April 22, 2019

Via Electronic Transmission

The Honorable David J. Kautter
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Ave., N.W.
Washington, D.C. 20220

The Honorable Charles Rettig
Commissioner
Internal Revenue Service
1111 Constitution Ave., N.W.
Washington, D.C. 20224

Dear Assistant Secretary Kautter and Commissioner Rettig:

The Information Technology Industry Council (ITI)[1] appreciates the efforts by the U.S. Department of the Treasury and the Internal Revenue Service to issue proposed regulations that provide guidance related to how expenses should be allocated and apportioned under the new Global Intangible Low-Taxed Income (GILTI) regime.[2] ITI represents some of the world's most innovative companies, and our sector spends over $200 billion on R&E annually, making how these expenses are allocated especially critical to our industry.[3]

As you are considering the feedback you have already received, we wanted to build on some of our previously submitted comments relating to the proposed foreign tax credit regulations and submit additional thoughts for consideration for providing further relief for the treatment of research and experimentation (R&E) expenses. Specifically, to ensure that R&E activities will continue to be performed in the United States to the greatest extent possible, we believe it is important for further considerations to be made for not allocating or apportioning R&E expenses to the GILTI income basket under §904(d)(1)(A), particularly when using the sales method. While we understand that you are actively planning to review the allocation of R&E under Treas. Reg. §1.861-17 later this year, we believe some additional

[1] For more information on ITI, including a list of its member companies, please visit: http://www.itic.org/about/member-companies.
[2] Proposed regulations issued under § 78, 861, 904, & 960 of the Internal Revenue Code of 1986, as amended, in REG–105600–18, 83 Fed. Reg. 63200 (December 7, 2018).
[3] Calculated using publicly available data for the most recent year relating to the S&P Global 1200 index for companies operating in the IT sector (plus Alphabet [Google], Amazon, and Facebook, which are classified in other sectors).

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relief may be needed in the shorter term to clarify the interaction with the GILTI regime. We look forward to continuing to work with you on this important issue.

As you know, Congress has continually worked to discourage the movement of jobs, R&E, and intellectual property away from the United States. The intent of the Tax Cuts and Jobs Act (TCJA) was to neutralize this choice and make the U.S. a more competitive place to perform critical functions associated with high-paying domestic jobs, including R&E.

For many companies who perform R&E on a global basis, the allocation of those expenses is pivotal to the placement of the R&E activity. Under existing Treas. Reg. §1.861-17, the rules require allocation solely to classes of gross income that can "reasonably be expected to benefit, directly or indirectly, from the taxpayer's research expense." Following this established logic, in instances where the ownership of the IP resulting from the R&E is in the U.S., R&E expenses should only be allocated to classes of income that are directly created or earned by the activities of the U.S. IP owner, and not to classes of income constituting deemed dividends from its controlled foreign corporations (CFCs). Requiring R&E expenses to be allocated to GILTI income for purposes of calculating foreign tax credits will significantly reduce or eliminate the incentives for companies to locate their R&E activities in the United States – and, in fact, would create an incentive for companies to perform those activities and locate the associated jobs outside of the United States. This would run explicitly counter to the statutory intent of the TCJA.

Additionally, existing regulations for the allocation of R&E expenses generally provide that expenses should be allocated in a manner that reflects the factual relationship between the deduction and grouping of income. We believe that this should continue to be true for R&E expenses, and that "gross income from successful research and experimentation must bear the cost of unsuccessful research and experimentation" (Treas. Reg. §1.861-17(a)). When a U.S. parent owns IP and contracts with its CFCs solely to perform support functions (whether those functions include sales, manufacturing or other support), the only taxpayer benefitting from the income derived from the R&E is the U.S. parent, and not the foreign CFC. In this context, income earned by the CFCs arises solely from their functions, and not from any U.S.-based IP. Because the CFC's income does not include any return to U.S.-based IP, GILTI income should not attract any U.S. R&E expense. Therefore, these R&E expenses should not be allocated to the GILTI basket when IP is owned by the U.S. group. Based on the lack of factual relationship between U.S. generated R&E and GILTI, we do not believe that this factual relationship supports the allocation of R&E expenses to GILTI income.

Moreover, the TCJA Conference Report provides that Congress intended for GILTI to operate as a worldwide minimum tax at 13.125 percent and that taxpayers subject to a foreign tax rate on tested income at or above 13.125 percent would not be subject to GILTI, because any U.S. tax would be fully offset by foreign tax credits.[4] However, the allocation of R&E expenses to the GILTI basket reduces a taxpayer's foreign source income and its foreign tax credit limitation in the GILTI basket. Because foreign tax credits permitted against taxes on GILTI income are so limited (due to the haircut and the inability to carry credits over), it is easy for the GILTI to result in double taxation of income, something both our U.S. tax system and our global international tax system have historically sought to avoid. Reducing or eliminating the requirement to allocate R&E expenses to the GILTI basket would reduce the incidence of double taxation, which we believe results in a better overall system.

Situations where a taxpayer has an overall domestic loss (ODL) because of the exclusive apportionment of U.S. based R&D can also reduce the GILTI basket when the ODL is reallocated to baskets with positive income. We believe the ODL arising from exclusive R&E apportionment should be allocated back to the basket of income that the R&E would have been allocated to absent exclusive apportionment, rather than being partially allocated to the GILTI basket.

In the broader context of our overall international regime, we hope that as you continue to work through how R&E expenses should be allocated, you will consider that the statutory intent of the GILTI and Foreign-Derived Intangible Income (FDII) provisions was to create parallel provisions to encourage companies to invest in the United States by neutralizing the tax impact of investing domestically as compared to foreign locations. In light of those design considerations, we hope you will also consider how expense allocation to FDII impacts this balance.

We stand ready to work with you to as you move toward revising and finalizing these regulations.

Sincerely,

Sarah Shive

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Senior Director, Government Affairs

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[4] See, H.R. Rep. No. 115-466, 626-27 (2017) ("At foreign rates greater than or equal to 13.125 percent, there is no residual tax owed on GILTI, so that the combined foreign and U.S. tax rate on GILTI equals the foreign tax rate.")

cc: Lafayette G. “Chip” Harter, Deputy Assistant Secretary for International Tax Affairs, Office of Tax Policy, U.S. Department of the Treasury