Protecting the U.S. Corporate Tax Base Act of 2016

The *Protecting the U.S. Corporate Tax Base Act of 2016* would limit two tax loopholes currently exploited by certain foreign-controlled U.S. multinational groups:

Hopscotching: The first loophole allows a foreign parent or a foreign affiliate to borrow deferred earnings of controlled foreign corporations ("CFCs") without subjecting United States shareholders to U.S. tax. This technique is known as "hopscotching."

De-Controlling: The second loophole permits foreign-controlled U.S. multinational groups to avoid U.S. tax on deferred earnings of CFCs by reducing the U.S. ownership of CFCs to a level that no longer subjects the foreign subsidiaries to U.S. taxation. This technique is known as "de-controlling." Both of these loopholes erode the U.S. corporate tax base.

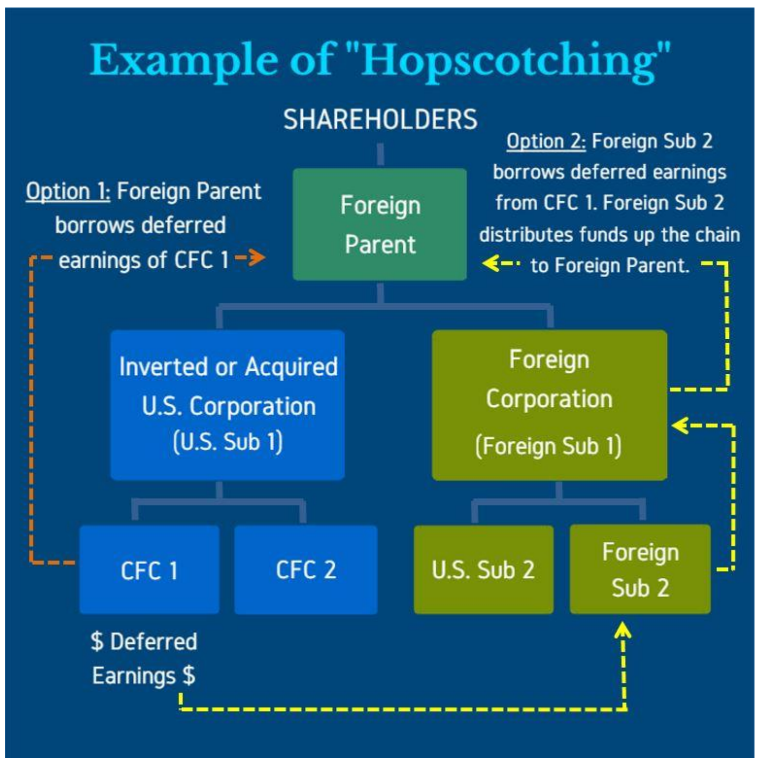
THE PROBLEM

It is currently estimated that U.S. multinational businesses have over $2 trillion in deferred foreign earnings. It is common for foreign-controlled U.S. multinational groups – like those formed through inversions and other foreign acquisitions – to use loopholes in the tax code to invest those deferred foreign earnings back into the U.S. without paying U.S. taxes.

What is a foreign-controlled U.S. multinational group? In a foreign-controlled U.S. multinational group, a foreign parent entity has controlling ownership of a U.S. entity that, in turn, owns one or more CFCs. The foreign parent entity typically has additional foreign subsidiaries that are not CFCs ("non-CFC foreign affiliates"). The CFCs generate operating income in various foreign jurisdictions. Although such "active" income may be subject to income taxes on a current basis in the foreign countries where the income is earned, U.S. taxes may be deferred on that income unless and until the income is distributed to Untied States shareholders – also known as "repatriation."

"HOPSCOTCHING"

The indefinite deferral of U.S. income taxes on foreign earnings provides ample opportunity for companies to find ways to lower their U.S. taxes. One common technique – known as "hopscotching" – involves having CFCs lend their deferred earnings to non-CFC foreign affiliates. These loans do not trigger U.S. tax to United States shareholders under present law. The borrowed funds can then be used to repay debt, make capital investments in the U.S. and elsewhere, purchase stock of a related domestic or foreign corporation, or make dividend payments to shareholders. Through this loophole, CFCs can circumvent the rule – presently contained in Section 956 of the Tax Code – that was intended to prevent the use of a CFC's untaxed earnings for direct investments in the United States without incurring U.S. tax.



