Statement of Stephen E. Shay

Committee on Ways and Means
United States House of Representatives

Hearing on Fair and Equitable Tax Policy for America's Working Families

September 6, 2007

Mr. Chairman and Members of the Committee:

My name is Stephen Shay. I am a partner in the law firm Ropes & Gray in Boston. I specialize in U.S. international income taxation and was formerly an International Tax Counsel for the Department of the Treasury.[1] The views I am expressing are my personal views and do not represent the views of either my clients or my law firm.

With the Chairman's permission, I would like to submit my testimony for the record and summarize my principal observations in oral remarks.

The subject of today's hearing is a fair and equitable tax policy for America's working families. I will address the issue of fairness in the context of our international tax rules. I will direct my testimony and remarks toward the how fairness concerns may be taken into account in U.S. tax rules relating to the taxation of foreign business income, that is, income earned from conducting economic activity outside the United States.[2]

U.S. Tax Policy Objectives – The Role of Fairness

The principal function of the U.S. Federal income tax system is to collect revenue.[3] The manner in which the system serves this role is guided by traditional tax policy criteria of fairness, efficiency and administrability.[4] In applying these criteria, the correct measure of U.S. welfare is the well being of individual U.S. citizens and residents. Accordingly, the primary focus of U.S. income tax policy should be how to

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1 I have attached a copy of my biography to this testimony.

2 In June, 2006, I testified before the Subcommittee on Select Revenue Measures on the impact of international tax reform on U.S. competitiveness. I will draw on that testimony in my testimony today.

3 Secondary roles of the U.S. income tax system include appropriating public funds, through "tax expenditures," and regulating behavior through tax penalties (which sometimes are sometimes referred to as negative tax expenditures). *See* Daniel N. Shaviro, "Rethinking Tax Expenditures and Fiscal Language," 57 TAX L. REV. 187 (2004); David A. Weisbach & Jacob Nussim, "The Integration of Tax And Spending Programs," 113 YALE L. J. 955, 961 (2004).

4 U.S. TREAS. DEP'T, TAX REFORM FOR FAIRNESS, SIMPLICITY AND ECONOMIC GROWTH 13-19 (1984).

raise revenue in a manner that improves the lives and living standards of those individuals and fairly allocates the burden of the taxes imposed.[5]

The policy criteria of fairness, efficiency, and administrability conflict. Nonetheless, while there may be differences in opinion regarding the ideal tax base or rate structure to employ in taxing income, there is a broad consensus supporting application of fairness criteria to policy analysis of the income tax system. Indeed, fairness has been a principal justification for the income tax in the United States since its inception.[6]

The fairness criterion is based on the accepted notion that a fair tax should take account of taxpayers ability to pay. One of the reasons to base a tax on a taxpayer's entire income is that income is a reasonable proxy for "ability to pay." Relating the amount of tax to a person's income is considered to achieve fairness by relating the tax to the taxpayer's ability-to-pay.[7]

I will not in this testimony review the arguments regarding what neutrality principles should guide international tax policy.[8] There is a lack of consensus among economists regarding what neutrality principle should guide U.S. tax policy in an open economy setting.[9] Generally, the efficiency criterion supports rules that distort pre-tax economic decisions as little as possible. A common sense approach to efficiency would be to seek to reduce the tax incentives to shift economic activity in response to differences in, e.g., lower, effective tax rates.[10] In other words, from an overall U.S.

[5] See Michael J. Graetz, "The David Tillinghast Lecture: Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies," 54 Tax Law Rev. 261, 284 (2001) [hereinafter Graetz, Taxing International Income].

[6] There is a rich academic literature about the theoretically appropriate bases on which to evaluate fairness claims and even whether such claims have normative content. *See* J. Clifton Fleming, Robert J. Peroni & Stephen E. Shay, "Fairness in International Taxation: The Ability-to-Pay Case for Taxing Worldwide Income," 5 FLA. TAX REV. 299, 301 at note 12 (2001) [hereinafter Fleming, Peroni & Shay, Fairness in International Taxation]. It seems clear, however, that the perception that imposing tax on income tax is fundamentally fair has played an important role in the continued importance of the income tax as a means of raising revenue in the United States and other developed countries.

