American Institute of CPAs
1455 Pennsylvania Avenue, NW
Washington, DC 20004-1081

June 23, 2016

The Honorable Kevin Brady, Chairman
House Committee on Ways and Means
1102 Longworth House Office Building
Washington, DC 20515

RE: Tax Reform Act of 2014

Dear Chairman Brady:

As the United States House Ways and Means Committee continues to consider international tax reform proposals, the AICPA offers the enclosed comments on the tax reform legislative act, entitled the Tax Reform Act of 2014 (113th Congress).

Our specific recommendations primarily focus on the technical issues of the international provisions in the Tax Reform Act of 2014. From a policy perspective, we generally refrain from supporting or opposing most of the provisions because our membership's client base is comprised of a variety of taxpayers, and the specific provisions could either benefit or negatively impact them. Instead, we aim to objectively identify potential technical issues, administrative-type concerns, provisions needing clarification, and areas we think warrant further consideration as Congress moves forward with international tax reform. We previously submitted a letter[1] to the House Committee on Ways and Means providing comments on the domestic tax issues most important to the AICPA and our membership.

The AICPA is the world's largest member association representing the accounting profession, with more than 412,000 members in 144 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 welcome the opportunity to further discuss our comments on the Tax Reform Act of 2014 or any legislative proposal you are considering. I can be reached at (801) 523-1051 or tlewis@sisna.com; or you may contact Jeffrey Porter, Chair of the Tax Reform Task Force, at (304) 522-2553 or jporter@portercpa.com; or you may also contact Kristin Esposito, Senior Technical Manager – AICPA Tax Policy & Advocacy, at (202)-434-9241 or kesposito@aicpa.org.

[1] The AICPA submitted a comment letter dated January 1, 2015 to the United States House Committee on Ways and Means http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/AICPA-Comments-on-2014-Camp-Draft-General-Comments-Final.pdf.

Sincerely,

Troy K. Lewis, CPA
Chair, Tax Executive Committee

cc: The Honorable Sander M. Levin, Ranking Member, House Committee on Ways and Means
The Honorable Orrin G. Hatch, Chairman of the Senate Committee on Finance
The Honorable Ronald L. Wyden, Ranking Member of the Senate Committee on Finance
The Honorable Mark Mazur, Assistant Secretary for Tax Policy, Department of the Treasury
The Honorable William J. Wilkins, Chief Counsel, Internal Revenue Service

American Institute of CPAs Comments on The Tax Reform Act of 2014 (113^{th} Congress)

Our attached comments relate to the United States (U.S.) House of Representatives, Committee on Ways and Means tax reform legislative text of the Tax Reform Act of 2014[1] (hereinafter referred to as the "Tax Reform Act" or the "Proposal").

Unless section references are noted as from the Internal Revenue Code (IRC or "Code"), the section references are to the proposed legislative text in the Tax Reform Act. The American Institute of CPAs (AICPA) appreciates the opportunity to submit these comments and is happy to discuss with Members of Congress and their staff any of the issues addressed in this letter.

General Comments

An optimal tax system is one that is administrable, does not hinder 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.

The AICPA is a long-time advocate for an efficient and effective tax system based on principles of good tax policy. As with our prior comments on tax proposals, we have considered the AICPA's Principles of Good Tax Policy, as follows:

[1] From 2011 to 2013, former House Ways and Means Committee Chairman Camp released several discussion drafts outlining his proposals to reform the U.S. tax system. The first of which was the discussion draft, released on October 26, 2011, containing proposed legislation that would reform the U.S. international tax regime. Former Chairman Camp subsequently released a second comprehensive discussion draft on February 21, 2014. The second discussion draft was formally introduced in the U.S. House of Representatives as the Tax Reform Act of 2014 (H.R. 1 – 113^{th} Congress) on December 10, 2014.

Principles of Good Tax Policy

1. *Equity and Fairness.*
   Similarly situated taxpayers should be taxed similarly.
2. *Certainty.*
   The tax rules should clearly specify when the tax is to be paid, how it is to be paid, and how the amount to be paid is to be determined.
3. *Convenience of Payment.*
   A tax should be due at a time or in a manner that is most likely to be convenient for the taxpayer.
4. *Economy in Collection.*
   The costs to collect a tax should be kept to a minimum for both the government and taxpayers.
5. *Simplicity.*
   The tax law should be simple so that taxpayers understand the rules and can comply with them correctly and in a cost-efficient manner.
6. *Neutrality.*
   The effect of the tax law on a taxpayer's decisions as to how to carry out a particular transaction or whether to engage in a transaction should be kept to a minimum.
7. *Economic Growth and Efficiency.*
   The tax system should not impede or reduce the productive capacity of the economy.
8. *Transparency and Visibility.*
   Taxpayers should know that a tax exists and how and when it is imposed upon them and others.
9. *Minimum Tax Gap.*
   A tax should be structured to minimize noncompliance.
10. *Appropriate Government Revenues.*
    The tax system should enable the government to determine how much tax revenue will likely be collected and when.

AICPA

We strongly encourage Congress to use these principles to guide comprehensive tax reform. We recognize that it is not always possible for every provision in the overall tax system to equally meet each of the ten principles of good tax policy. Yet, it is important for lawmakers to carefully balance the principles to achieve a respected and administrable tax system. We hope that dedication to achieving an appropriate balance of the principles of good tax policy governs the decisions on tax reform.

<u>Specific Comments</u>

<u>Title IV – Participation Exemption System for the Taxation of Foreign Income</u>

<u>Subtitle A – Establishment of Exemption System</u>

1. **Section 4001 – Deduction for dividends received by domestic corporations from certain foreign corporations**

Proposal

Section 4001 of the Proposal provides for a 95% deduction for the foreign-source portion of dividends received by a domestic corporation (DC) from certain foreign corporations (FCs). The FCs are referred to as "specified 10% owned foreign corporations" when 10% or more of the voting stock is directly or indirectly owned by a DC.

- Provides an ordering rule for dividends attributable to post-1986 and pre-1987 earnings and profits (E&P).
- Does not change the treatment of a foreign branch owned by a DC. Subjects the dividends-received deduction (DRD) to a six-month holding period requirement.
- Does not allow credits and deductions for foreign taxes paid on dividends that benefit from the DRD.

AICPA Comments/Observations

(1) The DRD applies only to U.S. shareholders that are C-corporations. Individuals, S corporations, partnerships, trusts and estates do not qualify for the proposed DRD.

Provide clarification on whether dividends paid to a partnership, with a U.S. corporate partner that is a U.S. shareholder, qualify for the DRD, to that extent.

(2) Earnings of U.S. owned foreign branches, to the extent they are not considered foreign intangible income, are subject to U.S. taxation, as they are currently, at the statutory rate (will phase down to 25%), less a foreign tax credit (FTC) for eligible foreign income taxes.

