July 23, 2019

The Honorable Steven Mnuchin
United States Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Secretary Mnuchin:

We are writing with regard to the allocation of domestic expenses to Global Intangible Low-Taxed Income (GILTI) in light of the proposed GILTI regulations released on June 14, 2019.

The proposed GILTI regulations include a high-tax exception (HTE) that allows U.S. shareholders to elect, on an all-or-nothing basis, to exclude income subject to a foreign tax rate greater than 18.9 percent (i.e., 90 percent of the current 21-percent corporate tax rate) from GILTI. These proposed regulations would provide some relief to certain taxpayers and we appreciate the efforts of Treasury in promulgating this proposed rule. However, as discussed below, we continue to believe that a regulatory modification to the GILTI expense allocation rules is also needed to achieve congressional intent and avoid unintended harm to the U.S. economy.

As you know, Congress intended that GILTI apply to *low-taxed* income and the *Tax Cuts and Jobs Act* (TCJA) conference report states "[at] foreign tax rates greater than or equal to 13.125 percent, there is no residual U.S. tax owed on GILTI, so that the combined foreign and U.S. tax rate on GILTI equals the foreign tax rate." However, as explained below, notwithstanding the HTE, many taxpayers subject to foreign tax at a rate above 13.125 percent will remain subject to U.S. tax on GILTI as a result of the expense allocation rules in the proposed foreign tax credit regulations:

- For taxpayers all of whose income is subject to a foreign tax rate of between 13.125 percent and 18.9 percent, the HTE is not available and, for these taxpayers, every $100 of domestic expense allocated to GILTI increases U.S. tax on GILTI by $21.

- For taxpayers with pools of foreign income that are subject to foreign tax at rates that are both above and below 18.9 percent, expense allocation will cause GILTI to be owed where the average foreign tax rate after the HTE is 13.125 percent or more.

Thus, to achieve congressional intent, Treasury should promulgate regulations (in addition to the HTE) that limit the allocation of domestic expenses to GILTI in situations where it would result in excess foreign tax credits. This would prevent GILTI tax from being imposed on U.S. taxpayers with foreign tax rates of 13.125 percent or more. Draft regulatory language that would achieve this result is attached in Appendix A. Treasury's authority to issue these regulations is set forth in Appendix B.

We understand that some justify the allocation of domestic interest expense to the GILTI category because of concerns that, absent such allocation, U.S. companies with foreign operations will have an incentive to borrow disproportionately in the United States. We note that TCJA includes new section 163(j), which specifically addresses congressional concerns about excess domestic interest deductions. In addition, the reduction in the corporate tax rate from 35 percent to 21 percent substantially reduces the tax incentive to have disproportionate U.S. debt.

Not only are the GILTI expense allocation rules inconsistent with congressional intent, very importantly, they also will have adverse effects on the U.S. economy. No other country has a minimum tax like GILTI, so if implemented incorrectly, it will put U.S. jobs at risk because U.S. companies would:[1]

- Be less competitive in selling products and services in global markets than their foreign competitors and thus lose global market share;

- Be outbid by foreign companies in pursuing cross-border acquisitions;

- Be the target of foreign takeovers because their foreign operations can be conducted more tax efficiently by foreign-headquartered companies;

- Have an incentive to shift R&D, managerial jobs, and other activities that relate to the expense allocation regime outside of the United States; and

- Have an incentive to locate new manufacturing plants and other debt-financed facilities outside the United States so the interest expense would not be subject to the expense allocation rules.

The Tax Cuts and Jobs Act is an important step in strengthening our economy and creating U.S. jobs. To avoid undermining the positive impact of this historic legislation and to carry out congressional intent, we urge Treasury to fix the GILTI expense allocation rules in forthcoming regulations.

Sincerely,

Alliance for Competitive Taxation
American Forest and Paper Association
National Association of Manufacturers
National Foreign Trade Council
Retail Industry Leaders Association
U.S. Chamber of Commerce
United States Council for International Business

Attachments

Appendix A: Draft Regulatory Language

Appendix B: Treasury and IRS Have Broad Regulatory Authority to Address GILTI Expense Allocation

[1] These impacts were described in a March 27, 2019, *Wall Street Journal* article, "Tax Changes Hit Overseas Profits of Some U.S. Companies."

