

ENTITY CLASSIFICATION WORKING GROUP

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WHY THE ADMINISTRATION'S "CHECK-THE-BOX" PROPOSAL IS THE WRONG PROPOSAL AT THE WRONG TIME

President Obama's budget includes a proposal to change the tax treatment of many foreign businesses that are owned by U.S. companies by undoing the application of Clinton Administration "check-the-box" regulations as they apply to these foreign subsidiaries. The Administration coupled this proposal with two other major changes that would also have the effect of dramatically curtailing the application of the long-standing deferral principle that normally applies to the foreign income of U.S. corporations operating abroad. Like the two other anti-deferral proposals, the exclusion of most foreign subsidiaries from the check-the-box rules would increase the tax burden on American companies operating overseas *and* reduce their flexibility and competitiveness in the global marketplace. Whether considered together or individually, these proposals are not "corporate loophole closers; rather, they would damage the ability of U.S. companies to compete globally.

➤ **Use of Check-the-box is by no means Abusive.**

- The Clinton Administration created the check-the-box regime to simplify outmoded rules, by providing an election to determine whether a business operation will be taxed as a corporation, partnership, or by reference to some other classification.
- The effect of "checking" a foreign subsidiary is to tax the subsidiary in the same manner as a branch, with the subsidiary's income passed through to its owner— *this income does not "disappear," as the Administration has suggested, but is reported directly by the U.S. or foreign entity that owns the business operation.*

➤ **Barring Check-the-box Would Damage U.S. International Competitiveness.**

- Check-the-box has developed into an important tool that allows global business operations to facilitate the movement of goods and services across borders, the reinvestment of profits where most needed, and the restructuring of business operations, *without* incurring noncompetitive U.S. and foreign tax penalties.
- The check-the-box regulations are part-and-parcel of the rules that enable domestic corporations to compete against foreign multinationals that are able to achieve the same results under the tax systems of their home countries.

➤ **Congress should delay consideration of *all three* of the Administration's major international tax proposals until it turns its attention to comprehensive tax reform legislation.**

- Additional study is needed to determine whether there are check-the-box uses that should be curtailed, and if so, to develop a measured response.
- In any case, the goal of preserving the competitiveness of American companies relative to foreign corporations with which they compete would be ill-served by a piece-meal approach to international tax changes.