The proposed treatment for branch income is inconsistent with many countries that are part of the Organisation for Economic Co-operation and Development (OECD). Those countries provide for a participation exemption for the earnings of foreign branches and dividends from foreign companies in which a home country corporation is a significant investor (although in some cases the exemption for branches is allowable only pursuant to a bilateral income tax treaty).

If the Proposal was changed to treat foreign branches in the same way as controlled foreign corporations (CFCs), it would exempt the earnings of a foreign branch from current U.S. tax, but would impose a net 1.25% tax (i.e., to allow a 95% deduction) when foreign branch earnings are remitted to the U.S. home office. Similarly, under the Proposal, all of the current Subpart F income (including the proposed foreign base company intangible income (FBCII)), is subject to current U.S. tax.

Please provide guidance on what constitutes a branch (e.g., under IRC section 367(a) and/or when there is a permanent establishment under an applicable treaty), if the Proposal intends to treat foreign branches as CFCs. Also, please provide guidance on transition rules, including considerations to the potentially adverse effect from dual consolidated loss recapture, currency gain and other tax consequences pursuant to IRC section 367.

We acknowledge that the 2011 discussion draft adopted an approach that is similar to the above approach to branch income that was not repeated in the Proposal. We further note that removing foreign source branch income may affect the amount of a DC's income that qualifies for the reduced 15% rate for foreign intangible income because it could reduce the foreign percentage of the income of the DC.

In addition, note that many foreign subsidiaries of S corporations and partnerships have made the so-called "check-the-box" elections and are treated as fully transparent. Thus, shareholders of S corporations and partners of partnerships are subject to tax immediately in the U.S. on foreign income earned by those subsidiaries and can utilize section 901 credits on foreign tax paid by those subsidiaries under current rules. In this situation, the subsidiaries of S corporations or partnerships effectively fall within the proposed branch rules. This is why the treatment of branches under the Proposal could broadly affect pass-through entities.

(3) Under the Proposal, the foreign-source portion of a dividend equals the amount that bears the same ratio to the dividend that the post-1986 undistributed foreign earnings bears to the total undistributed post-1986 earnings. Similar treatment applies to dividends paid out of accumulated pre-1987 E&P. An ordering rule treats dividends as paid out of post-1986 E&P first.

The AICPA supports granting the 95% DRD only to foreign source earnings because E&P derived from U.S. effectively connected income (ECI) qualifies separately for a partial or complete DRD under section 245. Dividends from an at least 80% owned (by vote or value) domestic corporation qualify separately for a DRD under IRC section 245.

Consider modifying the current domestic DRD rules under IRC section 245(a) to conform with the proposed IRC section 245A (i.e., the 95% DRD).

We further request guidance on the computation of the foreign portion of the dividend for specified 10% owned FCs with a deficit in accumulated E&P, but with current-year positive E&P (i.e., where the so-called "nimble dividend" rule applies).

If combining the positive amount of current E&P and the accumulated E&P deficit results in an amount that is zero, or negative, the foreign portion of the dividend is not determinable under the Proposal as drafted. As a result, U.S. tax of 25%, the full statutory rate, may apply to the dividend, which is in clear contradiction to the policy behind allowing the 95% DRD.

(4) Under the Proposal, IRC section 959 remains in effect; thus, a previously taxed income (PTI) distribution from a CFC is not considered a dividend. Any IRC

section 986(c) gain associated with the PTI distribution does not appear to qualify for the DRD, and is included in gross income (as it is under present law).

(5) Does an excess distribution of a passive foreign investment company (PFIC) that is owned by a 10% U.S. shareholder qualify for the 95% DRD? Similarly, does income of a qualifying electing fund (QEF) that is owned by a 10% U.S. shareholder qualify for a DRD? The passive nature of the earnings of a PFIC or QEF may warrant treatment that is similar to the treatment of foreign personal holding company income (FPHCI). Consider whether it is more appropriately taxed at the full statutory rate, offset by FTCs.

(6) IRC section 1248 is not modified by the Proposal.

Consider if it is reasonable to conclude that gain recognized upon the sale of the stock of a CFC that is recharacterized as a dividend under IRC section 1248 is eligible for the 95% DRD under the Proposal. If yes, then the language in the statute or committee report should clearly reflect this intention.

Also, a similar issue exists for "constructive dividends" that are taxed to a DC that owns stock in a FC where the dividend is imputed to the DC as the result of an IRS audit. In addition, consider whether the application of IRC section 1248 should extend to 10/50 companies. If CFC status is irrelevant as to whether dividends qualify for the DRD, then is it relevant as to whether gains are recharacterized as DRD-eligible dividends?

2. Section 4002 – Limitation on losses with respect to specified 10-percent owned foreign corporations

<u>Proposal</u>

Section 4002 of the Proposal provides for a reduction in the basis of shares of a specified 10% owned FC for purposes of determining losses with respect to dispositions of the shares.

- Provides that the adjusted basis of the shares is reduced by the amount of DRD allowed with respect to dividends from the FCs.

Section 4002 of the proposal also provides for recapture as income, the "transferred loss amount" with respect to the transfer of *substantially all* of the assets of a foreign branch (within the meaning of section 367(a)(3)(C)) to a specified 10% owned FC. (Note: Although this rule is included in section 4002, for the most part, it is not related to the basis-reduction proposal described immediately above.)

- The transferred loss amount equals the excess of the post-effective-date losses incurred by the foreign branch that were deducted by the DC, over the sum of the taxable foreign branch profit earned after the loss is incurred and the overall foreign loss (OFL) recapture arising out of disposition of the branch assets.

- The transferred loss amount is limited to the aggregate amount of DRD allowable to the DC during the taxable year of the transfer and subsequent years.
- For transfers not covered by IRC section 367(a)(3)(C), the transferred loss amount is further reduced by any other recognized gains.
- There is coordination with the amount recognized under IRC section 367(a)(3)(C).
- Treasury is authorized to issue regulations to adjust the basis of the transferee stock.
- The amount recognized under the Proposal is U.S.-source income. Any amount recognized under IRC section 367(a)(3)(C) is also U.S.-source.

<u>AICPA Comments/Observations</u>

(1) Provide guidance on what constitutes "substantially all."

(2) With a DRD regime for dividends, a targeted basis reduction provision is arguably necessary to prevent the sheltering of gains by pre-sale dividends that benefit from the 95% DRD. The basis reduction provision, as drafted, however, could extend to stock losses that may not have been created by pre-sale dividends. In this respect, the language of the basis reduction provision appears too broad.

