ITEP
INSTITUTE ON TAXATION AND ECONOMIC POLICY

Informing the debate over tax policy nationwide

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Internal Revenue Service
CC:PA:LPD:PR (Notice 2017-38)
Room 5205
P.O. Box 7604
Ben Franklin Station
Washington, DC 20224

RE: Notice 2017-38

To Whom It May Concern,

I am writing on behalf of the Institute on Taxation and Economic Policy (ITEP) in support of the Department of the Treasury's "Final and Temporary Regulations under Section 385 on the Treatment of Certain Interests in Corporations as Stock or Indebtedness." This rule should be fully implemented and indeed strengthened to curb the costly tax avoidance behavior of multinational corporations who have used the "earnings stripping" loophole to avoid paying their fair share in taxes.

ITEP, is a non-profit, non-partisan research organization that provides timely, in-depth analyses on the effects of federal, state, and local tax policies. ITEP's mission is to ensure the nation has a fair and sustainable tax system that raises enough revenue to fund our common priorities, including education, health care, infrastructure, and public safety.

One recent estimate found that corporations shifting profits offshore costs the United States over $100 billion per year. Earnings stripping is one of the common methods used to shift profits offshore. As a public interest organization, we believe that the American taxpayer should not have to make up for the revenue hole created by this kind of corporate misbehavior.

Earnings stripping is an accounting gimmick largely used by foreign multinational corporations to avoid taxes by shifting profits from the U.S. to lower-tax jurisdictions. This practice usually involves foreign multinational companies issuing excessive loans to subsidiaries in higher-tax jurisdictions (like the United States) from subsidiaries in low- or zero-tax jurisdictions (like Bermuda or Ireland). The interest payments on these loans are tax-deductible in the higher-tax country and are paid out to the subsidiary in the lower-tax country, thus allowing the company to artificially shift a substantial amount of income from the jurisdiction with higher taxes to the one with lower taxes. The corporation and all of its subsidiaries are really acting as one company, and the idea that one part of the company can make a "loan" to another part of the company is merely an accounting fiction that serves little purpose beyond tax avoidance.

The part of the tax code known to tax lawyers simply as "subpart F" wisely ensures that interest income received by an American corporation and its offshore subsidiaries is subject to U.S. tax. But subpart F does not apply to foreign corporations, which are thus able to use earnings stripping to obtain an advantage over American corporations. American corporations that want to engage in earnings stripping have sought to "invert," which involves using mergers to characterize themselves as foreign companies for tax purposes.

Given all of this, we strongly support the "Final and Temporary Regulations under Section 385 on the Treatment of Certain Interests in Corporations as Stock or Indebtedness," also known as the "earnings stripping" rule. By inhibiting multinational corporations' ability to artificially shift profits out of their U.S. affiliates through the use of debt, this proposed action would take an important step toward putting an end to offshore tax avoidance. In fact, the Treasury estimates that this rule could recover $7.4 billion in tax revenue over 10 years that companies would have otherwise avoided.

While curbing the abuse of earnings stripping will undoubtedly help ameliorate the problem of corporate tax avoidance and inversions, further steps can be taken. These critical regulations should be strengthened, not weakened or eliminated. To this end, I urge Treasury to reconsider a series of exceptions added into the draft regulations when they were made final. Most notably, Treasury should reconsider its exceptions to the regulations for certain entities and so-called ordinary business course and business transactions. These exceptions substantially limit the scope of these regulations and should be eliminated.

A recent study by ITEP found that U.S. companies likely owe up to $767 billion in taxes on the $2.6 trillion in earnings that they stash offshore. The amount held offshore, and thus the amount these companies are avoiding in taxes, grows by around one hundred billion dollars each year. This must end. In the absence of Congressional action to fix this problem, Treasury should take every possible step to prevent the base erosion and profit shifting created by corporate tax inversions and other corporate tax avoidance.

Thank you for your careful consideration of these comments.

Sincerely,

Alan Essig
Executive Director
Institute on Taxation and Economic Policy