[7] I do not consider here issues relating to whether rates of tax on income should be progressive (i.e., increase with income) or flat. Nor do I consider how the distribution of tax burden should be analyzed, i.e., should it take account of governmental transfer payments to individuals and subsidies to businesses.

[8] See David L. Brumbaugh and Jane G. Gravelle, "Reform of U.S. International Taxation: Alternatives," CRS-4 – CRS-11 (CRS Report for Congress R.L. 34115) (July 31, 2007) [hereinafter Brumbaugh and Gravelle, Reform of International Taxation]; American Bar Association Tax Section Task Force on International Tax Reform, "Report of the Task Force on International Tax Reform," 59 TAX LAW. 649, 680 – 689 (2006) [hereinafter ABA Report].

[9] *See* ABA Report, *supra* note 8.

[10] The President's Advisory Panel on Federal Tax Reform articulated a standard for evaluating proposals that favor one activity over another that should be applied to evaluate proposals to tax foreign income more or less favorably than domestic income:

> Tax provisions favoring one activity over another or providing targeted tax benefits to a limited number of taxpayers create complexity and instability, impose large compliance costs, and can lead to an inefficient use of resources. A rational system would favor a broad tax base, providing special tax treatment *only where it can be persuasively demonstrated that the effect of a deduction, exclusion, or credit justifies higher taxes paid by all taxpayers*. (Emphasis added.)

perspective, the effective tax rate on an item of foreign income, taking into account foreign taxes, should not be materially lower than the effective rate on domestic income. A corollary is that relief should not be given to high foreign effective tax rates through cross-crediting.

The administrability criterion recognizes that the costs of administration and enforcement, to government and taxpayers, are not productive costs and should be kept to the minimum possible. While recognizing that taxpayers with international income are generally sophisticated and able to deal with complex provisions, a system whose complexity fosters wasteful tax planning and which is difficult to administer by tax authorities is undesirable.

The taxation of foreign business income presents particular fairness issues. Before reviewing those issues, I will briefly outline the U.S. rules for taxing U.S. persons' foreign business income.

Current U.S. Rules For Taxing International Income

Worldwide taxation subject to a limited tax credit for foreign income taxes. The United States taxes the worldwide income of U.S. citizens, resident aliens and domestic corporations. Generally, the United States allows a taxpayer to elect to credit foreign income taxes paid or deemed paid up to the amount of U.S. tax on foreign-source net income in the same limitation category.

U.S. source taxation of a foreign corporation. In contrast to the taxation of U.S. persons, foreign persons are taxed by the United States only on a source basis. Foreign persons that carry on a U.S. trade or business are taxed on their net income effectively connected with that trade or business. If resident in a treaty country, the foreign person's income must be attributable to a so-called "permanent establishment" in the United States. Foreign persons earning U.S. source income not connected with a U.S. trade or business are taxed on U.S.-source interest, dividends, royalties and other fixed or determinable, annual or periodical ("FDAP") income at a rate of 30% (or lower treaty rate) on the gross amount of the income. U.S. effectively connected earnings of a foreign corporation are subject to a second level branch profits tax.[11] A foreign corporation is not taxed by the United States on foreign income unless the foreign income is effectively connected with a U.S. trade or business.

U.S. shareholder taxation of income earned through a foreign corporation. Most active foreign business income earned by a U.S.-owned foreign corporation is not taxed

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PRESIDENT'S ADVISORY PANEL ON FEDERAL TAX REFORM, SIMPLE, FAIR & PRO-GROWTH: PROPOSALS TO FIX AMERICA'S TAX SYSTEM, REPORT OF THE PRESIDENT'S ADVISORY PANEL ON FEDERAL TAX REFORM xiii (Nov. 2005), *available at* http://www.taxreformpanel.gov/final-report/ [hereinafter PRESIDENT'S ADVISORY PANEL REPORT].