3. Section 4003 – Treatment of deferred foreign income upon transition to participation exemption system of taxation

<u>Proposal</u>

Section 4003 of the Proposal provides for transition rules related to the immediate inclusion of the post-1986 E&P of CFCs and so-called 10-50 FCs in the income of the U.S. shareholder, subject to tax at a bifurcated reduced rate.

- Applies to U.S. shareholders regardless of whether they are DCs, individuals, partnerships, corporations, trusts or estates. A U.S. person who owns less than 10% of a 10-50 FC or of a CFC is not subject to this mandatory income inclusion.
- Provides that deductions from the inclusion are allowable such that earnings invested in cash, cash equivalents, and other short-term assets are taxed at an effective rate of 8.75% and other earnings are taxed at an effective rate of 3.5%. The 8.75% and 3.5% effective rates are the tax rates on a DC (by applying the 90% deduction for non-cash E&P and the 75% deduction for cash E&P to the current 35% corporate tax rate). The rate for an individual (or an estate or trust) in the top 39.6% bracket is slightly higher.
- Provides rules for allocating E&P deficits to offset post-1986 positive E&P. Only deficits in a CFC or in a 10-50 FC that is owned by the U.S. shareholder as of February 26, 2014 are taken into account for this purpose.
- Provides that foreign tax credits and deductions are not allowed with respect to the deductible portion of the inclusion.

- Provides special rules to allow deferral of the transition rule inclusion for S corporation shareholders.
- Provides for the ability to pay the tax on the transition rule inclusion in installments without interest.

AICPA Comments/Observations

(1) Under the Proposal, only post-1986 E&P is subject to the deemed inclusion. Pre-1987 E&P not subject to the deemed inclusion would nevertheless qualify for the 95% DRD when repatriated.

(2) For C corporation shareholders, the FTC is allowable against the taxable portion of the deemed inclusion, in contrast with the new 95% DRD whereby no FTC is allowed against the U.S. tax imposed on the 5% taxable portion of the dividend.

(3) Distributions during the last taxable year of a 10-50 FC or of a CFC would not reduce the post-1986 E&P subject to the deemed inclusion. These distributions are likely considered distributions of PTI.

(4) Consider whether it is appropriate to "force" inclusion of pre-effective date earnings of a 10-50 FC.

Historically, E&P of a FC that is not controlled by U.S. shareholders is not included in income until it is repatriated or otherwise "cashed in" (thus, Subpart F does not apply to U.S. persons who own 10% or more of the stock in a 10-50 FC, and the PFIC rules do not apply until there is an "excess distribution" from the PFIC in the form of either a dividend or a sale of the PFIC stock, or unless the shareholder makes an election to include E&P in gross income, that is, by making a QEF election with respect to a PFIC). In this respect, the 14% transition rule inclusion, which would tax the accumulated E&P of most CFCs as proposed in the Administration's Fiscal Year 2017 Revenue Proposals ("FY 2016 Budget") only applies to CFCs.

(5) Consider whether the payment deferral extended to shareholders of S corporations extends to a U.S. individual, a U.S. partner of a partnership, or the U.S. beneficiaries of a trust or an estate as well.

(6) The deemed inclusion would not trigger recapture of OFL.

Consider how the proposed IRC section 965(a) inclusion interacts with IRC section 904(c) FTC carryforwards and IRC section 907.

Since proposed IRC section 965(g) already disallows FTCs on the deductible portion of the inclusion, consider a rule that allows a reduction of the OFL equal to the amount of the DRD.

(7) Generally under IRC section 909, it is possible to "suspend" foreign income tax so that it is not taken into account for FTC and E&P purposes if, under certain specified circumstances, foreign income tax is taken into account by a person that is not the person that takes into account the income or earnings (related income) from which the tax is assessed. Foreign taxes are "unsuspended" generally if the taxes and related income are reunited in the same person or if the related income is subject to tax in the U.S.

Consider whether to release taxes suspended under IRC section 909 as all accumulated E&P is taken into account by the U.S. shareholder under this provision. If they are unsuspended, consider if a recalculation of E&P for the last taxable year of a foreign corporation that begins before January 1, 2015 is necessary in order to account for the unsuspended taxes.

In addition, consider whether it is appropriate to release suspended taxes that are related to deficit in related income.

(8) Consider increasing the basis of the stock of the FC under IRC section 961 upon the deemed inclusion. If you permit such increase, should the basis also decrease by the amount of the deduction?

4. Section 4004 – Look-thru rule for related controlled foreign corporations made permanent

<u>Proposal</u>

Section 4004 of the Proposal would make permanent the "CFC look-through rule" of IRC section 954(c)(6).

<u>AICPA Comments/Observations</u>

The AICPA supports making IRC section 954(c)(6) permanent. H.R.2029 – Consolidated Appropriations Act of 2016[2] extended IRC section 954(c)(6) through 2019.

<u>Subtitle B - Modifications Related to Foreign Tax Credit System</u>

1. Section 4101 – Repeal of section 902 indirect foreign tax credits; determination of section 960 credit on current year basis.

<u>Proposal</u>

Section 4101 of the Proposal would repeal IRC section 902 indirect foreign tax credits; determination of IRC section 960 credit on current year basis.

[2] Pub. L. No. 114-13.

- Deemed paid taxes include foreign taxes attributable to distributions from previously taxed E&P, including distributions made through tiered-CFCs, to the extent they have not been deemed paid by the DC for any prior taxable year.

AICPA Comments/Observations

(1) Section 960 will continue to allow a FTC against a CFC's Subpart F income. A CFC that realizes 100% Subpart F income should essentially have the same treatment as a foreign branch. Therefore, it is appropriate to allow any direct foreign taxes, such as withholding taxes on the distribution of income that has been included as Subpart F income, or PTI, in addition to IRC section 960 indirect FTC. Also, it is appropriate to allow the same treatment even if the PTI is paid out in a later year and is only utilizable against other taxable foreign-source income realized by the DC in the later year (compare withholding taxes that are imposed in some foreign countries when a local branch remits its after-tax profit to the U.S., in a manner similar to IRC section 884).

(2) Since IRC section 960 indirect FTCs are determined on a current year basis and IRC section 902 indirect FTCs are repealed under the DRD regime, it appears that any taxes in CFCs suspended under IRC section 909 will generally become permanently disallowed.

(3) Are any changes to the IRS audit period for foreign tax credits anticipated?

(4) Are changes to the limitations on taxpayers regarding the election to take a deduction versus credit anticipated?

2. Section 4102 – Foreign tax credit limitation applied by allocating only directly allocable deductions to foreign source income

Proposal

Section 4102 of the Proposal applies the FTC limitation by allocating only directly allocable deductions to foreign-source income.

- Directly allocable deductions include only deductions directly incurred as a result of activities that produce the related foreign-source income.

