UNICE
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UNICE COMMENTS ON

THE PROPOSED AMERICAN COMPETITIVENESS AND CORPORATE ACCOUNTABILITY ACT OF 2002

This July the Chairman of the Committee on Ways and Means of the United States' House of Representatives (the Committee) introduced the American Competitiveness and Corporate Accountability Act of 2002 (the Act) in Bill HR5095. In the Introduction to the Act it is presented as an initiative to make the U.S. Tax Code more competitive for U.S. companies and to bring it into line with the WTO rulings on the FSC and ETI regimes.

The uncompetitiveness of the Tax Code, according to the Committee, is primarily demonstrated by the recent increase in inversion transactions in the U.S. An inversion is a U.S. tax-planning technique whereby a U.S. company transforms itself into a U.S. subsidiary of a foreign corporation, usually located in a tax haven. The primary result of the transaction is that foreign assets of the U.S. company are brought outside the reach of the U.S. system of worldwide taxation.

UNICE wishes to comment on that part of the proposed Act which impacts on foreign investors into the USA, namely Section 201.

Section 201 of the Act introduces a tightening of interest deduction rules for U.S. subsidiaries of foreign-owned companies (Section 163j of the U.S. Tax Code). These rules apply to interest paid to a related party abroad or interest paid on loans guaranteed by a foreign parent company (for ease of reference both are referred to as related-party interest).

Currently a U.S. subsidiary of a foreign company may deduct all of its interest expense if its interest income exceeds its interest expense (the netting rule). In addition, a U.S. subsidiary can deduct all interest paid to or guaranteed by a foreign party as long as the U.S. subsidiary's debt-to-asset ratio is less than 1.5 to 1. If the debt-to-asset ratio is greater than that, the interest deduction is limited to 50% of the adjusted taxable income. Interest paid in excess of the 50% threshold can be carried forward indefinitely.

Under the proposed rules these interest-deduction provisions would be severely tightened:

- the netting rule will be eliminated,
- related-party interest will be disallowed to the extent that the U.S. subsidiary of a foreign-owned company's debt-to-asset ratio exceeds the foreign company's worldwide debt to asset ratio. The debt-to-asset ratio has to be calculated according to U.S. tax accounting standards,
- the allowable interest percentage will be lowered to 35% of the adjusted taxable income, and
- interest above the debt-to-asset ratio will be disallowed permanently, whereas interest above the 35% test can be carried forward for a maximum of only five years.

None of these provisions applies to U.S. subsidiaries of U.S.-based multinationals (neither the current provisions of Section 163j nor the proposed changes). U.S. subsidiaries of U.S. companies are only subject to the "facts and circumstances" test of Section 385 of the Tax Code and general case law standards for distinguishing true debt from disguised equity.

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UNICE is deeply concerned about the new proposal for a number of reasons:

First, the Act entails a tightening of interest-deduction rules for U.S. subsidiaries of foreign-owned companies, which are already discriminatory when compared with the rules applicable to U.S. subsidiaries of U.S. companies. If, for example, two subsidiaries borrow from a bank with a parent guarantee, the subsidiary held by the foreign-owned company will be subject to the onerous rules of Section 163j whereas the subsidiary of the U.S. parent will only have to comply with the much more lenient rules of Section 385. Therefore, the subsidiary of the foreign-owned parent is worse off than its counterpart owned by a U.S. company, though in effectively the same circumstances. This disadvantage is further amplified by the limitation on the carry-forward rules.

Second, UNICE is concerned that adoption of the Act would dramatically increase compliance costs for foreign-owned companies that have a U.S. subsidiary. These foreign-owned companies typically do not keep their books based on U.S. GAAP, let alone U.S. tax accounting standards. However the debt-to-asset test in the proposed legislation would oblige these companies to restate the relevant financial information of the entire group using the adjusted basis as determined under US tax principles.

Third, the proposals to introduce a worldwide debt-to-asset ratio test is contrary to the arm's-length rule which has been adopted by the OECD countries as the standard for taxing international cross-border trade and investment and in whose development and adoption U.S. Administrations have for many years taken the lead role.

Action in the U.S. itself which casts doubt on this standard could well be seized upon by its opponents as a precedent to introduce their own convoluted tax regimes, thereby undoing the present tax world order and negatively impacting not only on foreign companies in the USA but also on U.S. companies operating around the world.

From the above UNICE concludes that the proposed rules would severely discriminate against U.S. subsidiaries of European companies vis-à-vis their U.S. counterparts and lead to an unnecessary and dramatic increase in the compliance burden for European companies with U.S. subsidiaries. UNICE therefore wishes to express its great concern about the major negative impact the introduction of such rules could have on transatlantic trade, investment and political relations.

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