[11] The determination of whether a corporation is domestic or foreign is essentially elective. A corporation is domestic if it is incorporated under the laws of the United States, one of the states of the United States or the District of Columbia or is a business entity that is otherwise organized under such laws and elects to be taxable as a corporation.

to its U.S. shareholders until distributed (this is referred to as "deferral"). The United States allows a U.S. corporate shareholder owning 10% or more by vote of a foreign corporation a credit for foreign income taxes associated with the foreign corporation's earnings that are distributed or deemed distributed to that shareholder.[12] This "indirect" or "deemed paid" credit mitigates double corporate taxation of the foreign dividend.[13] An individual U.S. taxpayer may treat certain dividends from publicly traded foreign corporations and foreign corporations qualifying for the benefits of a comprehensive income tax treaty with the United States as qualified dividend income ("QDI") eligible for the 15% tax rate (through 2010).

Anti-deferral rules. A series of so-called anti-deferral rules are intended to discourage use of foreign corporations as mechanisms to avoid U.S. tax on certain passive and other "base company" income. The two principal anti-deferral regimes today are the controlled foreign corporation rules and the passive foreign investment company rules.[14] The tax rules relating to a United States shareholders' share of income earned by a controlled foreign corporation, in addition to limiting deferral for passive income, also end deferral for certain active business income that is earned through use of "base companies" and is subject to an effective rate of foreign tax that is lower than the U.S. rate. The investment in U.S. property rules are designed to prevent earnings of a controlled foreign corporation that have not been taxed to a United States shareholder from being made available, directly or indirectly, to a United States shareholder.

A United States shareholder's gain on the sale of stock in a controlled foreign corporation generally will be treated as a dividend to the extent of the shareholder's share of the controlled foreign corporation's earnings. What was once considered a negative provision for taxpayers that recaptured the benefits of deferral, is in many cases favorable or neutral. The dividend income will carry foreign tax credits to a 10% corporate shareholder and may constitute qualified dividend income eligible for the 15% rate (until 2010) to an individual shareholder.

A U.S. shareholder in a passive foreign investment company (or PFIC), that is not also a United States shareholder in a controlled foreign corporation, is subject to the rough equivalent of current taxation of the foreign corporation's earnings (or appreciation in value) under one of several alternative taxing regimes. As currently designed, the PFIC rules are intended to cause taxable U.S. shareholders in foreign investment

[12] Because the U.S. tax on foreign income earned by a foreign corporation is deferred until the earnings are repatriated, rules are required to associate the foreign taxes to the earnings that are repatriated, either as an actual dividend or as income inclusions under subpart F. In addition, to permit the foreign tax credit limitation to operate effectively, the limitation categories are applied on a look-through basis to income of a controlled foreign corporation and a non-controlled Section 902 corporation.

[13] A dividends received deduction is not allowed with respect to a dividend from a foreign corporation of earnings that were not effectively connected with a U.S. trade or business.

[14] A "controlled foreign corporation" is a foreign corporation that is more than 50% owned, by vote or value, directly or indirectly under constructive ownership rules, by United States shareholders. A "United States shareholder" is a U.S. person that owns 10% or more by vote, directly or indirect under constructive ownership rules, of the foreign corporation. A passive foreign investment company is a foreign corporation that has 75% or more passive income or 50% or more passive assets.

companies to elect to be taxed in a manner that is comparable to the tax that would be imposed on a shareholder in a U.S. mutual fund.

Transfer pricing. The Internal Revenue Service has broad authority to reallocate income, deduction or expense between commonly controlled taxpayers if they engage in transactions that do not satisfy the arm's length standard. Regulations under Section 482 prescribe the method for determining whether loans of money or transfers of tangible property, intangible property and services are within a range of arm's length prices. Generally, if an arm's length price determined under methods prescribed in the regulations falls within the inter-quartile range of arm's length prices as finally determined, no transfer pricing adjustment will be made.