AICPA Comments/Observations

(1) Deductions such as stewardship expenses, general and administrative expenses, and interest expense are not considered "directly allocable," and are not allocated to foreign-source income for FTC limitation purposes.

(2) This rule is relevant only in calculating a DC's FTC limitation, where the DC:

a) Claims a FTC under IRC section 901 with respect to foreign income taxes imposed on foreign branch income, on dividends from non-10%-owned FCs that are possibly subject to foreign withholding tax, and/or other foreign income subject to a foreign withholding tax (such as foreign-source royalties); and/or where

b) Claims a FTC under section 960 with respect to Subpart F income.

(3) Although the Tax Reform Act of 2014 Discussion Draft Section-by-Section Summary (the "Summary") and the Macroeconomic Analysis of the "Tax Reform Act of 2014" prepared by the Joint Committee on Taxation (JCT) ("JCT Summary") both stated that interest expense is not treated as "directly allocable" to foreign sources, the text of the bill itself appears much more subjective. We request confirmation that interest expense is not directly allocable even though certain interest is treated as allocable under Treas. Reg. § 1.861-10. In addition, consider whether rules similar to Treas. Reg. § 1.882-5 should apply to directly allocate interest expense to foreign branch operations.

(4) To the extent that this provision does not require the allocation of certain deductible expenses (such as interest expense) to foreign sources under the "directly allocable" rule, the same expense is not included in a DC's ongoing OFL calculations. However, to the extent a DC does incur expenses other than interest, stewardship, and general and administrative expenses that were directly allocable to foreign income, those expenses are part of the OFL calculation.

3. Section 4103 – Passive category income expanded to include other mobile income

Proposal

Section 4103 of the Proposal renames "passive category income" for FTC purposes to "mobile category income" and expands it to include foreign base company sales income and foreign base company intangible income.

Financial services income described under IRC section 904(d)(2)(C) is no longer treated as general category income.

AICPA Comments/Observations

(1) The adoption of a 95% DRD in the Proposal would, in theory, reduce the importance of the role of FTCs in relieving double taxation. However, because the Proposal would also expand the scope of Subpart F through the broad reach of FBCII and substantially leave in place the taxation of non-dividend foreign source income earned by a DC, FTCs likely will remain the primary means for relieving double taxation.

(2) This provision is significant because it could move "active" business income that is Subpart F income from the "general" (often colloquially called the "active" basket)

into the "passive" basket, which historically has included only investment-type income such as interest, dividends, royalties, etc. (unless the so-called "high tax kick-out" rule recharacterizes them to the general basket).

It appears that the Proposal places foreign base company sales income (FBCsalesI) and the new FBCII in the passive basket due to the "mobile" nature of the income. It also appears that the inclusion of the income in the mobile basket is to prevent "cross-crediting" of low-taxed income with excess credits generated by other high-taxed foreign-source income (such as branch income that is subject to high foreign income tax) in the general basket.

(3) Please provide an explanation as to why the Proposal does not reclassify foreign base company services income (FBCsrvcsI) from the general basket to the passive basket. Such treatment results in the possibility of applying a zero tax rate to a CFC's FBCsrvcsI. By leaving it in the general basket, an incentive for taxpayers is established to arrange their CFCs to generate FBCsrvcsI, which is possible to shelter by highly taxed foreign branch income. Note, this result is not the case if the branch income qualifies for the 95% DRD. Also, please provide clarification on the overlap between foreign base company sale and service income.

In addition, considering the broad scope of the FBCII, is it appropriate to allow FBCsrvsI to remain in the general basket, while placing a CFC's low-taxed income from the provision of other kinds of services in the mobile basket?

(4) Many foreign countries offer tax incentives to "pioneer industries" that establish manufacturing facilities within those countries (similar to what Puerto Rico and the U.S. Virgin Islands offer on a more limited basis). Does the broad, rate base low-taxed subpart F threshold have the effect of penalizing companies that invest in those economies?

(5) We recommend issuing detailed transition guidance with respect to FTCs carried forward in different baskets. In addition, please provide detailed guidance with respect to overall domestic loss recapture.

4. Section 4104 – Source of income from sales of inventory determined solely on basis of production activities

Proposal

Section 4104 of the Proposal provides that income from the sale of inventory produced by the taxpayer within and sold without the U.S., or produced by the taxpayer without and sold within the U.S., is sourced solely on the basis of the location of production activities.

- In the case of inventory produced entirely within the U.S. and exported to foreign customers, the income is sourced entirely within the U.S. In the case of inventory property produced entirely outside the U.S. and imported into the U.S., the gross profit is sourced entirely foreign. Gross profit from the sale of inventory produced by the taxpayer partly within and partly without the U.S. is sourced partly in the U.S.

AICPA Comments/Observations

(1) This provision could have a significant effect on U.S. exporters of U.S.-manufactured products, and foreign companies that sell foreign-manufactured products to U.S. customers. The proposal would not apply to companies that act solely as distributors (i.e., that purchase products and resell them in their own name) but only where the company that produced the products sells them in a cross-border context. For most of those companies, the "title passage" rule would continue to apply, subject to the special exceptions and rules in IRC sections 861-865 and in the regulations thereunder.

(2) With respect to U.S. exporters, the Proposal overrides Treas. Reg. § 1.863-3(b)(1), which permits the classification of 50% of the gross profit from export sales as foreign-source if title and risk of loss pass to the customer outside the U.S., even if no foreign income tax is imposed on the sale. Thus, it is possible to argue that the proposal is fair, because it avoids the "windfall" that often results in the creation of untaxed foreign-source general basket income with respect to export profits. However, if the U.S. exporter is subject to foreign income tax in the country where sales take place, the Proposal is overly harsh because it would effectively deny a foreign tax credit for the foreign tax on the sales, unless the exporter has excess foreign tax credits from other foreign operations. However, if the foreign country has a comprehensive income tax treaty with the U.S. and if the U.S. exporter has a sales office there that is taxable as a permanent establishment, in most cases a foreign tax credit is allowed under the treaty despite the provisions of U.S. law.

The AICPA suggests revising the Proposal to allow treating the sales portion of the gross profit as foreign-source if one or more foreign countries impose income tax (not sales tax or value added tax) on the exporter. We suggest using a minimum prescribed rate of tax, only if a foreign tax credit is not available under a tax treaty (compare IRC sections 865(e)(1)(B) and 865(g)(2)). This type of relief provision is also consistent with the various incentives in the Code during the past fifty years to encourage exports.

