NATIONAL TAXPAYERS UNION

November 4, 2020

The Honorable Chuck Grassley, Chairman
The Honorable Ron Wyden, Ranking Member
Committee on Finance
U.S. Senate
Washington, DC 20510

The Honorable Richard Neal, Chairman
The Honorable Kevin Brady, Ranking Member
Committee on Ways and Means
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Grassley, Ranking Member Wyden, Chairman Neal, Ranking Member Brady, and Members of the Committees:

On behalf of National Taxpayers Union (NTU), I write to commend your Committees' attention to an important expiring tax provision known as the Section 954(c)(6) "Look-Through Rule." This portion of the law should be extended to prevent significant tax increases and planning challenges that could ensue for businesses as well as their employees and customers at a time when they can least afford them. As an organization which is committed to ensuring that tax laws function as intended for individuals and businesses, this communication is one of several that NTU is issuing on various expiring provisions.

During consideration of the Tax Cuts and Jobs Act (TCJA), NTU's concerns over tax reform for corporate and pass-through business entities were made clear: the laws then in existence were untenable, afflicted with high rates, poorly designed bases, mind-numbing complexity, immobility of investment, and uncompetitiveness with other systems abroad. TCJA made considerable progress toward remedying these problems, though only gradually. This is particularly true of international tax provisions because many of the rulemakings surrounding this area of law have taken affect sequentially – some of them as recently as this summer.

Since NTU last wrote Congress on the Look-Through Rule during 2019 (via the Senate Finance Task Force on Expiring Provisions), much has changed for the economy and the tax system due to COVID-19. The CARES Act has delivered important relief for business taxpayers and their employees and customers, through provisions such as the Employee Retention Tax Credit and Net Operating Loss carrybacks. The result has been to diminish some of the volatility that threatened to precipitate a deeper and more prolonged recession, or even a depression.

Section 954(c)(6) fits well with efforts to control such volatility, and should not be discarded when so many major American businesses face a critical planning juncture for their 2021 operations. These firms, already hampered by an unclear economic outlook for 2021, must make difficult decisions about how to structure their financial and human resource investments to remain viable. Congress should avoid creating additional tax planning headaches that could make such structuring much less efficient and more costly.

The Look-Through Rule, which was proposed in various iterations until enacted in 2006, addresses a highly technical but critical area of structural efficiency: how related Controlled Foreign Corporations deploy active earnings among themselves, by making clear that these transactions are not subject to U.S. corporate taxes under Subpart F. While the details here are obtuse to the average taxpayer, the underlying concept is simple: reduce the tax penalties for normal movements of investment, which must be particularly nimble in an economy constantly shifting in its reactions to the effects of COVID-19.

Furthermore, the legislative history of TCJA convincingly indicates that the Look-Through Rule was not left to wither because of conscious policy decisions that the provision was no longer useful or appropriate in the new international tax framework. Indeed, early House and Senate versions of the package did contemplate retaining Section 954(c)(6). Rather, a fair reading suggests that budgetary "scoring" rules might have been a large factor. While such conventions are important, in the case of the Look-Through Rule they have acted to impede

construction of a more solid, coherent approach to taxation of Controlled Foreign Corporations (CFCs) that Congress intended. In the interest of such stability, which is now at a premium in the pandemic era, the Look-Through Rule deserves prioritization in the international tax space.

Regardless, while the final version of TCJA signed into law did not enact a purely territorial tax system for CFCs (or their dividends), tax experts have noted the importance of the Look-Through Rule would have in ensuring the viability of such a massively redesigned system. Thus, in a less-than-purely territorial structure such as the one intended today, Section 954(c)(6) should assume an even *greate*r role as a reinforcing element. As David G. Noren, former Joint Tax Committee Counsel and current Partner at McDermott, Will & Emery wrote in 2012:

> One of the primary efficiency gains from adopting a territorial dividend exemption system would be to remove present-law distortions of cash-management decisions by eliminating (or significantly reducing) the tax drag on redeployments of foreign earnings in the United States. Under such a system, the Look-Through Rule would serve a critical function of ensuring that foreign earnings that are intended to be subject to exemption under the new system are not subjected to full U.S. tax as they are distributed up through a chain of CFCs. It would make little sense to go to the effort of adopting a territorial system only to limit the territorial approach to those active business earnings that happen to be generated at the first tier of CFCs.

Those who remain concerned about the potential of Look-Through Rule abuse should be encouraged by the fact that under TCJA, with its tightly-woven fabric of minimum tax provisions and anti-base erosion measures, there is actually less prospect for "gaming" today than there might have been prior to December 2017.

In NTU's estimation, the extenders process is a highly flawed method for making tax policy. While it is reasonable to consciously build "sunsets" into certain sections of the law so their effectiveness may be periodically evaluated, too often temporary tax provisions are employed for far less utilitarian ends. They become instruments of convenience when consensus over policies cannot be reached, or worse, bargaining chips to enlist support for bigger policy priorities.

However, Section 954(c)(6) and its predecessors are not necessarily "extenders" in the traditional sense. They were conceived as practical, bipartisan responses to unintended consequences in existing law that thwarted legitimate business decisions about how to arrange active earnings most efficiently among CFCs. Therefore, they more closely resemble "ongoing technical corrections." The temporary status of the current Look-Through Rule, as with its forebears, appears more likely a consequence of revenue impacts than its relevance.

Overall, the Look-Through Rule was designed not only to help mitigate some of the least competitive aspects of the U.S. tax system, but also to uphold the principle that tax consequences should generally not be the primary factor in making everyday business decisions. Both considerations should factor into Congress's policymaking now more than ever before. Taxpayers deserve the certitude that Section 954(c)(6) can help to provide, especially in a COVID-19 environment where all economic actors are struggling to maintain some sense of financial direction.

Should you have questions on these comments, or views NTU has expressed on other expiring areas of tax law, I am at your service. Thank you for your consideration.

Sincerely,

Pete Sepp
President

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