



# New York State Bar Association

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September 12, 2003

The Honorable Orrin G. Hatch  
Senate Finance Committee  
United States Senate  
104 Hart  
Washington, DC 20510

Dear Senator Hatch:

I am pleased to enclose New York State Bar Association Tax Section Report No. 1037 commenting on two recent proposals that would modify the “earnings stripping rules” contained in section 163(j) of the Internal Revenue Code of 1986, as amended. The principal drafter of the report was Peter Blessing.

The report discusses certain provisions of the Bush Administration’s Fiscal Year 2004 Revenue Proposals (the “Bush Proposal”), as well as section 2001 of H.R. 2896, the “American Jobs Creation Act of 2003”, introduced by Ways and Means Committee Chairman Thomas on July 25, 2003 (the “Thomas Bill,” and, together with the Bush Proposal, the “Proposals”). The report also addresses a proposal to liberalize the guarantee provisions of section 163(j) contained in section 255 of the Promote Growth and Jobs in the USA (PRO GROW USA) Act of 2003 introduced by Senator Orrin Hatch on July 28, 2003 (the “Hatch Bill”).

The Proposals reflect, in part, a policy response to the perceived abuses of inversion transactions. The Tax Section has recently indicated its support for legislation to address inversion transactions and suggested tightening the rules on earnings stripping as one possible way of doing that.<sup>1</sup>

<sup>1</sup> Tax Section Report No. 1014, at 60 (May 24, 2002).

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We note that the modifications to the earnings stripping rules contained in the Proposals would have a far greater impact on foreign investment in the United States than targeted anti-inversion legislation.

The Tax Section generally supports tightening the earnings stripping rules as an appropriate response to transactions that erode the United States tax base. We are concerned, however, that certain aspects of the Proposals could adversely impact cross-border investments in ways that may not be appropriate and go beyond what is necessary to accomplish the main purpose of the legislation. Our specific comments can be summarized as follows:

1. We recommend retention of a safe harbor. We generally would favor the debt-to-assets safe harbor set forth in the Bush Proposal (as the asset categories may be further refined) but using, at the taxpayer's election, U.S. tax basis, U.S. GAAP book value, or fair market value.

2. We recommend against adoption of a worldwide leverage test as was proposed in the Bush Proposal (and in an earlier proposal introduced by Chairman Thomas as section 201 of H.R. 5095, the "American Competitiveness and Corporate Accountability Act of 2002"). In our view, such a test would be extremely difficult for taxpayers to apply and for the Internal Revenue Service to audit.

3. We recommend that proposed reductions in the percent limit for purposes of the adjusted taxable income test take into account, among other factors, that the resulting amount allowed should be consistent with arm's length principles.

4. We recommend that if the carryforward of disallowed interest is limited, that the limit be the same length of time as for net operating losses, i.e., 20 years.

5. We recommend that, especially in connection with the proposed tightening of the earnings stripping rules, it would be appropriate to

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reconsider to what extent section 163(j) should continue to apply to loans guaranteed by affiliates. In this regard, we believe in particular that a tailored approach such as the Hatch proposal deserves serious consideration.

Please feel free to contact the undersigned if you wish to discuss any of our suggestions or any other issues relating to the Report.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Andrew N. Berg". The signature is written in a cursive style with a large initial 'A'.

Andrew N. Berg  
Chair

cc: Mark Prater  
Edgar D. McClellan  
Russ Sullivan