(3) Where a foreign manufacturer sells products to U.S. customers and title and risk of loss pass within the U.S., the "force of attraction" rule in IRC section 864(c)(3) taxes the sales portion of the gross profit as ECI if the foreign seller is engaged in a U.S. trade or business (ETBUS). If title and risk of loss pass to the U.S. customer outside the U.S., it is possible to tax the sales portion of the gross profit taxed as ECI if the seller has an "office" in the U.S. to which the sales are "attributable" under IRC section 864(c)(4) and (5) (See example (1) in Treas. Regs. § 1.863-6(c)(3)). Section 4104 of the Proposal would eliminate the "force of attraction" rule in IRC section 864(c)(3) where a foreign manufacturer sells goods to U.S.

customers and where title and risk of loss pass to U.S. customers, and where the seller has no U.S. "office." To that extent, the Proposal is positive, because it would eliminate a "trap for the unwary seller." Where the foreign company has a U.S. "office" to which sales are "attributable" under IRC sections 864(c)(4) and (5) of current law, the Proposal would presumably eliminate U.S. income tax on any portion of the income as well.

(4) A rule which is comparable to the Proposal already exists with respect to natural resources that are extracted within one country and sold within another (See Treas. Reg. § 1.863-1(b) and the examples thereunder). Those rules provide in general that income from mineral products that are extracted in one country and sold to customers in another is sourced entirely in the country of extraction. The Proposal in section 4104 would apparently apply to mining companies as well as to manufacturers, because it applies to all "inventory property" on the basis of "production activities." However, the Congressional committee reports should clarify this rule's application.

<u>Subtitle C – Rules Related to Passive and Mobile Income, Part 1 – Modification of Subpart F Provisions</u>

1. Section 4201 – Subpart F income to only include low-taxed foreign income

<u>Proposal</u>

Section 4201 of the Proposal provides an exclusion from Subpart F for certain high-taxed income as follows:

- Foreign base company income and insurance income does not include items of income received by a CFC that are subject to a foreign effective tax rate greater than or equal to the maximum U.S. corporate rate.
- Foreign base company income does not include foreign base company sales income if the income is subject to a foreign effective tax rate greater than or equal to 50% of the maximum U.S. corporate tax rate.
- Not included in foreign base company intangible income (described below) are items of income received by the CFC that are subject to a foreign effective tax greater than or equal to the U.S. tax imposed on the income.

<u>AICPA Comments/Observations</u>

(1) It appears that the intent of the 95% DRD provision and this provision is to address the "lock-out effect" as a result of the current rules but without creating an unrealistic "cliff effect" (a situation where U.S. tax is either 0% or 25%, with the choice based entirely on a foreign government's decision on a tax rate on income that is either above or below a fixed, arbitrary threshold). Please explain the tax policy reason for establishing three different "foreign tax rate" thresholds (12.5% for FBCsalesI, 15% for FBCII, and 25% for other categories of foreign base

company income), for excluding CFCs' income items from Subpart F, in place of the current 90%-of-the-U.S.-rate threshold.

2. Section 4202 – Foreign base company sales income

Proposal

Section 4202 of the Proposal provides an exclusion from foreign base company income for 50% of income that is otherwise foreign base company sales income and for 100% of income that is otherwise foreign base company sales income if the CFC is "eligible as a qualified resident [of a treaty country] for all the benefits of a comprehensive tax treaty with the United States."

- The taxes paid by the CFC with respect to the 50% excluded portion are eligible for FTC treatment as deemed-paid taxes.

AICPA Comments/Observations

(1) Why does the Proposal reduce the U.S. tax rate on FBCsalesI to 12.5%, while FBCsrvcsI remains taxed at 25%?

(2) Please explain the purpose behind the proposed treaty exception, especially since there is no similar exception for FBCsrvcsI or FBCII that is realized by a CFC in a treaty country (and where the foreign ETR is below the relevant safe harbor rate). Is the intention to treat FBCsalesI more favorably than other types of foreign base company income, perhaps based on the fact that few (if any) of the other developed countries with CFC rules of their own are applying those rules to income that is classified as FBCsalesI under U.S. law?

(3) If the same exception is available if a treaty country offers a zero tax rate as a "tax incentive" for a DC's CFC to establish a sales office in the country, would that not place a CFC sales company in an even more favorable position than a CFC that realized FBCsrvcsI or FBCII?

(4) How does the exclusion of 50% of FBCsalesI interact with IRC section 959, particularly if all of the FTCs are allowed under IRC section 960? Is the excluded portion eligible for the DRD when distributed, or is it treated as PTI?

3. Section 4203 – Inflation adjustment of *de minimis* exception for foreign base company income

Proposal

Section 4203 of the Proposal provides inflation adjustments for the Subpart F *de minimis* exception.

AICPA Comments/Observations

The AICPA has no comments on section 4203 of the Proposal at this time.

4. **Section 4204 – Active finance exception extended with limitation for low-taxed foreign income**

Proposal

Section 4204 of the Proposal provides a modification and extension for five years of the active financing exception to Subpart F income.

- Qualified banking or financing income or qualifying insurance income of a qualifying insurance company that is subject to a foreign ETR of at least 50% of the maximum U.S. corporate rate is excluded from foreign personal holding company income.
- 50% of qualified banking or financing income or qualifying insurance income of a qualifying insurance company that is subject to a foreign ETR of less than 50% of the maximum U.S. corporate rate is excluded from foreign personal holding company income.
- The taxes paid by the CFC with respect to the 50% excluded portion is eligible for FTC treatment as deemed-paid taxes.

AICPA Comments/Observations

Please provide the policy reason for not making this provision permanent in order to provide more certainty to taxpayers and potential investors.

5. **Section 4205 – Repeal of inclusion based on withdrawal of previously excluded subpart F income from qualified investments**

Proposal

Section 4205 of the Proposal repeals section 955, which imposes current U.S. tax on previously excluded foreign shipping income of a CFC if there is a net decrease in qualified shipping investments.

AICPA Comments/Observations

The AICPA has no comments on section 4205 of the Proposal at this time.

Subtitle C – Rules Related to Passive and Mobile Income, Part 2 - Prevention of Base Erosion

1. **Section 4211 – Foreign intangible income subject to taxation at reduced rate; intangible income treated as subpart F income**

Proposal

Section 4211 of the Proposal provides that foreign income deemed intangible income is taxed on a current basis at a reduced rate of tax, regardless of whether the income is earned by a DC directly or is earned indirectly through an interest in a CFC. Deemed intangible income includes:

- FBCII of a CFC, and
- Foreign intangible income of a DC.

Certain income of a CFC is treated as a new category of Subpart F income, which is FBCII.

