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### Don't fault the tax director

By Phil Cohen, professor, Pace University, New York City - 09/24/12 11:19 AM ET

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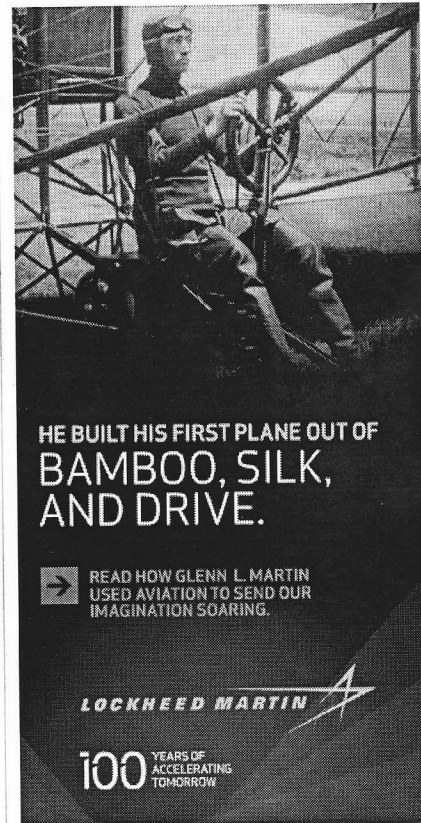
On September 20, a hearing on offshore profit shifting and the U.S. tax code, held by the Permanent Subcommittee on Investigations of the U.S. Senate Committee on Homeland Security and Government Affairs focused on certain cross-border tax practices of Hewlett-Packard and Microsoft. These companies were used as case studies to identify structures and transactions that result in the shifting of significant profits from the United States taxing jurisdiction and in certain cases having the economic effect as if the earnings were distributed back to the United States parent company without incurring federal taxation. Among the witnesses called to testify were the tax directors of Hewlett-Packard and Microsoft, the chief counsel of the IRS, the deputy commissioner (International) in the Large Business & International division of the IRS and two noted tax law professors.

Hewlett-Packard and

Microsoft are both great American companies. They employ significant amounts of U.S. employees, many of them highly-paid. They are technology development leaders whose products improve the lives of people across the globe. They make significant contributions to the U.S. economy. It is important to have a U.S. tax policy that doesn't serve to impair companies such as these. Their tax departments are led by exceptionally capable people who take their jobs very seriously and I'm sure strive to help their companies achieve their financial goals employing what in their best judgments are legally sound tax strategies. They shouldn't be criticized for their efforts. That's in fact what they're being paid to do.

Nevertheless shifting profits from intellectual property and otherwise from the United States, often referred to as base erosion, is a real issue currently facing our nation. Turning a blind eye to the predicament, especially given our budget deficit, would be foolish. Continuous study of the problem, unaccompanied by positive action, is not the answer. Even worse would be enacting so-called tax reform measures, in the name of simplification or otherwise, that serve not to correct the dilemma but to exacerbate the problems identified. For example, enacting legislation that would permit billions of dollars of off-shore earnings to be repatriated back to their United States parent companies subject to little or no federal taxes, as was done by Congress a few years ago, would be irresponsible. So too would adoption of a territorial tax regime, that is a tax system whereby earnings of U.S. companies' foreign subsidiaries from offshore activities would escape federal taxation permanently even upon repatriation to

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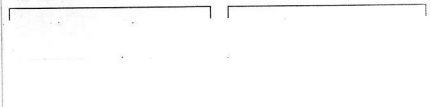
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Rep. Dennis Cardoza's (D-Calif.) blog appears here on The Hill's Congress Blog every week.

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the United States, absent full-proof safeguards.

There were some potential solutions to the dilemma in the report and from the witnesses. The need for stable and predictable funding for the IRS should be obvious. There were some thought-provoking, albeit controversial, recommendations from Professor Avi-Yonah. He testified that Congress should enact legislation overriding in certain cases "cost sharing" that provides the umbrella for moving the fruits of R&D incurred in the US offshore. He also suggested Congress repeal certain "look-through" rules that weaken provisions in the Internal Revenue Code, known as Subpart F, that treat certain offshore income as if it had been repatriated to the United States. He also recommended revising the so-called check the box rules that among other things permit certain foreign corporations to be treated as disregarded entities for federal tax purposes in ways that undermine Subpart F. The Subcommittee report also suggested tightening the Internal Revenue Code Section 956 to close loopholes whereby offshore funds are made available to the United States parent company without triggering federal tax. Others have suggested that we revise the Internal Revenue Code to treat a corporation as U.S. or foreign from the current place of incorporation rule to one based on where the company is managed and controlled. The pros and cons of these suggestions and others should be thoroughly vetted and appropriate action taken.

This is no doubt as IRS Chief Counsel Wilkins noted a "challenging" area. It requires action by Congress and Department of Treasury/IRS employing the same sort of smarts that the tax directors of Hewlett-Packard and Microsoft utilized in saving their respective companies significant amounts of U.S. tax.

*Cohen is a professor in the Legal Studies and Taxation Department of Pace University's Lubin School of Business and a retired Vice President-Tax & General Tax Counsel for Unilever United States, Inc. The views expressed here are his personal views.*

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