The American Chamber of Commerce in Japan
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September 19, 2019

The Honorable Charles P. Rettig
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20044
Via Online Submission

Re: Proposed Rule REG-101828-19 — Guidance Under Section 951A (Global Intangible Low-Taxed Income)

Dear Commissioner Rettig:

The American Chamber of Commerce in Japan (ACCJ) was established in 1948 and currently has approximately 3,500 members from over 1,000 companies. A large number of those companies are Japanese and owned by American citizen and resident small and medium-sized business owners that are living in Japan, and thus meet the definition of controlled foreign corporations. The imposition of both GILTI and the one-time transition tax that resulted from the 2017 Tax Cuts and Jobs Act enactment has negatively impacted many of these small business owners, both in terms of the administrative burden with complying with the provisions, and in cases where the U.S. income tax could not be offset through the mechanisms available, in the cash position of their companies from paying the taxes due. We do not believe that this result was the legislative intent of Section 951A and appreciate the Service's efforts to develop a high tax exclusion election to Global Intangible Low-Taxed Income (GILTI). We would however, like to offer four recommendations where we feel the regulation could be improved to better serve its purpose. We respectfully request that you consider our below suggested comments; which would help ensure that U.S. business owners in Japan with an overall effective foreign tax rate exceeding 18.9 percent also benefit from the high tax exclusion.

1. <u>Requested modifications to the calculation of effective rate of tax for the high tax exclusion from GILTI to account for foreign net operating loss carryforwards.</u>

The Proposed Regulations calculate the effective rate of tax for the GILTI high tax exclusion election under §1.951A-2(c)(6) as follows:

> (iii) Effective rate at which taxes are imposed. For a CFC inclusion year of a controlled foreign corporation, the effective rate with respect to the controlled foreign corporation's tentative net tested income items is determined separately for each such item. The effective rate at which taxes are imposed on a tentative net tested income item is--
> (A) The U.S. dollar amount of foreign income taxes paid or accrued with respect to the tentative net tested income item, determined by applying paragraph (c)(6)(iv) of this section; divided by
> (B) The U.S. dollar amount of the tentative net tested income item, increased by the amount of foreign income taxes referred to in paragraph (c)(6)(iv) of this section.

While the above calculation in general serves as an effective test, controlled foreign corporations with a net loss carryover reflected on the foreign jurisdiction's income tax return may fail the test, even though the rate of tax in the foreign jurisdiction exceeds 18.9%.

The proposed GILTI regulations (REG-104390-18) confirm that a controlled foreign corporation must compute its tested income or tested loss as if it were a domestic corporation. It is unclear, however, whether a tested loss carryover can be used for GILTI purposes, and if the tested loss can be used, how the tested loss carryover from a prior year can be used to offset tested income in a later year. The inability to use a tested loss carryover would convert the income tax on the Global Intangible Low Tax Income inclusion to an effective tax on the receipts of the foreign corporation in years where a net operating loss carryover is used on the foreign jurisdiction's tax return, even if any income beyond the net operating loss carryover is taxed at a rate greater than 18.9%.

U.S. corporations may generally carry over a net operating loss to subsequent years. Extending this treatment to controlled foreign corporations and their U.S. shareholders is fair and equitable. Absent such treatment, if a U.S. shareholder of a CFC has a tested loss of $10,000 in year 1 and tested income of $10,000 in year 2, the U.S. shareholder receives no benefit from the year 1 loss. The foreign jurisdiction will likely allow the net operating loss carryforward to offset net operating income in the current year, resulting in reduced income taxes or no income taxes in the foreign jurisdiction, depending on the size of the loss. In these scenarios, if similar treatment is not allowed on the U.S. side for Section 951A purposes, the taxpayer will not meet the high tax exception, and even if the taxpayer makes a Section 962 election, the individual may also not have sufficient foreign income taxes to offset the U.S. tax on the GILTI income inclusion, even though any income beyond the net operating loss carryover is subject to an income tax rate in

excess of 18.9%. This result arises due to Section 951A income being included in its own category under Section 904(d)(1)(A) and the foreign tax credits in this category of income not carrying forward under Section 904(c).