- FBCII is the excess of adjusted gross income of the CFC less 10% of the adjusted basis of certain tangible assets, reduced by allocable deductions.
- FBCII is reduced by the "applicable percentage" of the CFC's foreign personal holding company income, FBCsalesI, FBCsrvcsI, and foreign base company oil related income.
    - The applicable percentage is the excess of the CFC's adjusted gross income (AGI) over 10% of the CFC's adjusted basis in depreciable tangible property, divided by the total AGI of the CFC.
- FBCII is Subpart F income only to the extent that the income is subject to a foreign effective tax rate (ETR) that is lower than the effective U.S. tax rate imposed on the income after taking into account the deduction for foreign intangible income (described in the next major bullet).
    - All FBCII is treated as a single item of income for purposes of this foreign ETR test.

The Proposal would provide a deduction for a DC with respect to its FBCII and to the foreign percentage of the DC's "intangible income."

- The DC's intangible income is computed in the same manner as the FBCII of a CFC.
- A DC's foreign percentage equals the ratio of the foreign-derived AGI over the DC's total AGI for the taxable year.
- "Foreign-derived AGI" equals gross income derived in connection with:
    - Property which is sold for use, consumption, or disposition outside the U.S. ("foreign sales gain"), or
    - Services provided with respect to persons or property located outside the U.S. ("foreign services income").
- The deduction results in a reduced tax rate of 15% (when fully phased in) on FBCII of a CFC, as well as on foreign intangible income realized directly by a DC (i.e., not through a CFC).

AICPA Comments/Observations

(1) It appears that this provision is a substantially modified version of Option C from the 2011 House Committee on Ways and Means tax reform discussion draft.

(2) The amount that is deemed foreign intangible income is not necessarily the same as the amount of separately measured foreign source income that is generated by intangibles. Restated, income related to property or services may not need to have a direct link to intangible property (IP) in order to qualify for the 15% rate. The deemed intangible income is simply an amount of earnings that is above the 10% return threshold on fixed assets. It appears that the formulary approach utilized in the Proposal is a response to comments regarding the subjective approach taken in the 2011 discussion draft, which requires an analysis of the facts to determine to what extent the CFC's profits are actually attributable in part to some kind of intangible property, for determining foreign intangible income.

(3) This provision appears to approximate the amount of intangible income of a company by subtracting return on tangible assets from income, thereby making any residual earnings return on intangible assets. It appears that the 10% of the adjusted basis of certain tangible assets is a proxy for the return on tangible assets. Consider whether the residual method is the best method to estimate the intangible income of a company. The residual amount may, for example, represent risk and other factors that are not historically defined as intangible assets under the IRC. In addition, consider whether the 10% of the adjusted basis of fixed assets is an equitable measurement of return on fixed assets. An asset that has been fully depreciated for tax purposes, for example, could continue to generate income. In this respect, consider an option that would permit the use of fair market value of fixed assets.

This provision, as drafted, would likely cause inclusion by a U.S. shareholder of a substantial portion of income from CFCs that is subject to a foreign ETR of less than 15%. Consider whether it is possible to view the intentionally broad base of FBCII as a *de facto* minimum tax, similar to the proposed 19% tax on the current E&P of all CFCs that has been proposed in the Administration's Fiscal Year 2017 Revenue Proposal.

(4) Income from manufacturing, from selling (for example, in the case of a pure distributor that did not deal with related companies such as a smart "arbitraging" company), and services that are not FBCsrvcsI, are treated as FBCII whenever the foreign tax rate was less than 15% and whenever the 10% return on fixed assets did not provide a shelter from FBCII. Although a CFC that generated profit in these areas could have some kind of IP that it had acquired from a related company in order to justify its profit, it is also possible to attribute the high profitability to transactions or factors that are not motivated by shifting of income out of the U.S. Any valuable IP could have been acquired (either indirectly through an acquisition of a foreign owned business or by outright purchase), or it could have been developed by the CFC itself with no assistance from any related party.

Alternatively, there are many other reasons why the CFC earns a substantial profit despite the fact that it has little or no IP and is not required to pay fees to any related companies under IRC section 482. As such, this provision, as an anti-income shifting provision, appears overly broad and is punitive to any offshore ownership of IP by U.S. based groups regardless of any motivate for shifting income from the U.S. In contrast, the Administration's Fiscal Year 2015 Revenue Proposals limits its "excess return on intangibles" proposal to CFCs that exploits IP transferred from related U.S. persons and does not apply that concept to other kinds of companies.

In addition, consider whether the ETR is an effective measure of abusive tax structures and whether it effectively curbs base erosion.

(5) The reduction of FBCII by the applicable percentage of other Subpart F income is to prevent double-counting of income that is currently subject to tax in the U.S.

(6) Are losses in this FBCII category available for carry-forward to offset future income in this category of subpart F income?

(7) We note that the 15% rate on foreign intangible income of a DC is similar to a "patent box" regime. In a report released by Senate Finance Committee Republican Staff in December 2014[3], a patent box is described as a tax incentive that takes the form of a reduced corporate income tax rate on certain income arising from the exploitation of IP. The report suggested that a territorial tax system might create greater incentives for U.S. multinational corporations to migrate IP abroad and that a patent box could serve as a "carrot" to incentivize U.S. multinational corporations (USMNCs) to retain ownership of IP in the U.S.

This provision defines foreign-derived AGI as gross income derived in connection with (1) foreign sales gain, or (2) foreign services income.

Consider including foreign source income from licenses and leases in determining foreign-derived AGI.

2. Section 4212 – Denial of deduction for interest expense of United States shareholders which are members of worldwide affiliated groups with excess domestic indebtedness

<u>Proposal</u>

Section 4212 of the Proposal provides a "thin capitalization" rule which would deny a deduction for a portion of a DC's net interest expense.

- Applicable if the DC fails to meet both a "relative leverage test" and a "percentage of adjusted taxable income (ATI) test."

[3] Refers to the Comprehensive Tax Reform for 2015 and Beyond, by the United States Senate, Republican Staff Committee on Finance, December 11, 2014. http://www.finance.senate.gov/newsroom/ranking/release/?id=0df91455-c895-49b4-9044-d8fd9873b1dc.

- Under the relative leverage test,
  - All domestic members of the worldwide affiliated group are treated as a single member to determine whether the group has "excess domestic indebtedness";
  - Excess domestic indebtedness equals the amount by which the debt to equity ratio of the U.S. domestic members exceeds 110% of the aggregate debt to equity ratio of the worldwide affiliated group; and
  - Ownership interest in a FC group member held by a DC group member is disregarded when determining the assets of the DC.
- Under the ATI test, the interest potentially disallowed equals the excess (if any) of the net interest expense over 40% of the adjusted taxable income of the DC.
- Any disallowed interest equals the lesser of a DC's interest expense that (i) is attributable to excess domestic indebtedness or (ii) is in excess of 40% of ATI.
- A carryforward of disallowed interest expense is permitted.
- Any amount disallowed under this provision reduces the disallowance under the earnings stripping rules of section 163(j).

