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Three Problems Associated With Territorial Taxation

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LETTERS TO THE EDITOR

Three Problems Associated With Territorial Taxation

To the Editor:

Lisa Nadal's mention of territorial taxation in her article ''Repatriation Gluttony — Was It Worth It?'' reminded me of three problems that could accompany a switch to territoriality. (See *Tax Notes Int'l*, June 23, 2008, p. 985, *Doc 2008-13145*, or *2008 WTD 116-4*.) Two were brought up by Deputy Assistant Treasury Secretary for International Tax Affairs Michael Mundaca at the Second International Taxation Summit last November in Shanghai.

After noting the preference for territoriality that had been expressed by business leaders at the July 26 Treasury Conference on Business Taxation and Global Competitiveness here in Washington, Mundaca acknowledged two problems that would accompany such a switch and that would likely cause taxes on U.S. companies to rise. The first was disallowance of domestically incurred expenses that would be properly allocable to exempt foreign-source income. The second — which was the flip side of disallowance of expenses — was the need to impute royalties to some foreign business units. To the extent these offshore entities were transparent, parent income and parent taxes would rise. Mundaca said Treasury was looking for ways to end-run these ''give-backs.''

A few months later, in February 2008, Edward Kleinbard, the new Chief of Staff of the Joint Committee on Taxation, spoke at a BNA luncheon in Washington. During his remarks, he raised a third potential problem with a switch to territoriality: enormous transfer pricing problems and pressures due at least in part to intangibles and the ease with which they can be transferred to low/no tax jurisdictions.

One conclusion that could be drawn, and that Steve Shay of Ropes & Gray in Boston is fond of drawing, is that the current U.S. business taxation rules are, overall, more favorable to U.S. business than territoriality would be. Steve put it this way two years ago in his written testimony to the House Subcommittee on Select Revenue Measures:

> With proper planning, U.S. income tax rules may be applied to achieve, with respect to low-taxed foreign income, effective tax rates comparable to those possible under a territorial tax system that exempts foreign income. However, high foreign income taxes also may be cross-credited against U.S. tax on other ''foreign'' income in the same foreign tax credit limitation category. The latter benefit may be contrasted with an exemption system that generally does not allow a benefit for high foreign taxes. The current U.S. rules, while complex, represent the best of all worlds for U.S. multinational taxpayers. It is difficult to conclude that the U.S. rules for taxing international business income unfairly disadvantage U.S. multinational taxpayers. ◆

Martin B. Tittle

Washington
June 17, 2008

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