While the U.S. shareholder has not recognized a cumulative economic benefit, the shareholder may still have a GILTI inclusion and pay U.S. tax on the inclusion. If a taxpayer is taxed during profitable periods without receiving any tax relief (e.g. a refund) during periods of net operating losses, the U.S shareholder residing in the foreign jurisdiction is put in a position worse than that of a shareholder residing in the U.S. The net effect of such a result, especially in the case of U.S. citizen and resident small business owners, may result in fewer U.S. taxpayers or shareholders engaging in business creation, as new businesses often incur losses in their formative years, and thus would cause the profits of later years to be subject to Section 951A. Alternatively, such U.S. persons may be forced to structure such businesses in a suboptimal manner to avoid being subject to the provisions of Section 951A. Current U.S. shareholders may be forced to cede control of their foreign corporations to non-U.S. partners to avoid application of Section 951A and the cash flow issues that arise from its application, resulting in a loss of revenue for Treasury through reduced dividends from the foreign corporation and reduced capital gains from the sale of the shares of the corporation, as well as the potential acquisition or control of what would otherwise be U.S. physical or intellectual property by the non-U.S. shareholders.

As such, the ACCJ suggests the following addition to the calculation of effective rate of tax for the high tax exclusion from GILTI:

> In taxable years which are affected by a net operating loss carryforward on the corporate tax return of the foreign jurisdiction, the numerator above be replaced with (A) The U.S. dollar amount of foreign income taxes that would have been paid or accrued with respect to the tentative net tested income item, determined by applying paragraph (c)(6)(iv) of this section had the net loss carryforward not been considered; divided by…

While the suggestion above does not perfectly ameliorate the effect of an annual accounting period imposed by Section 951A, the change will help adequately recognize the exigencies of business, and, reduce the instances of grave injustice that would otherwise be imposed by Section 951A, especially for small business owners who own a single foreign entity in order to conduct their business.

2. <u>Effective date of proposed regulation – retroactive to GILTI applicability date</u>

The Proposed Regulations provide that the GILTI high tax exclusion election is effective for taxable years of foreign corporations "beginning on or after the date of publication of the Treasury decision adopting these rules as final regulations in the Federal Register, and to taxable years of United States shareholders in which or with which such taxable years of foreign

corporations end." The ACCJ requests that the effective date be changed to the first date that a corporation is subject to Section 951A.

As noted in the preamble to the proposed regulations, the legislative history shows an intent to exclude high-taxed income from gross tested income. The proposed regulation 1.951A-2(c)(6) is designed to fix this problem, but in order to be fully achieve this purpose, the regulation should be effective for years beginning after December 31, 2017. Allowing taxpayers to make the election to apply the GILTI high tax exclusion retroactively would achieve the purpose of the GILTI high tax exclusion and ensure that tax years 2018 and 2019 would be treated consistently as future years.

For the reasons discussed above, we request that final regulations provide that taxpayers may elect to apply this GILTI high tax exclusion retroactively to tax years beginning after December 31, 2017.

3. Election to exclude the high tax GILTI income should be on an annual basis

The Proposed Regulations provide that the GILTI high tax exclusion election may be made or revoked at any time but once revoked, the U.S. shareholder cannot make the election again within sixty months following the close of the tax year in which the election was revoked, notwithstanding a change in control and permission from the Commissioner. Additionally, if a taxpayer chooses to make the election again after the sixty months have elapsed, the election cannot be revoked again within sixty months of the subsequent election.

The ACCJ respectfully requests that Treasury and IRS provide that the GILTI high tax exclusion election be made available annually. An annual election would help ensure that the legislative intent of Section 951A is served even if business conditions may change within the 60 month period. Also, an annual election would align timing of the GILTI high tax election with the timing in the Subpart F high tax exception election, both of which are based upon section 954(b)(4) and regulations thereunder (Reg. §1.954-1(d)) per the preamble to the Proposed Regulations.

4. Ability to elect application of the Exclusion on a Controlled Foreign Corporation by Controlled Foreign Corporation basis

The Proposed Regulations provide that if a CFC is a member of a controlling domestic shareholder group, the election applies with respect to each member of the controlling domestic shareholder group. See proposed §1.951A-2(c)(6)(v)(E)(1). The ACCJ requests that the election be made available to each CFC owned by a U.S. shareholder, rather than apply to all members of the controlling domestic shareholder group. As stated above, per the preamble to the Proposed Regulation, Treasury is relying on section 954(b)(4) as the authority for the GILTI high tax exclusion election, and the availability of such an election would also be consistent with Section 954. Section 954 allows the election for the high tax exception to be made on a CFC-by-CFC

basis. Thus, for consistency and alignment with Section 954, the same should apply under the high tax exclusion election for Section 951A.

We appreciate your consideration of these comments and welcome the opportunity to discuss these issues further. If you have any questions, please contact Anne Smith with our External Affairs Department at external@accj.or.jp.

Sincerely,

Peter M. Jennings
President
The American Chamber of Commerce in Japan

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