Appendix A
Draft Regulatory Language

Section 1.861-8 is amended by:

1. Adding paragraph (d)(3).
2. Adding to paragraph (g) Examples 34 and 35.

The additions read as follows:

1.861-8 Computation of taxable income from sources within and the United States and from other sources and activities

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(d)***

(3) Allocation and apportionment of deductions to the section 951A category.—For purposes of applying this section to section 904 as the operative section, deductions shall be allocated and apportioned in the following manner:

(i) First, deductions shall be allocated and apportioned in the manner prescribed in §§ 1.861-8 through 1.861-14 and 1.861-17 (without regard to this section).

(ii) Second, the amount of deductions allocated and apportioned (other than the deduction allowed under section 250(a)(1)(A)) to the section 951A category shall not exceed, the excess (if any), of--

(A) The taxpayer's gross income in the section 951A category reduced by the portion described in paragraph (e)(14) apportioned to the section 951A category, over

(B) The product of the taxpayer's entire taxable income (after application of the adjustment under §1.904(b)-3(a)(2)) multiplied by the ratio of the foreign income taxes within the section 951A category deemed to be paid by the taxpayer to the tax against which a credit for such taxes is taken.

The amount in the preceding sentence comprises a ratable portion of the deductions that would have been allocated and apportioned to the section 951A category but for this paragraph (d)(3).

(iii) Third, any deductions that would have been allocated and apportioned to the section 951A category but for this paragraph (d)(3) shall be allocated to the residual grouping.

(g)***

Example 34. Section 951A Category.

(i) **Facts.** X, a domestic corporation, wholly owns 100 percent of the single class of stock of M, a controlled foreign corporation (as defined in section 957(a) of the Code) for the entire taxable year. During the taxable year X had $940 of U.S. source gross income, $180 of foreign source of section 951A category income, a $20 amount included under section 78 assigned to the section 951A category and a $100 section 250 deduction apportioned to the section 951A category. In addition, X had other deductions, $30 of which were properly allocated and apportioned to the section 951A category and $10 of which were properly assigned to the section 245A subgroup. X was deemed to have paid $16 of foreign income taxes under section 960(d) with respect to the section 951A category. X's U.S. tax against which a foreign tax credit could be allowed was $210.

(ii) **Allocation and apportionment §§ 1.861-8 through -14 and 1.861-17.** The section 250 deduction is definitely related to the income to which it gives rise and is therefore allocated to the section 951A category. In addition $30 of deductions are properly allocated and apportioned to the section 951A category.

(iii) **Maximum allowable deductions allocated and apportioned to the section 951A category.** Under paragraph (d)(3) (ii) of this section, the maximum amount of deductions (other than the deduction allowed under section 250(a)(1)(A)) that would be allocated and apportioned to the section 951A category is calculated as follows:

Amount described in paragraph (d)(3)(ii)(A) ($180+$20-$100)	**$100**
Entire taxable income (after application of the adjustment under §1.904(b)-3(a)(2)) ($940+$180+$20-$100-$40+$10)	**1010**
Ratio of the foreign income taxes in the tested income group within the section 951A category deemed to be paid by the taxpayer to the tax against which such a credit for such taxes is taken. ($16/$210)	**7.619%**
Maximum amount of deductions allocated to the section 951A category (if any) ($100 – ($1010*7.619%))	**$23.05**

(iv) **Calculation of section 904(a) limit to the section 951A category.** Under the general principles of §§1.861-8 through -14 and §1.861-17 $30 of deductions are properly allocated and apportioned to the section 951A category. However, by operation of paragraph (d)(3), the maximum deductions allowed to be allocated and apportioned to the section 951A category is $23.05. X's calculates its section 904(a) limit for the section 951A category in the following manner:

Section 951A Category Income ($180+$20-$100-$23.05)	**$76.95**
Entire taxable income (including adjustment under §1.904(b)-3(a)(2) ($940+$180+$20-$100-$40+$10))	**1010**
United States income tax	**210**
Total amount of allowable credit for the section 951A category (($76.95/$1010) x $210)	**$16**

(v) **Disallowed deductions allocated to the residual.** The deductions not allocated and apportioned to the section 951A category due to application of paragraph (d)(3) of this section (**$30 – $23.05 = $6.95**) are allocated to the residual grouping.

Example 35. Section 951A Category.

