CARRIX, INC.

SUBMISSION OF WRITTEN COMMENTS FOR THE HEARING RECORD
U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON WAYS AND MEANS

HEARING ON THE TREATMENT OF CLOSELY-HELD BUSINESSES IN THE CONTEXT OF TAX REFORM

MARCH 7, 2012

Mr. Chairman, Ranking Member Levin and distinguished Members of the Committee:

Carrix, Inc. ("Carrix") is pleased to submit written comments for the record in connection with the March 7, 2012 hearing of the Committee on Ways and Means ("the Committee") on the critically important topic of treatment of closely-held businesses in the context of tax reform.

Background on Carrix:

Carrix is a **closely held** U.S.-based port terminal operating company that manages more cargo terminals than any other company in the world. Carrix provides a full spectrum of transportation services, from terminal management to stevedoring, in a number of U.S. and foreign ports.

As a closely-held company built on international trade, Carrix fully appreciates the topic of the hearing: how the tax code imposes a variety of burdens on closely-held companies, which public companies do not face. Carrix, like many other U.S.-based companies in all sectors of the economy, faces fierce competitive pressure from foreign-based companies. Unlike most other U.S.-based companies, many of our foreign-based competitors are large foreign multinationals, some of which are closely aligned with foreign governments, and operate under more favorable home country tax regimes.

We would like to bring to the Committee's attention a tax issue that directly and negatively impacts our ability to grow our U.S. operations: the potential application of the personal holding company (PHC) tax to earnings we would seek to repatriate in the form of dividends from our foreign subsidiaries. As will be discussed further, the PHC tax is an outmoded relic in the Tax Code that offers little, if any, compelling policy rationale for its continued existence. As the Committee considers fundamental tax reform, we believe the regime should either be repealed or substantially revised.

Background on the Personal Holding Company Tax

The PHC tax was enacted in 1934 and, at the time, represented an appropriate response to prevent individuals from sheltering investment income from individual income tax by using their closely held US corporations to hold investments, referred to as the incorporated checkbook. At the time the maximum individual income tax rate was substantially higher than the maximum corporate tax rate[1] and corporations could be liquidated on a tax-free basis.[2] Neither possibility exists today because of changes to the tax laws, yet the PHC provisions were never updated to reflect more modern circumstances, particularly closely held consolidated groups with foreign affiliates.

The PHC rules impose a corporate level penalty tax of 15% (the rate will become 39.6% in 2013 if the Bush tax cuts expire as scheduled at the end of 2012) on the undistributed PHC Income of a PHC. A corporation constitutes a PHC if 60% of its adjusted ordinary gross income is PHC income and if 50% of its stock is owned by five or fewer individual shareholders at any time during the last half of the taxable year. PHC income generally is defined as interest, dividends, royalties, rents, and certain other types of passive investment income. The PHC penalty tax can be avoided by an entity by distributing PHC income to its shareholder(s), resulting in the shareholder(s) paying the appropriate tax on the distribution.

In the case of a group of US corporations filing a consolidated return, the PHC calculations are generally conducted on a consolidated basis. However, in certain circumstances the PHC test and tax computation must be made on a separate company basis. Section 542(b)(2) provides the PHC test must be applied on a separate company basis if more than 10 percent of any corporate member's adjusted ordinary gross income is received from a source outside the affiliated group (such as foreign subsidiaries) and more than 80 percent of such adjusted ordinary gross income is PHC income. PHC income would include dividends from foreign subsidiaries.

For each taxable year, if any separate corporate entity included in the affiliated group fails the test under Section 542(b)(2), the entire corporate structure is tainted and each separate corporate entity is potentially subject to the PHC tax. Thus, when the test is conducted on a separate company basis, a US group of corporations filing a consolidated return can easily find that it has a personal holding company tax liability even though a majority of its consolidated revenue may be active trade or business income and it would not otherwise be subject to the PHC tax except for the rules requiring separate company testing.

[1] In 1934, the highest individual tax rate was 63% and the highest corporate tax rate was 13.5%, resulting in a 49.5% rate differential.

[2] *General Utilities & Operating Company v. Helvering*, 296 U.S. 200 (1935). The *General Utilities* doctrine was repealed by Congress in 1986.

The policy rationales that led to the PHC tax regime are no longer operative. First, the top marginal tax rate for both individuals and corporations is 35%.[3] Second, with the repeal of the *General Utilities* doctrine in 1986, corporate liquidating distributions of appreciated assets are taxed at the corporate level. ***Simply put: Today's tax laws do not provide an incentive to incorporate portfolio investments to escape the individual income tax.***

Application of PHC tax to Carrix

An example will help to clarify the lack of a compelling policy justification for the application of the PHC tax. The requirement to conduct the PHC tests on a separate company basis often unfairly penalizes corporate groups that are actively engaged in business. A common fact pattern that gives rise to this unwarranted imposition of the PHC tax is where a member of the group receives dividends from foreign subsidiaries. ***In this case, the separate company PHC tax computation serves as a deterrent to the repatriation and reinvestment of foreign earnings in the United States, further exacerbating the so-called 'lockout' effect.***

In other words, Carrix would be hit by the PHC tax to the extent it repatriated dividends from its overseas affiliates simply because it is a closely held company. If Carrix were organized as a public company, the PHC penalty tax would not apply. Simply because Carrix is closely held, the tax rate on foreign earnings repatriated back to the United States would be, rather than the normal 35% rate, a 50% tax rate. Such a level of tax makes it more economical for Carrix to keep foreign earnings offshore for purposes of further developing international operations, rather than repatriating earnings from overseas operations to fund productive investments in the United States. In Carrix's case, for example, we would plan to use a portion of the repatriated cash to fund the construction of a major port terminal facility in Washington State.

Additional Policy Considerations

Carrix believes that additional policy considerations argue in favor of repealing, or substantially modifying, the PHC tax regime. The tax was enacted to prevent affluent individuals from escaping the reach of the individual income tax. Given the changes described above in our nation's tax laws, the PHC tax regime does less to deter the formation of so-called "incorporated pocketbooks" than to inhibit certain closely-held active businesses from pursuing logical business transactions that other companies are able to do because they may give rise to PHC tax consequences.

While some companies are able to evade the reach of the PHC tax through sophisticated tax counsel, other companies are not so lucky and are either unaware of the PHC tax or cannot avoid the tax unless they change their ownership structure. In addition, the PHC

[3] The top individual tax rate is slated under current law to rise to 39.6% on January 1, 2013 – resulting in less than a 5% differential between the top corporate and individual rates.

tax adds significant complexity to the Internal Revenue Code while raising a relatively nominal amount of tax revenue: approximately $38 million per year.[4]

Most importantly, from our perspective, the PHC tax unnecessarily and unfairly taxes revenues which would otherwise be available for investment in much needed infrastructure projects or other important corporate uses which would promote economic development in the United States.

Conclusion

Thank you for the opportunity to submit these written comments for the record. Carrix looks forward to working with you and your staff to ensure that the U.S. tax code is reformed in a way that makes sense, treats similarly situated taxpayers equally, and doesn't penalize certain closely-held taxpayers due to certain antiquated provisions of the Internal Revenue Code.

[4] 2008 IRS SOI data.