WORKING GROUP ON INTANGIBLES

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STATEMENT OF THE WORKING GROUP ON INTANGIBLES

ON

INCOME FROM INTANGIBLE PROPERTY THAT IS ESSENTIAL TO THE ACTIVITIES OF A GLOBAL U.S. BUSINESS

SUBMITTED FOR THE RECORD OF THE HEARING

ON

"HOW OTHER COUNTRIES HAVE USED TAX REFORM TO HELP THEIR COMPANIES COMPETE IN THE GLOBAL MARKET AND CREATE JOBS"

BEFORE

THE COMMITTEE ON WAYS AND MEANS

ON

MAY 24, 2011

Introduction

The Working Group on Intangibles (the "Intangibles Working Group") welcomes the opportunity to provide comments for the record of the May 24, 2011 Committee on Ways and Means ("Committee") hearing to "examine international tax rules in various countries with an eye toward identifying best practices that might be applied to international tax reform in the United States.[1]" The Intangibles Working Group is composed of U.S.-based worldwide companies representing a cross-section of industries, including medical device manufacturers, food product companies, consumer nondurable goods companies, pharmaceutical companies, software companies, and information technology companies.

Although the make-up of the Intangibles Working Group is diverse, the member companies generally share several major characteristics – they spend billions of dollars annually on research and development ("R&D") in the United States, and they deploy cutting edge technologies that are integral to products sold to consumers around the globe. In almost every case, they derive foreign-related income from patents, trademarks, or other intellectual property that has substantial value independent of underlying goods or services ("intangibles"). Moreover, members of the Intangibles Working Group compete throughout the world with foreign-headquartered companies that have limited exposure to the U.S. tax regime and may also benefit from special rules in other countries. Thus, the U.S. tax treatment of foreign source intangibles income is of critical importance to companies in the Intangibles Working Group.

The current U.S. tax rules relating to R&D and the use of intangibles, combined with the U.S. deferral rules, contribute to the creation of high-paying U.S. jobs that result from our

[1] http://waysandmeans.house.gov (Hearing Advisory: accessed 18 May 2011).

companies' successful worldwide operations. Thus, legislative proposals negatively affecting the taxation of intangibles income could have a dramatic impact on both the number and location of R&D jobs currently in the United States as well as the ability of our companies to compete effectively in the global marketplace. Given the focus on "policy choices that maximize competitiveness and job creation,[2]" we would like to share our preliminary views regarding the implications of four regimes that were designed to provide more competitive rules for intangibles income, namely those in Belgium, Netherlands, Luxembourg, and (most recently)the United Kingdom ("UK"). The treatment of intangibles under these European regimes – all of which have come into effect or been developed in or after 2007 – may provide useful "benchmarks" for U.S. policy makers who seek to reform the U.S. international corporate tax regime in a manner that is consistent with international norms. To summarize our findings, relevant to the Committee's goal of "identifying best practices[3]" the European countries we surveyed –

(1) Provide robust incentives to conduct R&D within their borders; and

(2) Provide a "carrot" of incentives to retain ownership and exploitation of intangibles in their countries, rather than utilizing a "stick" in the form of punitive taxes to address concerns about the "mobility" of intangibles income.

Discussion

Members of the Intangibles Working Group employ intangibles in *routine* ways as an integral part of their business activities, including manufacturing, R&D, distribution, and the provision of services. The Intangibles Working Group was originally formed in response to revenue-raising proposals to increase the tax burden on certain income from intangibles.[4] Previously, the Intangibles Working Group submitted a statement for the record of the Committee's July 22, 2010 hearing on transfer pricing, to explain why such proposals would threaten U.S. competitiveness and innovation. Consistent with the Committee's current focus on laying the groundwork for the consideration of comprehensive tax reform, this statement sets forth a conceptual basis for "design elements" that should be a part of any tax reform plan (territorial or otherwise), if the goal is to encourage companies to locate high-value jobs and activity associated with the development, manufacture, and exploitation of intangibles in the United States.