Observations Regarding Current U.S. Rules for Taxing Foreign Income of U.S. Persons

As I have previously testified, the current U.S. rules, while complex, represent the best of all worlds for U.S. multinational taxpayers.[15] The current U.S. tax rules relating to foreign business activity are a hybrid between actually taxing worldwide income and taxing foreign income at a lower or even zero rate (i.e., exempting foreign income).

Taxpayers that earn high-tax foreign income can use excess foreign tax credits against other low-taxed foreign income. The effect of this cross-crediting is to provide an incentive to a taxpayer with excess foreign tax credits to earn low-taxed foreign income and to credit the foreign tax against U.S. tax on this income. This effectively shifts the burden of a foreign country's high taxes to the United States. Excess foreign tax credits even can be used to offset U.S. tax on income from export sales that is treated as foreign-source income for U.S. tax purposes (though this income generally would not be taxed by the source country).

Allowing U.S. taxation of active foreign business income earned through a foreign corporation to be deferred until repatriated as a dividend encourages investment in lower tax countries. If low-taxed foreign income is earned through a foreign corporation, instead of directly by a U.S. person, and the earnings are reinvested in a foreign business, the U.S. tax may be deferred. Over a long enough period, deferral can be quite valuable and even approach exemption. The 85 percent dividends received deduction of Section 965 effectively exempted from U.S. tax substantially all of the earnings repatriated under that relief provision.[16]

[15] Statement of Stephen E. Shay, Subcommittee on Select Revenue Measures of the Ways and Means Committee, U.S. House of Representatives, Hearing on U.S. International Competitiveness (June 23, 2006) [hereinafter Shay, Testimony Before Subcommittee on Select Revenue Measures].

[16] Ostensibly, 15% of the repatriated earnings were subject to U.S. tax at up to 35% for an effective rate of 5.25% on the dividend. In many cases, the U.S. tax was eliminated by foreign tax credits so the earnings were effectively exempt from U.S. tax. While billed as an economic relief measure, the homeland dividend provision would be more accurately described as a partial amnesty from U.S. tax for low-taxed offshore profits. For a perceptive critique of the "farce" that homeland dividend relief represented, *see* Charles I. Kingson, "The Great American Jobs Act Caper," 58 Tax L. Rev. 327, 388 – 391 (2006) [hereinafter Kingson, Great American Jobs Act Caper].

The U.S. anti-deferral rules have been narrowed or interpreted narrowly in recent years.[17] Taken together with the adoption of elective entity classification and the inherent flexibility of transfer pricing, there is substantial scope for tax planning, often with low taxed countries, to reduce foreign taxes and accelerate utilization of remaining foreign taxes as credits.[18] If the United States allows unlimited deferral, it is reasonable to expect that use of low tax regimes will continue to increase.[19]

In practice, the current U.S. system of worldwide taxation with elective deferral of U.S. tax on foreign corporate business income, while complex, can be managed to achieve low effective rates of tax on foreign income. If U.S. multinationals earn income from active business operations carried on through foreign corporations in low-effective-tax rate structures, enhanced by transfer pricing planning, the U.S. multinationals generally pay no residual U.S. tax until they either receive dividends or sell their shares. When this effective tax reduction is combined with other features of the U.S. international tax regime (i.e., the ability to cross-credit excess foreign taxes against royalty income and export sales income), the overall effect can be more generous than an exemption system.[20] This is borne out by estimates that government tax revenues would *increase* if active foreign business earnings are exempt from U.S. tax when distributed as a dividend.

To summarize, our current international tax rules offer substantial planning opportunities to reduce foreign taxes and to shift income to entities with low-effective tax rates. The effect is to distort economic decisions and create incentives to structure business activity in a manner that takes advantage of low or reduced effective tax rates.