<u>AICPA Comments/Observations</u>

(1) This thin capitalization rule applies to interest paid by a DC to both related parties and to unrelated parties (third parties). The rule is applicable to a DC that is a U.S. shareholder with respect to any CFC. The Proposal does not apply to a wholly domestic group. The Proposal could apply to foreign-owned U.S. affiliated groups that own CFCs (i.e., the so-called "sandwich structures"), but the reference to section 864(f)(1)(C) would exclude non-CFC foreign affiliates from the term "worldwide affiliated group."

(2) In general, it appears that multinational corporations that centralize their worldwide financing through a U.S. group member are not able to deduct all of the U.S. group member's interest expense.

(3) The value of assets is determined based on the adjusted basis for purposes of determining gain (see IRC section 163(j)(2)(C)(i)). Consider whether it is appropriate to permit the use of foreign tax basis for ease of compliance.

(4) Unlike IRC section 163(j), which focuses on interest paid to foreign related persons or to unrelated persons when a related foreign person provides credit support, the Proposal includes interest paid to related and unrelated persons, regardless of foreign or domestic. The Proposal focuses on the interest deductions of DCs that are part of a U.S. corporate group that is not foreign-owned. IRC section 163(j), in contrast, lacks a relative leverage test and focuses on the U.S. group itself. A coordination rule is provided between this provision and IRC section 163(j).

(5) Consider providing a de *minimis* interest expense exception for all taxpayers.

(6) Consider an exception where all group debt (other than for a de *minimis* amount) that is with unrelated parties would exempt the group from these rules.

(7) Consider providing an exception for small multinational groups with, e.g., under $10 million in sales.

<u>Title III – Business Tax Reform</u>

<u>Subtitle G – Pass-Thru and Certain Other Entities</u>

Part 3 – REITs and RICs

1. Section 3648 – Interests in RICs and REITs not excluded from definition of United States real property interests

<u>Proposal</u>

Section 3648 of the Proposal amends the five-year Foreign Investment in Real Property Tax Act of 1980 (FIRPTA)[4] "cleansing rule" of IRC section 897(c)(1) to provide that it would not apply to a real estate investment trust (REIT) that disposed of its U.S. real property interest (USRPIs) pursuant to distributions for which it was eligible for the dividends paid deduction.

<u>AICPA Comments/Observations</u>

The AICPA has no comments with respect to section 3648 of the Proposal at this time.

2. Section 3649 – Dividends derived from RICs and REITs ineligible for deduction for United States source portion of dividends from certain foreign corporations

<u>Proposal</u>

Section 3649 of the Proposal provides that the DRD that is currently allowed to a DC under IRC section 245 with respect to dividends from a FC that receives dividends from an 80%-or-more owned U.S. subsidiary of the foreign payor, does not apply to the extent that the foreign payor received dividends from a U.S.-incorporated regulated investment company (RIC) or REIT.

<u>AICPA Comments/Observations</u>

The AICPA has no comments with respect to section 3649 of the Proposal at this time.

<u>Subtitle G – Pass-Thru and Certain Other Entities</u>

Part 4 – Personal Holding Companies

[4] Refers to The Foreign Investment in Real Property Tax Act of 1980, enacted as Subtitle C of Title XI ("the Revenue Adjustments Act of 1980") of the Omnibus Reconciliation Act of 1980, Pub. L. No. 96-499, 94 Stat. 2599, 2682, (December 5, 1980).

1. **Section 3661 – Exclusion of dividends from controlled foreign corporations from the definition of personal holding company income for purposes of the personal holding company rules**

Proposal

Section 3661 of the Proposal excludes dividends received by a DC from a CFC in which it is a "United States shareholder" from the definition of "personal holding company income" (PHCI) under IRC section 543. Although the dividends are excluded for personal holding company (PHC) purposes, the dividends remain subject to regular corporate income tax in the hands of the U.S. shareholder company.

AICPA Comments/Observations

(1) Under present law there is no category of dividends that is excluded from PHCI under IRC section 543. Presumably, this provision is intended to prevent dividends that are eligible for the proposed section 4001 DRD from being potentially taxed at the 20% PHC rate under IRC section 541. The Proposal would apparently not apply to Subpart F income that is taxed to a corporate U.S. shareholder under section 11, because Subpart F income is not a "dividend" for PHC purposes; thus, Subpart F income is already excluded from PHCI under present law.

(2) The Proposal appears intended to prevent dividends that are eligible for the proposed section 4001 DRD from becoming potentially subject to PHC tax. The AICPA recommends extending the provision to include dividends from 10-50 companies that are also eligible for the DRD.

Subtitle H - Taxation of Foreign Persons

1. **Section 3701 – Prevention of avoidance of tax through reinsurance with non-taxed affiliates**

Proposal

Section 3701 of the Proposal limits deductions by U.S. insurance companies for reinsurance premiums paid to affiliated corporations that are not subject to U.S. taxation.

AICPA Comments/Observations

The AICPA has no comments on section 3701 of the Proposal at this time.

1. **Section 3702 – Taxation of passenger cruise gross income of foreign corporations and nonresident alien individuals**

Proposal

Section 3702 of the Proposal provides that passenger cruise ship income earned in U.S. waters is treated as income that is effectively connected with the conduct of a U.S. trade or business and subject to net basis taxation regardless of reciprocal exemptions.

AICPA Comments/Observations

The AICPA has no comments on section 3702 of the Proposal at this time.

2. Section 3703 – Restriction on insurance business exception to passive foreign investment company rules

Proposal

Section 3703 of the Proposal provides for narrowing of the insurance income exception for purposes of the passive income test for PFIC status.

AICPA Comments/Observations

The AICPA has no comments with respect to section 3703 of the Proposal at this time.

3. Section 3704 – Modification of limitation on earnings stripping

Proposal

Section 3704 of the Proposal modifies the IRC section 163(j) earnings stripping rules.

- The adjusted taxable income limitation is lowered to 40%.
- The carryforward of excess limitation is eliminated, with a grandfather rule for excess limitation accrued prior to the effective date.

AICPA Comments/Observations

(1) Please explain the policy reason to lower the threshold to 40%.

(2) Consider whether the reduced withholding rates provided for under tax treaties still affects this provision as it does under current law.

4. Section 3705 – Limitation on treaty benefits for certain deductible payments

Proposal

Section 3705 of the Proposal provides that treaty benefits for deductible payments to a related person are conditioned on the foreign parent also being eligible for U.S. treaty benefits.