(i) **Facts**: X, a domestic corporation, wholly owns 100 percent of the single class of stock of M, a controlled foreign corporation (as defined in section 957(a) of the Code) for the entire taxable year. During the taxable year X had $940 of U.S. source gross income, $160 of foreign source of section 951A category income, $40 amount included under section 78 assigned to the section 951A category and $100 of section 250 deduction apportioned to the section 951A category, In addition, X had other deductions $30 of which were properly allocated and apportioned to the section 951A category and $10 of which were properly assigned to the section 245A subgroup. X was deemed to have paid $32 of foreign income taxes under section 960(d) with respect to the section 951A category. X's U.S. tax against which a foreign tax credit could be allowed was $210.

(ii) **Allocation and apportionment under general §§ 1.861-8 through -14 and 1.861-17.** The section 250 deduction is definitely related to the income to which it gives rise and is therefore allocated to the section 951A category. In addition $30 of deductions are properly allocated and apportioned to the section 951A category.

(iii) **Maximum allowable deductions allocated and apportioned to the section 951A category.** Under paragraph (d)(3)(ii) of this section, the maximum amount of deductions (other than the deduction allowed under section 250(a)(1)(A)) that may be allocated and apportioned to the section 951A category is calculated as follows:

Section 951A Category Income ($160+$40-$100)	**$100**
Worldwide taxable income (including adjustment under §1.904(b)-3(a)(2) ($940+$160+$40-$100-$40+$10)	**1010**
Ratio of the product of X's inclusion percentage multiplied by the sum of all tested foreign income taxes in the tested income group within the section 951A category to the tax against which such credit is taken ($32/$210)	**15.238%**
Maximum amount of deductions allocated to the section 951A category (if any) ($100 – ($1010*15.238%))	**0**

(iv) **Calculation of section 904(a) limit to the section 951A category.** Under §§1.861-8 through -14 and §1.861-17 (without regard to paragraph (d)(3) of this section), $30 of deductions are properly allocated and apportioned to the section 951A category, which is greater than the maximum allowable amount calculated under paragraph (d)(3) ($0). X calculates its section 904(a) limit in related to the section 951A category in the following manner:

Section 951A Category Income ($160+$40-$100-$0)	**$100**
Worldwide taxable income (including adjustment under §1.904(b)-3(a)(2) ($940+$160+$40-$100-$40+$10)	**1010**
United States income tax	**210**
Total amount of allowable credit for the section 951A category ($100/$1010) * $210	**$20.79**

(v) **Disallowed deductions allocated to the residual.** The deductions not allocated and apportioned to the section 951A category due to application of paragraph (d)(3) of this section (**$30 – $0 = $30**) are allocated to the residual grouping.

Appendix B
Treasury and IRS Have Broad Regulatory Authority to Address GILTI Expense Allocation

This Appendix B illustrates that the Treasury Department and the IRS have ample authority to limit the allocation of U.S. shareholder expense to income in the GILTI foreign tax credit (FTC) basket so as to carry out the purposes of GILTI.

The GILTI Regime and Its Intended Effects

The *Tax Cuts and Jobs Act* (the "Act") includes an entirely new tax regime imposing a residual tax on a U.S. shareholder with respect to the global intangible low-taxed income (GILTI) of its controlled foreign corporations (CFCs). The legislative history of the Act discusses the GILTI regime as a protective measure, intended to protect against the erosion of the U.S. tax base by reducing incentives for corporate groups placing highly profitable operations in low-tax jurisdictions. The legislative history shows no concern with profitable operations located in high-tax jurisdictions.

A key element of the GILTI regime is the allowance of a credit for 80 percent of the CFC's foreign tax allocable to its GILTI. The House report, Senate explanation, and conference report for the Act consistently include language indicating that no residual tax should apply to foreign earnings subject to foreign tax above an effective rate threshold of 13.125 percent or more. The 80 percent foreign tax credit is an essential component of this effective rate calculation.

Extensive commentary submitted in connection with the GILTI regime and the related foreign tax credit rules illustrate that the allocation of U.S. shareholder expenses, not deducted under a CFC's foreign tax regime, to reduce GILTI will frustrate the intended effects of the GILTI regime if such allocation is not subject to appropriate limitations. This occurs under Section 904(a), which (taking into account the separate GILTI basket under Section 904(d)(1)(A)) limits GILTI foreign tax credits to a proportion of the U.S. shareholder's U.S. pre-credit tax that is the same as the ratio of its GILTI-basket taxable income to its entire taxable income. Such U.S. shareholder expenses generally may not be charged to CFCs under arm's length principles.