Prepared by Democratic Staff, Committee on Ways and Means, Sander M. Levin, Ranking Member
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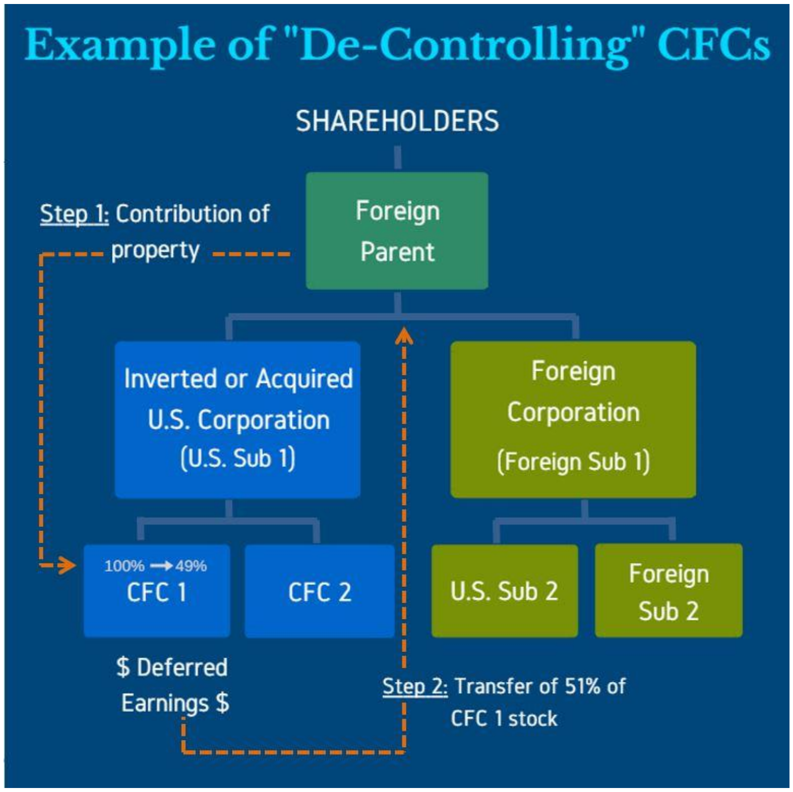
The *Protecting the U.S. Corporate Tax Base Act of 2016* would close this loophole by providing that a United States shareholder's[1] gross income includes not only a pro rata share of any increase in the CFC's investment of earnings in "United States property" but also a pro rata share of any increase in the CFC's investment of earnings in "foreign group property."[2]

"DE-CONTROLLING"



A foreign-controlled U.S. multinational group can also "de-control" its controlled foreign corporations in order to circumvent the rules of Section 956 of the Tax Code as discussed above. The term "controlled foreign corporation" is defined as any foreign corporation if more than 50 percent of its stock is owned by United States shareholders. To "de-control" a controlled foreign corporation, a non-CFC foreign affiliate can transfer sufficient amount of property to the CFC in exchange for 50 percent or more of the CFC stock. The result is that the foreign corporation is no longer a "controlled" foreign corporation. Once a CFC is "de-controlled" it is free to make direct investments in United States property without triggering U.S. taxes.

The *Protecting the U.S. Corporate Tax Base Act of 2016* would close this loophole by providing that the stock of a foreign corporation owned by a foreign person is attributed to a related United States person for purposes of determining whether the related United States person is a "United States shareholder" of the foreign corporation, and therefore, whether the foreign corporation is a "controlled foreign corporation." This proposal is similar to the proposal included in the Administration's FY2017 and FY2016 budget proposals.

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[1] The term "United States shareholder" means, with respect to any foreign corporation, a United States person who owns 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such foreign corporation.

[2] For purposes of this expanded rule, "foreign group property" means any stock or obligation of any non-CFC foreign affiliate.