



August 31, 2005

**Via Email**

The Honorable William Thomas, Chairman  
Committee on Ways and Means  
U.S. House of Representatives  
1102 Longworth House Office Building  
Washington D.C. 20515

The Honorable Charles Grassley, Chairman  
The Honorable Max Baucus, Ranking Minority Member  
Committee on Finance  
United States Senate  
219 Dirksen Senate Office Building  
Washington, D.C. 20510

Re: Tax Technical Corrections Act of 2005

Dear Chairmen Thomas and Grassley and Senator Baucus:

On behalf of AeA (American Electronics Association), I am writing to propose an additional provision be included in the foreign repatriation-related provisions in the Tax Technical Corrections Act of 2005, H.R. 3376 and S. 1447.

AeA is the nation's largest high-tech trade association, representing more than 2,500 member companies that span the high-technology spectrum, from software, semiconductors, and computers to Internet technology, advanced electronics, and telecommunications systems and services. AeA members include small, medium, and large high-tech companies.

Section 965 (often referred to as the "Homeland Investment Act" or "HIA") allows U.S. corporations to elect, for one year only, to claim a dividends received deduction ("HIA DRD") equal to 85 percent of qualifying cash dividends ("HIA dividends") received from controlled foreign corporations ("CFCs"). The HIA DRD allows U.S. corporations to receive HIA dividends subject to a 5.25% effective tax rate, instead of the normal 35% tax rate. HIA is intended to encourage U.S. corporations to repatriate cash from foreign subsidiaries for investment in the United States.

As described below, currently there is uncertainty regarding the portion of a distribution from a CFC that qualifies as a distribution out of earnings and profits (“E&P”) attributable to previously taxed income (“PTI”) as defined in section 959(c), i.e., the portion of the distribution that is not a dividend. With respect to the year for which the section 965 election is in effect (the “HIA election year”), this uncertainty complicates the calculation of the HIA DRD and therefore discourages maximum repatriations of offshore cash to the United States.

In order to eliminate this uncertainty, a technical correction should provide that the portion of a distribution from a CFC made during the HIA election year (“HIA distribution”) which is treated as a PTI distribution will be based on the CFC’s undistributed PTI for the most recent taxable year ending on or before June 30, 2003, as reduced by subsequent PTI distributions. This technical correction would be consistent with other provisions of section 965, which provide for computations based on amounts that are fixed prior to the HIA election year.

## **Issue**

There are three components of a distribution under section 965: (1) the distribution of PTI; (2) the base period dividend distribution; and (3) the HIA dividend distribution of deferred earnings. Section 965 currently allows taxpayers to determine with certainty some, but not all, of the material elements of the required calculation. While the statute allows taxpayers to determine the base period amount (as defined in section 965(b)(2)(B)) and the deferred earnings amount (as defined in section 965(b)(1)) with certainty, there is no certainty with respect to the amount of a CFC’s PTI that will have to be taken into account to determine either (i) the dividends which are declared to satisfy the base period dividend requirement, or (ii) the HIA dividend itself. This lack of certainty may prevent taxpayers from maximizing the amount of HIA distributions, and therefore prevent taxpayers from maximizing the amount of offshore earnings reinvested in the United States.

Absent further guidance, a CFC must distribute all of its PTI, determined as of the end of the HIA election year, before it can distribute a HIA dividend. The amount of the CFC’s PTI as of the end of the HIA election year, however, will not be known with certainty on the date that it makes an HIA distribution. The tax return for the HIA election year will not be filed until several months after the date of the HIA distribution. The tax return for the prior taxable year also may be filed after the date of the HIA distribution if the distribution is made early in the HIA election year.

In addition, there may be amended returns or audit adjustments for various open years up to and including the HIA election year that affect PTI but which are not finally determined until after the date of the HIA distribution. Despite the Service’s laudable initiative to bring large taxpayers current in their audit cycles, many large taxpayers with offshore earnings which potentially could be reinvested in the United States still have several taxable years open to examination. Under the statute as currently drafted, any adjustment by audit or amended return that increases PTI for any taxable year through the HIA election year would retrospectively reduce the HIA dividend, dollar for dollar, by recharacterizing a portion of the HIA distribution as a PTI distribution. Similarly, changes to PTI may affect whether the taxpayer received dividends in excess of the base period amount.

This uncertainty complicates the calculation of the HIA dividend and the tax accrual for that dividend. Corporate tax managers are under increasing pressure to precisely quantify the amount of the income tax accrual for all transactions. For many taxpayers, the decision whether to make an HIA distribution is a very significant one, which can be made only with a full understanding of the financial consequences. The existing uncertainty makes that determination difficult, which discourages maximum reinvestment of offshore earnings in the United States.

### **Proposed Technical Correction**

A technical correction should be enacted to provide taxpayers the same certainty in determining the PTI amount for purposes of calculating the HIA dividend that exists in determining the base period amount and the deferred earnings amount. Both of those amounts are determined as of June 30, 2003. The technical correction should provide that, for purposes of determining the amount of HIA dividends and dividends that are necessary to meet the base period amount, the amount of the distributing CFC's PTI that is taken into account shall not exceed the PTI amount as shown on the most recent return filed for the most recent taxable year ending on or before June 30, 2003 (excluding amended returns filed after that date) ("Fixed PTI Amount"), reduced by actual PTI distributions made prior to the HIA election year.

