



DEFENDING AMERICA'S SMALL AND FAMILY-OWNED BUSINESSES

## The S Corporation Association

### **The Committee on Ways and Means Discussion Draft Should Be Modified to Prevent Unintended Consequences to Subchapter S Corporations**

#### **S-CORP BOARD**

##### **CHAIRMAN**

Anthony Simmons  
McIlhenny Company  
*Avery Island, LA*

##### **PRESIDENT**

Stephanie Silverman  
Venn Strategies, LLC  
*Washington, D.C.*

##### **TREASURER**

Jim Garland  
The Jeffrey Company  
*Columbus, OH*

##### **GENERAL MEMBERS**

Cathy S. Brown  
Ferrellgas, Inc.  
*Overland Park, KS*

Bob Dickinson  
CoorsTek, Inc.  
*Golden, CO*

Marilyn Franson  
Amsted  
*Chicago, IL*

Christopher Hersey  
Dead River Company  
*Portland, ME*

Clarene Law  
Elk Country Motels, Inc.  
*Jackson Hole, WY*

Anthony Stayman  
ARC Abrasives, Inc.  
*Troy, OH*

##### **CHAIRMEN EMERITI**

Thomas McMahon  
Barker Company

Richard Roderick  
Dead River Company

##### **EXECUTIVE DIRECTOR**

Brian Reardon

The S Corporation Association commends the Committee on Ways and Means (the “Committee”) international tax reform discussion draft (the “Discussion Draft”) as part of the Committee’s broader effort on comprehensive tax reform that would lower top tax rates for both individuals and employers. We particularly appreciate the Chairman’s willingness to be transparent in this process and the opportunity to weigh in on these matters. The comments below should be viewed as a friendly effort to recommend areas where we believe the Discussion Draft could be improved.

Based on our initial review and analysis of the Discussion Draft, a number of provisions appear to unintentionally apply to Subchapter S corporations such that the income of these corporations would be subject to double taxation. Therefore, we respectfully request that the Discussion Draft be appropriately modified to prevent such unintended instances of double taxation for Subchapter S corporations. We would be pleased to work with the Committee to ensure the appropriate treatment of Subchapter S corporations.

#### Unintentional Impact on Subchapter S Corporations

The Discussion Draft proposes to replace the current worldwide system of taxation with a territorial system, whereby under Section 301, certain 10% U.S. shareholders are entitled to a 95% dividends received deduction from dividends paid by controlled foreign corporations (“CFCs”) out of undistributed foreign earnings. It is our understanding, consistent with the Committee’s intention, that this dividends received deduction is limited to Subchapter C corporations and that, therefore, Subchapter S corporations with CFCs<sup>1</sup> are not entitled to this deduction.

Despite the fact that Subchapter S corporations are not entitled to the dividends received deduction, a number of other proposals in the discussion draft that are designed as transition and/or anti-abuse rules related to the deduction are potentially applicable to Subchapter S corporations (i.e., such proposed rules are not dependent on a corporation’s eligibility for the dividends received deduction). The net effect of the potential application of these rules is to subject the income of Subchapter S corporations to unintended double taxation without the benefit of the dividends received deduction to mitigate such double taxation.

---

<sup>1</sup> Subchapter S corporations may own CFCs for a number of business reasons, including the acquisition of existing CFCs or the need to operate in certain foreign jurisdictions through so-called “per se” entities.



## Potential Application of the Deemed Repatriation Provision and the Repeal of the PTI Exclusion

It appears that the deemed repatriation provision (Section 303) and the repeal of the so-called previously taxed income (“PTI”) exclusion (Section 322) potentially apply to all taxpayers, including in particular Subchapter S corporations, regardless of their eligibility for the dividends received deduction. As a result, as a technical matter, the income of Subchapter S corporations would be subject to double taxation in at least two instances without the benefit of the dividends received deduction: (i) pre-enactment income of CFCs would be taxed once as a result of the deemed repatriation provision and again upon actual distribution in light of the repeal of the PTI exclusion, and (ii) post-enactment income of CFCs would be taxed once under the new modified subpart F regime and again upon actual distribution in light of the repeal of the PTI exclusion. In each case, there would be no dividends received deduction to mitigate the resulting double taxation. Presumably there was no intent to subject the income of Subchapter S corporations to double taxation in the examples described above.

## Potential Application of the Rule Treating Foreign Branches as CFCs

Although the dividends received deduction of Section 301 was not intended to benefit Subchapter S corporations, uncertainty exists whether the other provisions of section 301, such as the rule treating foreign branches as CFCs, could potentially be applied to the branches of a Subchapter S corporation. Such treatment would subject the post-enactment income of such branches to double taxation as described in greater detail above. Once again, it presumably was not intended to subject the income of Subchapter S corporations to double taxation in this instance, particularly given that the dividends received deduction is not available to mitigate such double taxation and that the provisions of Section 301 should appropriately be integrated with and dependent on each other.

## Potential Application of the “Base Erosion” Rules

In order to address the increased incentive to shift income to foreign jurisdictions under the proposed territorial system to enable such income to qualify for the dividends received deduction, the Discussion Draft proposes a number of anti-avoidance rules to address so-called “base erosion.” Sections 331A, 331B, 331C and 332. Given that these rules are premised on the availability of the dividends received deduction, their application should be limited to those Subchapter C corporations eligible for such deduction. Subchapter S corporations should not be subject to these anti-avoidance rules given that they are not eligible for the dividends received deduction. Subchapter S corporations would not have the same incentive as Subchapter C corporations to convert income subject to U.S. tax into income exempt from U.S. tax because they are not eligible for the dividends received deduction.



### An Identified Concern Can Be Addressed

It is our understanding that the deemed repatriation transition rule was drafted broadly because of a concern that limiting the rule to Subchapter C corporations could potentially create tax planning opportunities for Subchapter S corporations whereby such entities could restructure after the effective date of the transition rule in order to take advantage of the dividends received deduction on a going forward basis. Such a restructuring would allow Subchapter S corporations to benefit from the dividends received deduction while avoiding the transition rule. However, the broad drafting of the transition rule creates double taxation of Subchapter S corporations in the manner described in greater detail above. The S Corporation Association respectfully suggests that a preferable alternative for addressing the potential tax planning concern is to require application of the transition rule with respect to any taxpayer that utilizes the dividends received reduction. Such a modification would address the concern without raising taxes on those taxpayers that receive no benefit from the dividends received deduction.

### Conclusion

As described above, there appear to be a number of instances where the technical rules, including transition and/or anti-abuse rules, related to the proposal are applicable to Subchapter S corporations despite the fact that such corporations are not eligible for the dividends received deduction. Therefore, it is respectfully requested that the Discussion Draft be modified accordingly to prevent the unintended double taxation resulting from the application of these proposed rules. The S Corporation Association would be pleased to work with the Committee to ensure that Subchapter S corporations are protected from the unintentional application of these rules.