Sources of Regulatory Authority

The Code provides extensive regulatory authority for Treasury to limit the allocation of U.S. shareholder expense consistent with the purposes of GILTI. In particular, Section 864(e)(7)(G) specifically authorizes regulations providing that expense allocation under Section 864(e) "shall not apply for purposes of any provision of this subchapter to the extent the Secretary determines that the application of this subsection for such purposes would not be appropriate." Section 864 is broad, containing provisions entirely unrelated to expense apportionment as well as those relating to the apportionment of interest expense, research and experimental expense, and all other expenses. Section 864(e)(7)(G) expressly authorizes not applying the provisions of Section 864 at all, including those relating to the apportionment of interest expense and other expenses, where appropriate. Moreover, the broad authority granted by Section 864(e)(7)(G) may be exercised for the purposes of "any provision" of subchapter N of the Code, which would include Section 904(d)(1)(A). Thus, Section 864(e)(7)(G) expressly authorizes the Treasury and IRS to modify the apportionment of interest expense and other expenses solely with respect to the GILTI basket.

The authority granted under Section 864(e)(7) is not limited to the express grant in Section 864(e)(7)(G). Section 864(e)(7) generally authorizes rules necessary or appropriate to carry out the purposes of Section 864. The purposes of Section 864 extend to expense allocation and apportionment generally. In addition, Section 864(e)(7)(C) expressly authorizes regulations for apportioning expenses to Section 904(d) categories in a manner different than for other purposes, which would need to take into account the purposes of Section 904(d) including those articulated in the Act's legislative history with respect to GILTI.

More specific to the context of foreign tax credits, Section 904(d)(7) authorizes regulations to carry out the purposes of Section 904(d), which include the purposes of amended Section 904(d)(1)(A) (*i.e.*, the GILTI basket). This grant contemplates regulations that apply only for purposes of Section 904(d), and it contemplates regulations that can deviate from the general rules prescribed in regulations under other Code sections. One purpose of the new basket under Section 904(d)(1)(A) is similar to a purpose of the baskets introduced in the *Tax Reform Act of 1986*, which also introduced Section 904(d)(7), to prevent averaging foreign taxes across different categories of income. But another purpose of this new GILTI basket, distinctly articulated in the Act's House report, Senate explanation, and conference report, is to identify whether a U.S. shareholder's GILTI is subject to foreign tax near or above the identified effective rate threshold and ensure residual U.S. tax is not imposed, or in the case of effective rates near the threshold is imposed smoothly, with respect to that GILTI. Section 904(d)(7) authorizes the Treasury and IRS to promulgate regulations to carry out this additional purpose of Section 904(d)(1)(A).

Lastly, Section 7805(a) authorizes all needful regulations for tax administration, which includes interpreting the term foreign-source taxable income under Section 862(b) to determine the appropriate manner for allocating expenses generally. It also authorizes interpreting the term "global intangible low-taxed income" in a manner consistent with its component term "low-taxed" and with the legislative history that expressly articulates the meaning behind that component of the term.

Based on these grants of regulatory authority, the Treasury and IRS could promulgate a regulation providing that expense allocation to the GILTI basket is limited, based on a determination of appropriateness guided by the purposes of GILTI. As indicated in very name of the regime, as well as in the legislative history, Congress intended GILTI to result in the imposition of U.S. tax on low-taxed income earned by foreign subsidiaries. Within GILTI, the foreign tax credit is simply a means to an end of ensuring current U.S. tax is imposed on excess returns earned by low-tax foreign subsidiaries, based on a simple annual "snapshot" of the earnings and associated taxes in the taxpayer's foreign subsidiaries. There is no indication that Congress intended to increase the economic burden borne by U.S. taxpayers on income earned through foreign subsidiaries that pay significant foreign tax. Indeed, the legislative history of the TCJA as well as the descriptor, "global intangible low-taxed income" strongly indicate otherwise. It is therefore entirely "appropriate," within the language of Sections 7805(a), 904(d)(7), and 864(e)(7), to limit allocation of U.S. shareholder expenses in a manner consistent with the purposes of GILTI.