



International tax policy

Tashkent State University of Economics

Lecture 9



Planning Under Current Rules - Deferral

◎ US tax planners try to (and do)

- reduce foreign taxes below U.S. effective rate,
- defer U.S. tax on foreign income subject to low effective foreign income tax, and
- shift income to low-tax deferral environment

Planning Under Current Rules - Deferral

- ◎ Current transfer pricing rules allow income shifting to controlled foreign corporations in low-taxed countries
- ◎ No penalty for singles and doubles, only for swinging for the fences and getting caught

Planning Under Current Rules - Deferral

- ◎ Planning rewarded (examples):
 - *Dover* case affirms use of (retroactive) check-the-box planning to avoid Subpart F
 - *Hospital Corporation of America*, *UPS* other transfer pricing cases affirm nothing ventured, nothing gained approach to transfer pricing and tax planning; *DHL* case an exception

Planning Under Current Rules - Deferral

◎ Planning rewarded:

- In 2004, Congress passed homeland dividend tax relief to encourage repatriation of foreign earnings
- Untaxed earnings may be repatriated for one year at effective U.S. tax rate of 5.25% or less if reduced by foreign tax credits

Planning Under Current Rules – Foreign Tax Credits

- ◎ When income is taxed by U.S., tax planners try to (and do):
 - Generate low-taxed foreign income (using weak U.S. source rules), and
 - Use foreign tax credits from high-taxed foreign income to offset U.S. tax on low-taxed foreign income in same limitation category

Planning Under Current Rules – Foreign Tax Credits

- ◎ Low-taxed foreign income may be from either
 - activities in low-tax foreign countries, or
 - U.S. activities that generate income that Code allows to be treated as foreign income
- ◎ Low- and high-taxed income may be created by separating foreign taxes and income using U.S. tax planning techniques – “check-the-box” planning and more

Planning Under Current Rules – Foreign Tax Credits

- ◎ Planning rewarded (examples):
 - *Intel* case and subsequent regulations affirm source rule treating U.S. activity for export sales as foreign income
 - *Guardian Industries* case affirms use of check-the-box planning to split foreign taxes from foreign income
 - *Compaq* and *IES* cases affirm use of structured tax planning to trade foreign tax credits and weakness of anti-abuse doctrines

Assessment of Current Law

- ◎ Problems of current law are not difficult to diagnose
 - Effectively unlimited deferral offers too much of a rate differential for companies to resist – it is a hole in the system
 - Like water draining from a bathtub, U.S. multinationals are legally shifting increasing portions of their profits to low- or zero-tax foreign countries See Martin A. Sullivan, “U.S. Multinationals Move More Profits to Tax Havens,” 102 Tax Notes 690 (Feb. 9, 2004)

Assessment of Current Law

- ◎ Transfer pricing rules need adjustments, but the biggest need is smarter enforcement
- ◎ Weak source rules and broad cross-crediting high foreign taxes against U.S. tax on other “foreign” income under porous foreign tax credit limitation result in de minimis U.S. tax on repatriated foreign income

Assessment of Current Law

◎ Joint Committee on Taxation:

“The present-law system thus creates a sort of paradox of defects: on the one hand, the system allows tax results so favorable to taxpayers in many instances as to call into question whether it adequately serves the purposes of promoting capital export neutrality or raising revenue...”. (JCS-02-05; Jan. 27, 2005)