Carrix, Inc.
1131 SW Klickitat Way
Seattle, WA 98134
Phone: 206-382-4490
Fax: 206-623-0179

Submission of Written Comments for the Hearing Record
U.S. House of Representatives, Committee on Way and Means
Subcommittees on Oversight and Select Revenue Measures
Hearing on Harbor Maintenance Funding and Maritime Tax Issues
February 1, 2012

CARRIX, INC.

SUBMISSION OF WRITTEN COMMENTS FOR THE HEARING RECORD
U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEES ON OVERSIGHT
AND SELECT REVENUE MEASURES

HEARING ON HARBOR MAINTENANCE FUNDING AND MARITIME TAX ISSUES

February 1, 2012

Chairman Boustany, Chairman Tiberi, Ranking Member Lewis, Ranking Member Neal and distinguished Members of the Subcommittees:

Carrix, Inc. ("Carrix") is pleased to submit written comments for the record in connection with the January 25, 2012 hearing of the Committee on Ways and Means Oversight and Select Revenue Measures Subcommittees ("the subcommittees") examining critical maritime tax issues. 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. Carrix and its affiliates directly employs more than 1,350 American workers, and indirectly employs more than 4,900 FTE American union workers, all of whom provide necessary services to the maritime industry. In addition, Carrix and its affiliates have marine terminal operations in 13 states.

As a company built on international trade, specifically in the shipping industry, Carrix fully appreciates the topic of today's hearing: the role that tax issues play in the maritime industry. 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 return to the U.S. in the form of dividends from our foreign subsidiaries. This should not be confused with the income tax that U.S. companies would pay on these foreign dividends. PHC is a discriminatory tax of 15 percent that is paid in addition to the income tax. 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. We applaud the full Committee's examination of fundamental tax reform, undertaken at the Chairman's direction last year. As the Committee continues to work on fundamental tax reform this year, we believe the PHC tax regime should either be repealed or substantially revised.

Background on the Personal Holding Company Tax

Section 541 of the Internal Revenue Code imposes a corporate level penalty tax of 15%[1] on the undistributed personal holding company ("PHC") income of a PHC. The purpose of the PHC tax regime[2] is to prevent individuals from avoiding the individual income tax on interest, dividends, rents and similar types of income by holding investments through corporations. A corporation constitutes a PHC if 60% of its adjusted 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.

It is important to understand the roots of the PHC tax regime to appreciate why it needs to be reconsidered. In the 1930s the corporate tax rate was 13.5% and the top individual income tax rate was 63% (a 49.5% differential between the top corporate and individual tax rate). Also, pursuant to the so-called *General Utilities*[3] doctrine, corporations could liquidate and distribute to their shareholders appreciated assets tax-free. These two factors created incentives for individuals to incorporate their portfolio investments (so-called "incorporated pocket-book"). Congress responded to this situation appropriately by enacting the PHC tax provisions as part of the Revenue Act of 1934.

As the Committee knows full well, the nation's tax laws, and the need for many companies to operate on a global basis in order to effectively compete against our foreign counterparts, have changed significantly since the mid-1930s.

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%.[4] Second, 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. In the case of a group of corporations filing a consolidated return, the PHC test is generally conducted on the basis of the operations of the

---

[1] This rate is scheduled to return to the highest individual tax rate when the lower dividend tax rate expires.
[2] Sections 541 – 547 of the Internal Revenue Code of 1986.
[3] *General Utilities & Operating Company v. Helvering*, 296 U.S. 200 (1935). The *General Utilities* doctrine was repealed by Congress in 1986.
[4] 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.

consolidated group. However, in certain circumstances the test must be conducted on a separate company basis. When the test is conducted on a separate company basis, a group of corporations filing a consolidated return can easily find that it has a personal holding company tax liability even though a great majority of its revenue is generated from the active conduct of its trade or businesses.

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 controlled 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.***

In other words, Carrix could be subject to 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 returned 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 using earnings from overseas operations to fund productive investments in the United States.

In Carrix's case, for example, we could use foreign earnings to fund the construction of major port terminal facilities in Washington State, strengthen the financial well-being of the company and, most importantly, create and retain good, well-paying U.S. jobs.

Additional Policy Considerations

Carrix believes that additional policy considerations argue in favor or 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 the overall design elements of our nation's tax law today, in practice, the PHC tax regime does less to deter the formation of so-called "incorporated pocketbooks" than to inhibit closely–held active businesses with less than six shareholders from pursuing logical business transactions that other companies are able to do because they may give rise to PHC tax consequences.

Some companies are able to evade the reach of the PHC tax through sophisticated tax counsel, some companies elect to make investments internationally versus in the U.S. rather than pay this discriminatory tax, and 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 tax adds significant complexity to the Internal Revenue Code while raising a relatively nominal amount of tax revenue: approximately $38 million of total PHC tax was paid in 2008 (most recent year information available).

Most importantly, from our perspective, the PHC tax unnecessarily and unfairly taxes revenues which would otherwise be available for investment in much needed port infrastructure projects or other important corporate uses which would promote economic development in the United States. No federal support exists for port infrastructure other than a modest number of Tiger grants and a highway bill that is languishing and, more importantly, consistently lacks sufficient support to keep our ports competitive with other nations or to meet the growing demands of international trade.

Proposed Solution:

A proposed solution would eliminate the provisions that require certain consolidated groups of corporations to determine their PHC tax liabilities on a separate company basis.

This solution would not eliminate the PHC tax for a consolidated group of corporations that is determined to be a PHC on a consolidated basis. However, provided that a consolidated group of corporations is determined not to be a PHC on a consolidated basis, these corporations would not pay the additional 15% penalty tax, but would simply pay the same level of corporate tax as a similarly situated publically traded corporation.

Suggested Legislative Text:

(a) In General. – Section 542(b) is amended by –

    (1) striking paragraph (2) and (4), and

    (2) redesignating paragraphs (3), and (5) as paragraphs (2) and (3) respectively.

(b) Conforming amendments –

    (1) Section 542(b)(1) is amended by striking “paragraphs (2) and (3) and inserting “paragraph (2)”.

    (2) Section 1504(c)(2)(B)(ii) is amended by striking “section 542(b)(5)” and inserting “section 542(b)(3).

(c) Effective Date – The amendment made by this section shall apply to taxable years beginning after December 31, 2012.

Conclusion

Thank you for the opportunity to submit these written comments for the record. As a significant service provider to the U.S. maritime industry and a large employer of American workers, Carrix looks forward to working with you and your staffs to ensure that the U.S. tax code is reformed in a way that makes sense and that, in particular, removes this piece of tax legislative “dead wood” from the Code.