 15, 2016.
[5] AICPA letter "Proposed Tax Relief for Various United States and Canadian Equivalent Purpose", March 4, 2016.

Sincerely,

Annette Nellen, CPA, CGMA, Esq.
Chair, AICPA Tax Executive Committee