Business Roundtable

The Importance of the "Check-the-Box" Election in Maintaining a Level Playing Field for Worldwide American Companies

Background

The "check-the-box" election allows an American company to choose how an entity it owns, either domestic or foreign, will be treated for U.S. tax purposes. In general, U.S. tax rules classify a business organization as either a corporation or a flow-through entity, such as a partnership. When a business organization is treated as a flow-through entity, all income flows through to its owners where the U.S. tax effects are determined.

Prior to the check-the-box election, the determination of whether a business organization would be considered a corporation or flow-through entity was based on a complex review of its characteristics. This led to uncertainty and administrative burden on both taxpayers and the IRS to determine the appropriate classification of a business organization. In an effort to resolve these issues the Clinton Administration Treasury Department created the check-the-box election.

Importance of the check-the-box election

- The election helps level the playing field for American companies competing internationally. First, the election helps American companies reduce tax payments to foreign governments in a manner similar to that utilized by their foreign competitors. Second, the election helps American companies redeploy cash between foreign operations on the same tax terms as their foreign competitors. Eliminating the election would create a tax disadvantage for American companies relative to their foreign competitors and reduce the competitiveness of American companies in foreign markets.

- The election provides important simplification. The election replaced a complex, multi-factor analysis that was used prior to 1997 to determine whether a business should be treated as a corporation or a flow-through entity for U.S. tax purposes and thus provides important simplification for American companies.

- The election allows for the efficient consolidation of companies following a merger or acquisition. The election permits worldwide American companies to streamline their new business structure following a cross-border merger or acquisition. In the absence of the election, foreign laws and tax considerations may reduce the ability of worldwide American companies to enter new foreign markets through acquisitions.

If the check-the-box election were eliminated, American companies would be forced to restructure their foreign operations to minimize the impact. This would require significant time and expense without creating any additional value for American employees, customers, and shareholders.

Misunderstandings of the check-the-box election

The check-the-box election has been misunderstood to cause an American-owned foreign entity, properly classified as a flow-through entity, to "disappear" from the IRS's view. In fact, the flow-through entity's income is reported by its owner. Additionally, since 2004, an owner of such an entity is required to file with the IRS income and balance sheet information for the entity annually.

It has also been claimed that the election allows American companies to inappropriately reduce their tax payments to foreign governments. In contrast, the election permits overseas operations of American companies to legally reduce tax payments to foreign governments in full compliance with U.S. and foreign laws in a manner similar to that utilized by their foreign competitors.

Summary

The check-the-box election helps level the playing field for worldwide American companies. Without the election, U.S. companies would be required to employ more complicated and burdensome procedures, would utilize their foreign earnings less efficiently, and would face higher foreign taxes. Loss of the election would place worldwide American companies at a competitive disadvantage relative to their foreign counterparts and would result in fewer U.S. jobs and less growth for the U.S. economy.

As the rest of the world makes it easier for their companies to operate worldwide, eliminating the check-the-box election would be a movement in the opposite direction, making it more difficult for American companies to compete in overseas markets.

A massive increase in taxes will disadvantage American companies and make U.S. workers less secure.