Fairness In Taxation of International Income

There is no *a priori* reason for excluding foreign income from the analysis of a person's ability to pay, whether the income is earned directly by individuals or indirectly

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[17] *See e.g.*, I.R.C. 954(c)(6) (expanding the ability to shift income from high to low taxed affiliates without triggering current income inclusion to a United States shareholder), Notice 2007-13, 2007-5 I.R.B. 410 (limiting the circumstances in which services performed by a controlled foreign corporation will be considered to benefit from assistance of a U.S. person and therefore be subject to current income inclusion to a United States shareholder).

[18] *See* Kingson, Great American Jobs Act Caper, *supra* note 16, at 370 – 387; ABA Report, *supra* note 8, at 705.

[19] *See e.g.*, Martin A. Sullivan, "Economic Analysis: the IRS Multibillion-Dollar Subsidy for Ireland," 108 Tax Notes 287 (July 18, 2005). Charles Kingson correctly observes that repealing the application of the PFIC rules to United States shareholders in a controlled foreign corporation in 1997 eliminated the only tax-based limit on the amount of controlled foreign corporation earnings that could be deferred by a member of the U.S. control group. Kingson, Great American Jobs Act Caper, *supra* note 16, at 382 – 385. U.S. shareholders with less than 10% holdings remains subject to the PFIC rules and the PFIC asset test in particular. It would have made more sense to repeal the PFIC asset test for U.S. portfolio investors and retain it as a limit on deferral for greater than 10% U.S. shareholders in a controlled foreign corporation.

[20] *See e.g.*, Harry Grubert and Rosanne Altshuler,"Corporate Taxes in the World Economy: Reforming the Taxation of Cross-Border Income,"9 – 10 (Draft of December 12, 2006), *available at* http://www-snde.rutgers.edu/scripts/Rutgers/wp/rutgers-listwp.exe?200626.

through foreign activities of U.S. or foreign corporations.[21] If U.S. taxation of foreign business income is lower than on domestic business income, U.S. persons who do not earn foreign business income will be subject to heavier taxation solely because of where their business is located. This would violate the ability-to-pay norm. To justify relief from U.S. tax on foreign business income, there should be an identifiable benefit to individual U.S. citizens and residents.

Allowing unlimited deferral of U.S. taxation on foreign business income is not consistent with the ability to pay criterion. The justification for the deferral benefit (which is another form of subsidy for foreign investment) is that it allows U.S. companies to compete on a level playing field with foreign and local competitors. In addition to concerns about fairness, however, there are numerous adverse consequences of deferral, including that it distorts investment decisions toward low taxed countries, it penalizes redeployment of low taxed foreign earnings in the United States, it requires complex rules to allow foreign tax credits for corporate shareholders, and it requires anti-deferral provisions to prevent its abuse that are difficult to administer and enforce.

Allowing a credit for foreign income taxes, or exempting active foreign business income, also is not consistent with the ability to pay criterion. Such relief from double taxation may be justified, however, by the expectation that the benefits of international trade resulting from the elimination of double taxation will accrue to individual U.S. citizens and residents. There are significant aspects of the U.S. foreign tax credit rules, however, that allow credits beyond what would be necessary to eliminate double taxation of foreign income and can not be justified other than as a subsidy for foreign investment. These include, as discussed below, source rules that expand the definition of foreign income to include income that is attributable to U.S. economic activity and is not taxed by foreign countries. In addition, expenses attributable to earning foreign income are allocated to U.S. income in ways that expand the foreign tax credit limitation to allow foreign taxes to offset U.S. tax on what properly should be U.S. net income.

There is little or no empirical evidence that the benefits of allowing deferral to U.S. companies or excessive credits for foreign taxes is efficient in that it generates more benefits to U.S. citizens and residents than it costs in higher taxes on U.S. citizens and residents and domestic businesses. If the reduced level of U.S. tax on corporate income allowed under current U.S. international tax rules shifts the tax burden to U.S. citizens and residents beyond what can be justified to avoid double taxation of income, the fairness criterion is not satisfied. If current rules are not fair, what can be done about it?