Based on our comparative survey of the selected European regimes, we have developed a general framework for examining tax incentives and tax penalties designed to reward technical innovation, retain or create high-value jobs, and enhance the competiveness of U.S. companies. Of course, a particular country's treatment of intangibles income should be evaluated in the

[2] *Id.*

[3] *Id.*

[4]President Obama's FY2011 and FY2012 budgets include novel proposals to end deferral for income from intangibles under circumstances that have yet to be fully defined. As described, the current proposal would impose immediate U.S. tax on the "excess intangible income" from "transactions connected with or benefitting from" intangibles that a "U.S. person transfers…from the United States to a related CFC…if the income is subject to a low foreign effective tax rate." Very generally, "excess" income" would be defined as the excess of gross income from transactions over costs (excluding interest and taxes) plus a percentage mark-up. *See* General Explanation of the Administration's FY2012 Revenue Proposals, Department of the Treasury (February 2011) 43-44.

context of other features of the underlying corporate tax system (such as the maximum statutory tax rate and the existence of a dividend exemption system for foreign earnings) or applicable treaties (*e.g*., because the countries we surveyed are members of the European Union, they were limited in their ability to link incentives to in-country jobs; this would likely not be the case in the United States). Nevertheless, it is possible to discern broad similarities among the four countries that could be used to inform the legislative process in the United States.

- The Prevalence of R&D Incentives. As noted above, in addition to a special regime for intangibles income, all four countries provide a variety of R&D incentives such as credits or exemptions to wage withholding for research activity. For example Belgium provides an investment deduction or R&D credit, as well as wage withholding tax exemptions for researchers. In contrast, the temporary nature of the U.S. R&D tax credit detracts from its effectiveness due to the resulting lack of predictability. *To remain competitive internationally, the Intangibles Working Group supports an attractive and permanent R&D credit in the United States.*

- Use of Tax Regimes to Help Companies Compete Globally. Precisely because of concerns about the mobility of intangibles, the selected countries embraced incentives designed to encourage their companies to exploit intangibles in the home country. *A preferential regime for intangibles income would move the United States in a similar direction of encouraging companies to retain ownership of intangibles in the United States*.

- No "Claw Back" of the Tax Benefits of the Preferential Regime. None of the four countries have adopted or proposes to adopt broad anti-abuse rules that would have the effect of negating the promised benefits. As one example, the UK government considered expanding its controlled foreign corporation ("CFC") regime to tax intangibles income currently in the case of "excessive profits,[5]" similar to President Obama's FY2012 budget proposals to end deferral for "excess intangible income." We are informed, however, that the March 23, 2011 UK Budget Update reflects a reconsideration of this approach, consistent with the statement that the "aim is to make the CFC regime more competitive while providing adequate protection of the UK corporation tax base. The new regime will… operate in a targeted and more territorial way by bringing within a CFC charge *only* the proportion of overseas profits that have been artificially diverted from the UK" (emphasis added)."[6] *Because the current treatment of intangibles is part and parcel of the deferral rules that have helped U.S. global corporations to remain competitive and preserve high-paying U.S. jobs, an "excess returns" proposal (in present law or a territorial-type system) would have a similar anti-competitive effect.*

[5] *Corporate Tax Reform: delivering a more competitive system*, page 26, 29 November 2010 (http://www.hm-treasury.gov.uk/d/corporate_tax_reform_part2a_cfc_reform.pdf : accessed 20 May 2011)

[6] *Overview of Tax Legislation and Rate*, page 22, 23 March 2011 (http://www.hmrc.gov.uk/budget2011/overview.htm : accessed 20 May 2011).

Members of the Working Group have granted rights in or to intangibles to their related foreign subsidiaries in order to function in global markets and compete against foreign-based multinational corporations. Rights to use intangibles are not granted casually, and the granting of such rights is usually required to facilitate multi-source manufacturing, and to obtain protection under trademark, patent, or other applicable law, quite apart from tax considerations. Furthermore, such grants or transfers must be done in compliance with all applicable laws and regulations, not just U.S. transfer pricing rules. In the case of a global business, rights to intangibles must be granted across the worldwide affiliated group of corporations – with arm's length compensation provided for the functions performed, risks borne, and investments made by each such corporation. These business realities must be given consideration in applying the framework outlined above.

Conclusions

It is vitally important that policy makers seriously consider reforming the U.S. international corporate tax regime in a manner that is consistent with international norms, including the treatment of intangibles income. The transfer and collaborative use of intellectual property are necessary components of modern business practices. These transfers relate both to U.S. developed intellectual property used by foreign affiliates as well as foreign developed intellectual property used by U.S. affiliates. The Intangibles Working Group looks forward to assisting members of the Committee and their staffs to gain a more detailed understanding of the business practices that are necessary for our companies to compete globally, and the tax consequences of these practices. We are hopeful that the Committee will continue its thorough examination of much needed comprehensive reform of the U.S. international tax regime, rather than the development of piecemeal proposals that would produce unintended negative results for U.S. companies, U.S.-based R&D jobs, and ultimately U.S. competitiveness.