- Deductible payments of fixed or determinable, annual or periodical (FDAP) income made by a U.S. person to a foreign, related payee is not eligible for a treaty-based withholding tax reduction if the U.S. person and the foreign payee are under the common control of a foreign parent that is not eligible for a reduction of withholding tax under a U.S. treaty.
- Control is defined as greater than 50% direct or indirect ownership.
- The amount of the treaty reduction in the parent jurisdiction is irrelevant when determining whether a payment is eligible for treaty benefits.

AICPA Comments/Observations

(1) This provision may unilaterally override all existing income tax treaties. Consider whether it is more appropriate to address this issue by renegotiating all bilateral treaties.

Miscellaneous Proposals

This section discusses various provisions which directly apply to certain international operations, or which were not drafted with international transactions in mind but which could have a significant effect on certain kinds of cross-border taxpayers. These Proposals are not discussed in the Technical Explanation of the Tax Reform Act of 2014.[5]

Title I – Tax Reform for Individuals

Subtitle E – Deductions, Exclusions, and Certain Other Provisions

1. Section 1401 – Exclusion of gain from sale of principal residence

Proposal

Section 1401 of the Proposal changes the period during which the seller of a principal residence must occupy it in order to claim the $250,000/$500,000 exclusion, from 2 out of the prior 5 years, to 5 out of the prior 8 years.

AICPA Comments/Observations

(1) The Proposal reinstates the 5-out-of-8 year principal residence holding period that was applied under section 121 prior to 1978. However, until 1997 the IRC section 121 exclusion was only available to individuals age 65 and older. Prior to 1997, the tax relief available to individuals below age 65 from the sale of their principal residence, was the "rollover" rule in IRC section 1034. This rule did not require the

[5] Refers to the Technical Explanation of the Tax Reform Act of 2014, a Discussion Draft of the Chairman of the House Committee on Ways and Means to Reform the Internal Revenue Code: Title VIII – Deadwood and Technical Provisions, as prepared by the Staff of the Joint Committee on Taxation on February 26, 2014, JCX-19-14 https://www.jct.gov/publications.html?func=startdown&id=4561.

seller to have occupied the property as their principal residence for any prescribed period of time (it was only necessary that the property qualify as the seller's principal residence on the date of sale).

Section 1034 did not exclude gain from the sale from the seller's gross income, but instead permitted the seller to roll over the tax basis in the sold property to the principal residence that replaced it. However, in order to qualify for the tax-free rollover of basis in the property being sold, the seller was required to occupy the "replacement residence" for at least 2 years. When section 1034 was repealed in 1997, taxpayers of all ages became eligible for the IRC section 121 exclusion, provided that the seller had occupied the property as a principal residence for 2 out of the prior 5 years.

We have concerns with the Proposal with respect to individual taxpayers of all ages, and particularly taxpayers who are not yet retired, because neither IRC section 1034 nor IRC section 121 has ever required that the taxpayer occupy the principal residence for more than 2 years in order to qualify for tax relief with respect to gain on the sale of the residence (except for the limited 5-year rule for elderly sellers prior to 1978).

In view of the mobility of the U.S. workforce, extending the required period of occupancy from 2 years to 5 years would result in hardship for a substantial number of individuals who change jobs that they have held for more than 2 years but less than 5 years, and where the change in employment requires them to move to another part of the country (although IRC section 121(c)(2) allows the proration of the exclusion where the sale is related to a job relocation, extending the required occupancy period to 5 years will further reduce the amount of the pro-rated exclusion in those situations).

However, this provision may result in an overly harsh burden on employees who move to a foreign country. Many U.S. citizens and residents who are transferred abroad by their employers retain ownership of their principal residence in the U.S. (usually by renting it out), in the expectation of moving back into that property at the end of their foreign assignment. Frequently, however, their employer transfers them back to the U.S. to a different location, thereby requiring the employee to sell their U.S. residence.

Please provide an explanation for the policy reason for such a dramatic change to IRC section 121 considering the mobility of a global/domestic workforce in today's market.

2. <u>Section 1412 – Repeal of deduction for moving expenses</u>

<u>Proposal</u>

Section 1412 of the Proposal repeals the deduction for moving expenses under IRC section 217. However, the requirement in IRC section 82 that moving expense reimbursements are included in gross income is retained. Presumably a deduction in most cases under IRC section 162 is allowed as a substitute for the repeal of IRC section 217.

<u>AICPA Comments/Observations</u>

(1) Although the Proposal is possibly defensible as a revenue-raiser with respect to individuals who change job locations within the U.S., it could impose an excessive cost burden on U.S. companies that transfer employees from the U.S. to foreign countries, and vice versa. Because these types of transfers are usually more expensive than wholly domestic transfers and because the cost is usually borne by the employer (subject to a "tax gross-up" for reimbursements that are not tax-deductible by the employee), the Proposal could make U.S. companies even less competitive internationally are as a result of the present rules on taxation of their foreign income.

A compromise supported by the AICPA is to apply the proposed new rule to international assignment transfers only when the individual makes a job-related move to or from a contiguous country (Canada or Mexico) or to or from a Caribbean location.

<u>Subtitle F – Employment Tax Modifications</u>

1. Section 1503 – Repeal of exemption from FICA taxes for certain foreign workers

<u>Proposal</u>

Section 1503 of the Proposal repeals the Federal Insurance and Contributions Act (FICA) exemption for foreign agricultural workers and for most foreign students and "exchange visitors" who are temporarily within the U.S. (F-, J- M-, and Q-visa holders).

<u>AICPA Comments/Observations</u>

(1) It is believed that the exemption for F- and J-visa holders (later extended to M- and Q-visa holders) was established in the 1950s or early 1960s as part of the "Fulbright program." The FICA exemption was included because under the social security program as it then existed, few of the F- or J-visa holders would ever accumulate the 40 quarters of coverage required in order to become eligible for social security retirement benefits.

(2) Repealing the FICA exemption for these individuals would impose an additional cost on most of them, and would contravene various income tax rules in the Code (such as IRC sections 872(b)(3) and 1441(b)) that are intended to reduce the U.S. tax burden on these individuals. It would also contravene special exclusions from gross income that are included in most U.S. income tax treaties for the benefit of foreign students, teachers and trainees.

This provision could discourage many talented foreign individuals from seeking education or training within the U.S. Many of those individuals who do come to the U.S. for education or training eventually become U.S. permanent residents and citizens and make significant contributions to the U.S. economy (and when they become U.S. permanent residents or citizens, they generally begin paying substantial U.S. federal income tax and social security tax).

(3) We suggest reaching a compromise by limiting the Proposal to aliens who, immediately before coming to the U.S., are residents of a country that has a social security totalization agreement with the U.S. When they retire, they will take into account their quarters of FICA coverage for both U.S. and foreign social security benefit purposes.

(4) The AICPA has no comments on the proposed repeal of the FICA exemption for foreign agricultural workers at this time.