Possible Changes to Current U.S. Rules for Taxing Foreign Business Income to Increase Fairness

The major approaches by which the tax system of a country (the "residence country") taxes business income earned by its residents in a foreign country

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[21] *See* Fleming, Peroni & Shay, Fairness in International Taxation, *supra* note 6; *see also* Nancy H. Kaufman, "Fairness and the Taxation of International Income," 29 LAW & POLICY INT'L BUS. 145 (1998); Graetz, Taxing International Income, *supra* note 5.

("foreign-source income") are worldwide taxation subject to a credit for foreign taxes and exemption of foreign business income (also referred to as a territorial system).[22] The principal attractions of a foreign exemption proposal are that it would eliminate the tax on repatriation of earnings under a deferral regime and would foreclose relief for high foreign taxes through cross-crediting . It nevertheless leaves other problems of current law unsolved. Significantly, the incentive for income shifting activity to low-tax locations would increase.[23] I have previously testified why I do not believe that the benefits from an exemption system are likely to be superior on efficiency or fairness grounds to reforms based on current taxation of foreign business income with an appropriately limited foreign tax credit.[24]

I respectfully submit that reducing the scope for deferral and more closely aligning foreign tax credit rules to the purpose of avoiding double taxation should be supported on grounds of fairness and efficiency.

There are two basic approaches to taxing the income of a controlled foreign corporation currently in the hands of a U.S. shareholder. One approach would be to adopt pass-through treatment for earnings.[25] This would have the benefit of maintaining the character and source of the income and subjecting the income to the applicable tax rate of the shareholder. It would permit current pass-through of losses. While conduit taxation may be optimal as a theoretical matter, it would constitute a dramatic and difficult change from current law.

Current taxation of U.S. shareholders under an expansion of Subpart F, while second best to a conduit approach, would be a substantial improvement over current law

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[22] There have been a number of proposals to exempt foreign business income, including in the President's Advisory Panel on Federal Tax Reform's Simplified Income Tax Proposal. The President's Advisory Panel's exemption proposal would exempt a domestic corporation from tax on dividends from a foreign corporation attributable to certain active business income. PRESIDENT'S ADVISORY PANEL REPORT , *supra* note 10, at 124-25. The Joint Committee on Taxation Staff also has an exemption proposal that is more detailed than the President's proposal. STAFF OF JOINT COMM. ON TAX'N, OPTIONS TO IMPROVE TAX COMPLIANCE AND REFORM TAX EXPENDITURES, JCS-02-05, 191 (Jan. 27, 2005).

[23] As noted by Edward Kleinbard, "*Territorial tax systems, by contrast, reward successful transfer pricing gamers as "instant winners"* by enabling the successful U.S. firm to recycle immediately its offshore profits as tax-exempt dividends paid to the U.S. parent." (Emphasis in original.) Edward D. Kleinbard, "Throw Territorial Taxation From the Train," 114 TAX NOTES 547, 554 (February 5, 2007) [hereinafter Kleinbard, Throw Territorial Taxation From the Train].

[24] Based on analyses that rest more on efficiency and administrability considerations, other commentators also express skepticism regarding territorial taxation proposals. *See* Kleinbard, Throw Territorial Taxation From the Train, *supra* note 23; Brumbaugh and Gravelle, Reform of International Taxation, *supra* note 8.

[25] I and my co-authors, Professors Robert J. Peroni and J. Clifton Fleming, Jr., have outlined a proposal for a broad repeal of deferral. Essentially, our proposal would apply mandatory pass-through treatment to 10% or greater shareholders in foreign corporations. Robert J. Peroni, J. Clifton Fleming, Jr. & Stephen E. Shay, *Getting Serious About Curtailing Deferral of U.S. Tax on Foreign Source Income*, 52 SMU L. REV. 455 (1999); J. Clifton Fleming, Jr., Robert J. Peroni & Stephen E. Shay, *Deferral: Consider Ending It Instead of Expanding It*, 86 TAX NOTES 837 (2000).

