

Chairman’s Staff Request for Comments on Certain Technical and Policy Issues Raised in the Staff Discussion Draft

OPTION Y AND OPTION Z OF THE DISCUSSION DRAFT

1. Deduction for dividends received by domestic corporations from certain foreign corporations (sec. 1 of the Option Y discussion draft and new sec. 245A of the Code)

Request for Comments

The Chairman’s staff requests comments on the relative merits of using a dividends received deduction based mechanism for exempting foreign income as opposed to using an exemption system that treats exempt earnings as “previously taxed income” for purposes of applying section 959. The latter mechanism is used in the Option Z discussion draft.

2. Application of dividends received deduction to certain sales and exchanges of stock (sec. 2 of the Option Y discussion draft and secs. 964 and 1248 of the Code)

Request for Comments

The Chairman’s staff requests comments regarding the scope of the gain and loss rules in this provision. In particular, comments are requested regarding whether and to what extent an exemption from U.S. tax should be available for gain on CFC stock in excess of the section 1248 dividend. In addition, comments are requested regarding whether losses should be disallowed only to the extent that a United States shareholder received dividends from the CFC that were eligible for the section 245 100-percent dividends received deduction.

3. Inclusion of United States related income in subpart F income (sec. 3 of the Option Y discussion draft and secs. 952(a) and 955 of the Code)

Request for Comments

The Chairman’s staff requests comments regarding the scope of the United States related income rules. In particular, comments are requested regarding whether, as an alternative to the discussion draft proposal, income from U.S. markets should be taxed in the same manner as foreign market income (that is, treated as subpart F income only if it is passive income or low-taxed income) or should otherwise be limited based on other criteria.

4. Low-taxed income treated as subpart F income (sec. 4 of the Option Y discussion draft and secs. 952 and 956 of the Code)

Request for Comments

Under Option Y, an individual U.S. shareholder of a CFC with low-taxed income is generally allowed to take the deduction under new section 200 with respect to the subpart F income inclusion attributable to such low-taxed income. If, however, an individual U.S. shareholder receives a dividend attributable to non-subpart F income, under Option Y, such

individual is not allowed a dividends received deduction under section 245A. Nevertheless, such individual may be taxed at reduced rates under section 1(h)(11). In contrast, Option Z allows United States shareholders who are individuals to benefit from the exclusion for active foreign market income. Comments are requested regarding the application of the reformed international tax rules to non-corporate U.S. shareholders, including whether and to what extent section 1(h)(11), as it applies to dividends from foreign corporations, should be retained.

5. Repeal of foreign base company sales, services, and oil related income; modification of foreign personal holding company income (sec. 5 of the Option Y discussion draft and secs. 543 and 954 of the Code); Modifications to definition of subpart F income: active foreign market income (secs. 1(a), 1(b), 1(f) and 1(g) of Option Z discussion draft; secs. 951 through 959 of the Code)

Request for Comments

The Chairman's staff requests comments regarding the modifications to the foreign personal holding company rules under Option Y and the passive income rules in Option Z. In particular, comments are requested regarding whether a form of "CFC look-thru" rule should be retained and how such rule should interact with the low-taxed income rules. Comments are requested regarding the extent to which related party financing and licensing rules would facilitate cash management and other business operations of a multinational group.

In addition, comments are requested regarding the application of the foreign personal holding company income rules in Option Y and the passive income rules in Option Z to dealers, finance companies, and insurance companies, including whether such rules should be extended to putative dealers, finance, and insurance companies that are either in a start-up or wind-up phase of business. Comments are also requested regarding rules to address the application of these provisions to otherwise passive income arising following the acquisition of portfolios of loans, stocks, or securities. In addition, comments are requested on whether and to what extent related CFCs should be aggregated on a same-country basis or otherwise for purposes of applying any of these rules. With respect to the banking and financing rules, comments are requested regarding whether other categories of investment income, including income from hedging transactions undertaken in the ordinary course of an active banking or financing business, should be included in the definition of qualified banking and financing income and how any such provision should be administered.

6. Reform of foreign tax credit limitation (sec. 11 of the Option Y discussion draft and sec. 904(d) of the Code)

Request for Comments

The Chairman's staff understands that the reforms proposed in the discussion draft dramatically change the role of foreign tax credits and the amount of foreign source income available to support the foreign tax credit limitation. The staff requests comments on further changes to the foreign tax credit rules that could be made to address transition issues and to further simplify existing law in light of the proposed changes in either Option Y or Option Z. In particular, comments are requested regarding the application of the overall domestic loss and

overall foreign loss rules, including regarding the treatment of overall foreign loss and overall domestic loss accounts that carryover into post-effective date taxable years.

COMMON PROVISIONS DISCUSSION DRAFT

1. Treatment of previously deferred foreign income (sec. 31 of the Common Provisions discussion draft and sec. 965 of the Code)

Request for Comments

The Chairman's staff requests comments on whether and how deficits in the earnings and profits of controlled foreign corporations could be taken into account in computing the aggregate tax under section 965. In addition, comments are requested on the appropriate treatment under the provision of so-called "hovering deficits" in earnings and profits arising under section 381.

In addition, it should be noted that amended section 965 only applies to corporate U.S. shareholders. Comments are requested regarding whether this treatment is appropriate if non-corporate U.S. shareholders are allowed an exemption for certain controlled foreign corporation income, whether under Option Z or otherwise.

2. Prevent avoidance of U.S. tax through reinsurance with nontaxed affiliates (sec. 82 of the Common Provisions discussion draft and new sec. 849 of the Code)

Request for Comments

The Chairman's staff requests comments regarding alternative means of addressing outbound, related party reinsurance premiums. The staff understands that risk spreading is an important and valid part of multinational insurance operations. Comments are requested on an appropriate balance between such risk spreading and the erosion of the U.S. tax base. The staff is interested in proposals that would limit the occasions under which a U.S. deduction is denied, including potentially by testing whether the reinsurance premium is subject to tax or otherwise is considered income in a jurisdiction imposing a meaningful tax on insurance operations.