This proposal would allow taxpayers to calculate their HIA dividend with certainty and to distribute the maximum allowable HIA dividend. Taxpayers would not be required to base their HIA calculations on tentative estimates of a PTI amount that could change by the end of the HIA election year or that could be affected by subsequent audit adjustments.

Under this proposal, taxpayers will be required to distribute the full Fixed PTI Amount prior to distributing an HIA dividend. That distribution could occur in any taxable year after the year in which the Fixed PTI Amount is determined, up to and including the HIA election year. Therefore, if an amount equal to the Fixed PTI Amount had been distributed prior to the HIA election year, distributions would first be made from other E&P, rather than from PTI, up to the applicable base period dividend amount (to the extent not paid by other CFCs) and HIA dividend limits. The CFC's PTI account would remain intact, and distributions in excess of the CFC's share of the base period dividend and the HIA dividend would be attributable to the CFC's PTI account under normal rules.

If it is ultimately determined that, as of the end of the HIA election year, a distributing CFC had PTI in excess of the Fixed PTI Amount, that additional PTI would remain PTI of the CFC. Distributions exceeding the CFC's share of the base period dividend and the HIA dividend made during the HIA election year, or any distribution made in a subsequent year, would be made out of such additional undistributed PTI and other E&P under the normal ordering rules. Accordingly, any uncertainty over the CFC's actual PTI amount would not affect the calculation of the HIA dividend.

The Service may require taxpayers to attach a statement to the return for the HIA election year designating the E&P pools from which these distributions are made.

I have attached a draft of the proposed technical correction as an exhibit.

## Policy Reasons for Change

Congress enacted section 965 to encourage cash repatriation to fund investment and job creation in the United States. The proposed technical correction furthers this goal because it increases the certainty with which taxpayers can calculate the HIA dividend, thereby encouraging taxpayers to maximize repatriations to and investment in the United States.

The proposal is consistent with other elements of section 965 which provide certainty in computing the amount of the HIA dividend by allowing taxpayers to rely on tax attributes that are fixed prior to the beginning of the HIA election year.

All other existing limits under section 965 are preserved. The amount of the HIA dividend still could not exceed the distributing CFC's current or accumulated E&P in excess of undistributed PTI, as determined after all audit adjustments for all years through the HIA election year. In addition, this proposal does not affect the amount of deferred earnings that are eligible for the HIA DRD, and it does not alter the base period computation or the reinvestment plan requirement.

In light of the fact that some companies have already made an HIA distribution, it may be appropriate to provide this resolution to affected taxpayers by election.

This uncertainty is created by the unique situation that an HIA distribution can be made for only one taxable year, while the underlying elements that determine the amount of the HIA dividend may cover several years. This proposed technical correction will eliminate this unique uncertainty, and therefore will encourage maximum reinvestment and job creation in the United States. Since it deals with the one-time event of section 965, it will have no future impact on any taxpayer after the completion of the HIA distribution.

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Thank you for the opportunity to submit this proposed addition to the Tax Technical Corrections Act of 2005. If you have any questions about this letter, please feel free to contact me at (202) 682-4448.

Sincerely,

Marie K. Lee  
Tax Counsel

CC: The Honorable John W. Snow, Secretary of the Treasury  
George K. Yin, Chief of Staff, Joint Committee on Taxation

## EXHIBIT

New Section 965(c)(4). To be inserted between current Section 965(c)(3) and Section 965(c)(4).

(4) COORDINATION WITH SECTION 959.—Notwithstanding the rules of section 959, distributions of earnings and profits made by a controlled foreign corporation, which has a United States shareholder that has made an election under this section, shall be applied for the year of election in the following manner:

(A) First, out of earnings and profits described in section 959(c)(1) and (c)(2), in the order specified in section 959(c), up to the amount of such earnings and profits shown on the most recent return filed for the most recent taxable year ending on or before June 30, 2003 (except that amended returns filed after June 30, 2003, shall not be taken into account), reduced by the amount of distributions that

(i) are excluded from gross income under section 959, and

(ii) are distributed after the most recent taxable year ending on or before June 30, 2003, and before the taxable year for which the election under this section is in effect;

(B) Second, out of earnings and profits described in section 959(c)(3), to the extent that dividends received by the United States shareholder from other controlled foreign corporations during such year are less than the amount stated in section 965(b)(2)(B);

(C) Third, out of earnings and profits described in section 959(c)(3), to the extent of the amount distributed by such controlled foreign corporation which qualifies for the deduction provided in subsection (a)(1); and

(D) Fourth, out of earnings and profits in the manner described in section 959(c).

\* \* \* \*

New Section 959(g).

(g) COORDINATION WITH SECTION 965.—For special rules relating to the application of this section in years for which an election is made under section 965(f), see section 965(c)(4).