and probably would enjoy broader support.[26] One approach would be to tax 10% or greater U.S. shareholders by vote in a controlled foreign corporation (more than 50% owned, by vote or value, directly or indirectly, under constructive ownership rules, by 10% U.S. shareholders by vote), to be currently taxed on their share of the controlled foreign corporation's income. There are a number of changes that should be considered to the specifics of these rules, but they have a history of use since 1962 and could be implemented without substantial re-design.[27]

A taxpayer's ability to control inter-company pricing is a fundamental attribute of international taxation. The necessary flexibility of tax rules affecting transfer pricing is a critical factor in assessing the structure of international tax rules. Indeed, I would submit that no approach to transfer pricing, including formula apportionment, will eliminate the potential for manipulation. Instead, the focus must be on reducing the effective tax rate differentials that drive transfer pricing planning. Reducing the scope for deferral is key to achieving this objective.

The current foreign tax credit mechanism should be improved by repeal of the sales source rule and other rationalization of source rules for taxing income from intangibles. Thus, for example, income from the licensing of intangibles should be sourced consistently with the sale of inventory (after repeal of the sales source rule) subject to an adjustment to allow a credit for foreign withholding tax, if any, on the royalty.[28] Current expense allocation rules permit the over-allocation of expenses to U.S. income, thereby expanding the foreign tax credit limitation. These rules should be reviewed and revised to limit their scope to what is appropriate to avoid double taxation. Other changes to limit cross-crediting of foreign taxes also should be considered.

The changes described above would move toward equalizing the taxation of foreign and domestic income. A base broadening approach that allowed for reduction in corporate tax rates generally would assist U.S. businesses that export from the United States or compete against foreign imports as well as businesses that operate abroad. The result would be a fairer tax system.

I would be pleased to answer any questions the Committee might have.

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[26] I acknowledge the substantial benefits of Edward Kleinbard's proposal for a more fundamental reform of business income generally. *See* Edward Kleinbard, "The Business Enterprise Income Tax: A Prospectus," 106 TAX NOTES 97 (Jan. 3, 2005). That proposal also is beyond the scope of this discussion.

[27] Less than 10% U.S. shareholders and 10% U.S. shareholders in foreign corporations that did not have a controlling U.S. shareholder group would be taxed under current law rules on distributions when received. The passive foreign investment company (PFIC) rules would continue to apply, however, the PFIC asset test should be eliminated for portfolio investors and the passive income threshold should be reduced to 50% from 75%. The PFIC taxing rules, a deferred tax with an interest charge, qualified electing fund pass-through taxation, or mark-to-market taxation, would apply to a U.S. shareholder in a PFIC.

[28] Approaches to these proposals may be found in ABA Report, *supra* note 8, at 772 – 774.

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Mr. Shay is not appearing on behalf of any client or organization.

Practice

Stephen E. Shay is a tax partner with Ropes & Gray in Boston, Massachusetts. Stephen has extensive experience in the international tax area, advising clients that include large and medium-sized multinational companies, financial institutions, and global investors on issues such as foreign tax credits, deferral of U.S. taxation, foreign currency gains and losses, withholding taxes and financial product issues. Stephen regularly advises clients on transfer pricing issues and has successfully resolved numerous transfer pricing controversies with the IRS. Stephen also works with Ropes & Gray's Private Client Group advising high net worth clients on cross-border income tax planning.

Stephen is a Lecturer in Law at the Harvard Law School teaching a course on international aspects of U.S. income taxation. Stephen was the Jacquin D. Bierman Visiting Lecturer in Taxation at Yale Law School in 2004. Stephen has served as Associate Reporter for the American Law Institute's Federal Income Tax Project on Income Tax Treaties with Reporters David R. Tillinghast and Professor Hugh Ault. He also is a Council Director of the American Bar Association Tax Section and has served as Chairman of the Tax Section's Committee on Foreign Activities of U.S. Taxpayers.

