



August 31, 2005

The Honorable Bill Thomas
Chairman of the Ways and Means Committee
2208 Rayburn House Office Building
United States House of Representatives
Washington, DC 20515

The Honorable Charles Grassley
Chairman of the Finance Committee
135 Hart Senate Office Building
United States Senate
Washington, DC 20510

The Honorable Max Baucus
Ranking Minority Member of the Finance Committee
511 Hart Senate Office Building
United States Senate
Washington, DC 20510

Re: Tax Technical Corrections Act of 2005 – Corrections to Repatriation Provision

Dear Chairmen Thomas and Grassley and Senator Baucus:

The Organization for International Investment (“OFII”) appreciates your introduction of the Tax Technical Correction Act of 2005 in July. The enactment of this legislation will resolve a number of ambiguities in the American Jobs Creation Act of 2004 (“AJCA”), permitting taxpayers to move ahead with their tax compliance and planning.

This letter responds to the Committees’ request for comments on the proposed legislation. OFII respectfully requests that an additional technical correction relating to the repatriation provision in section 422 of the AJCA be included in the enacted legislation. The correction would clarify that loans from foreign parent companies and their foreign affiliates to related controlled foreign corporations (“CFCs”) are not related person indebtedness (“RPI”) within the meaning of section 965(b)(3) and that other cash transfers from foreign parent companies and their foreign affiliates to CFCs are not subject to the anti-abuse provision to the RPI limitation contained in the proposed technical corrections legislation. This clarification is essential so that the RPI limitation reduces section 965 benefits solely for the U.S.- funded dividends Congress intended and U.S. multinationals with foreign parents are treated in the same manner under section 965 as U.S. multinationals with U.S. owners.

Section 965 is intended to benefit *net* remittances of cash from CFCs to their U.S. shareholders. No net remittance of cash occurs if a CFC dividend is funded by a loan from its U.S. shareholder. To ensure that dividends eligible for the section 965 dividends received deduction

are not funded by a U.S. shareholder, Congress included the RPI limitation in section 965(b)(3). The Conference Report for the AJCA is very clear on the RPI limitation's purpose:

This [RPI] rule is intended to prevent a deduction from being claimed in cases in which the U.S. shareholder directly or indirectly (e.g., through a related party) finances the payment of a dividend from a controlled foreign corporation. In such a case, there may be no net repatriation of funds, and thus it would be inappropriate to provide the deduction.

Under the RPI limitation, to the extent that a majority U.S. shareholder has indebtedness outstanding to CFCs at the end of the year of a section 965 election in amounts greater than its indebtedness outstanding to CFCs as of October 3, 2004, the eligible dividend amount is reduced dollar-for-dollar.¹ To define "related person" indebtedness for purposes of the RPI limitation, Congress incorporated by cross-reference the related person definition routinely used for U.S. shareholders and CFCs for subpart F purposes. That definition, in section 954(d)(3), was drafted long before foreign-parented U.S. multinationals were common. The related person definition in section 954(d)(3), read literally, unfortunately encompasses not only majority U.S. shareholders of CFCs but their foreign parents and foreign subsidiaries of those foreign parents as well. The implication of this literal reading, which we believe was unintended, is that loans originating abroad -- made by foreign parents and their foreign subsidiaries -- to related CFCs are swept into the RPI definition and therefore may reduce section 965 benefits.

As indicated above, the RPI limitation is intended to police CFC borrowing from U.S. persons, not foreign persons. Just as CFC-to-CFC loans are generally excluded from the RPI definition, so too should loans from foreign parents (or their foreign subsidiaries) to CFCs generally be excluded since neither category of loan normally originates in the United States and, therefore, reduces net CFC remittances to the United States.

As drafted, the proposed technical corrections legislation would add an anti-abuse provision to the RPI limitation. The legislation would grant Treasury regulatory authority to prevent the avoidance of the purposes of the RPI limitation, including regulations providing that cash dividends shall not be eligible for section 965 benefits to the extent such dividends are attributable to the direct or indirect transfer (including through the use of intervening entities or capital contributions) of cash or other property from a related person to a CFC. Like loans from foreign parents or their foreign subsidiaries to CFCs, transfers of cash or other property from foreign parents or their foreign subsidiaries to CFCs, as long as not originating in the U.S., should not limit section 965 benefits.² The same is true for deemed capital contributions under

¹ The statutory language is: "The amount of dividends which would (but for this paragraph) be taken into account under subsection (a) shall be reduced proportionately for each shareholder by the excess (if any) of— (A) the amount of indebtedness of the controlled foreign corporation to any related person (as defined in section 954(d)(3)) as of the close of the taxable year for which the election under this section is in effect, over (B) the amount of indebtedness of the controlled foreign corporation to any related person (as so defined) as of the close of October 3, 2004. All controlled foreign corporations with respect to which the taxpayer is a United States shareholder shall be treated as 1 controlled foreign corporation for purposes of this paragraph." The initial measurement date may now be the nearest quarter-end to October 3, 2004, by taxpayer election. See Notice 2005-38, section 7.01(b)(vi).

² The proposed technical corrections legislation grants ample discretionary authority to the Service and Treasury to address any abuses that may arise involving loans and other property transfers from foreign parents to related CFCs. Specifically, the legislation allows the Service and Treasury to limit section 965 benefits in the case of *indirect* as well as direct funding of CFC dividends by U.S. shareholders. Under this authority, the Service and Treasury may,

the *Plantation Patterns*³ doctrine from foreign parents (or their foreign subsidiaries) that have guaranteed CFC debt. Such deemed capital contributions should be considered to go directly from the guarantor to the borrowing CFC and not through the intermediary U.S. parent.⁴

Many foreign-parented multinationals have CFCs with substantial earnings the repatriation of which section 965 was intended to encourage. The domestic reinvestment plan rules (at section 965(b)(4)) ensure that the amount of those repatriated earnings will be spent on permitted investments in the United States. As drafted, the RPI limitation will discourage foreign members of foreign-owned multinational groups from funding related CFC dividends otherwise eligible for section 965 treatment and, thus, thwart the purpose of the repatriation incentive and treat such groups unfairly.

In summary, the technical corrections legislation and accompanying explanatory language, should clarify that, when the parent company of a multinational group to which a CFC belongs is foreign: 1) the RPI limitation generally does not apply when CFC dividend funding is provided by a related foreign person; and 2) funding for CFC dividends may be provided by a related foreign person. The following technical correction language would accomplish this result:

Paragraph (3) of section 965(b) is amended by inserting “, except that no foreign person shall be considered a related person for purposes of this paragraph” after “section 954(d)(3)”.

Thank you for your consideration of this matter. If your staff has questions about this letter or we can otherwise be of further assistance, please have them call us.

Sincerely,

Todd M. Malan
President & CEO

Cc: David Noren, Legislation Counsel, Joint Committee on Taxation
Marc Gerson, Majority Tax Counsel, House Committee on Ways and Means
Chris Javens, International Tax Counsel, Senate Committee on Finance

on a discretionary basis, subject, for example, a foreign parent-to-CFC loan to the RPI limitation if it is funded indirectly by a U.S. shareholder via a loan or distribution from the U.S. shareholder to the lending foreign parent.

³ *Plantation Patterns, Inc. v. Commissioner*, 462 F.2d 712 (5th Cir. 1972).

⁴We recommend the points discussed in the last three sentences of this paragraph be included in the committee reports as examples of how Congress intends the grant of regulatory authority to be exercised by the Service and Treasury.