Before joining Ropes & Gray in 1987, Stephen was the International Tax Counsel for the United States Department of the Treasury. Prior to joining the Treasury Department as an Attorney Advisor in 1982, Stephen was associated with Reavis & McGrath and Coudert Brothers in New York City. Stephen received J.D. and M.B.A. degrees from Columbia University in 1976 and his B.A. from Wesleyan University in 1972.

Stephen has authored or co-authored numerous articles and has testified before Congress on international tax policy issues. Stephen's principal publications and testimony in the preceding 10 years are set out below.

Publications and Testimony

American Bar Association Tax Section, Task Force on International Tax Reform, "Report of the Task Force on International Tax Reform," 59 Lawyer 649 (2006) (principal draftsman)

Testimony , Subcommittee on Select Revenue Measures of the Ways and Means Committee, U.S. House of Representatives, Hearing on U.S. International Competitiveness (June 23, 2006)

Testimony, President's Advisory Panel on Federal Tax Reform, Panel on International Income Taxation (May 13, 2005)

"The David R. Tillinghast Lecture: 'What's Source Got to Do With It?' Source Rules and U.S. International Taxation," 56 Tax Law Rev. 81 (2003) (co-authored with Robert J. Peroni and J. Clifton Fleming Jr.)

Testimony, Finance Committee, United States Senate, Hearing on International Competitiveness (July 16, 2003)

"Reform and Simplification of the U.S. Foreign Tax Credit Rules," 31 Tax Notes Int'l 1145 (September 29, 2003) and 101 Tax Notes 103 (October 6, 2003) (co-authored with Robert J. Peroni and J. Clifton Fleming Jr.)

Testimony, Ways &Means Committee, U.S. House of Representatives, Hearing on WTO Extraterritorial Income Decision (February 28, 2002)

“Fairness in International Taxation: The Ability-to-Pay Case for Taxing Worldwide Income,” 5 Fla. Tax Rev. 299 (2001) (co-authored with J. Clifton Fleming, Jr. and Robert J. Peroni)

"An Alternative View of Deferral: Considering a Proposal to Curtail, Not Expand, Deferral," 20 Tax Notes Int'l 547 (January 31, 2000) (co-authored with J. Clifton Fleming, Jr. and Robert J. Peroni)

"Deferral: Consider Ending It, Instead of Expanding It," 86 Tax Notes 837 (Feb. 7, 2000) (co-authored with J. Clifton Fleming, Jr. and Robert J. Peroni)

"Taking Territorial Taxation to Task," 20 Tax Notes Int'l 1178 (April 17, 2000) (co-authored with Robert J. Peroni and J. Clifton Fleming, Jr.)

"Qualified Intermediary Status, Act III: Rev. Proc. 2000-12’s Final Qualified Intermediary Agreement and Amendments to Final Withholding Rules," 29 Tax Mgmt. Int'l J. 403 (July 14, 2000) (co-authored with Susan C. Morse and Christopher J. Peters)

“Getting Serious About Curtailing Deferral of U.S. Tax on Foreign Source Income,” 52 SMU Law Review 455-530 (Spring 1999)
(co-authored Robert J. Peroni and J. Clifton Fleming, Jr.)

"Qualified Intermediary Status: A New Withholding Role for Foreign Financial Institutions Under Final U.S. Withholding Regulations," 27 Tax Mgmt Int'l J. 3 (1998) (co-authored with Susan C. Morse)

"Selected International Aspects of Tax Reform Proposals," 51 U. Miami L. Rev. 1029 (1997), reprinted in American Bar Association Section of Taxation, Tax Systems Tax Force, "A Comprehensive Analysis of Current Consumption Tax Proposals" (1997) (co-authored with Victoria P. Summers)

"Revisiting U.S. Anti-Deferral Rules," TAXES (December, 1996)

"Chapter 6, Taxation Policy," co-authored with Elinore J. Richardson, Esq., in Pritchard, ed., Economic Development, Foreign Investment and the Law: Issues of Private Sector Involvement Foreign Investment and the Rule of Law in a New Era, (Kluwer 1996)