



## Repeal of the Corporate Alternative Minimum Tax Limitation on Use of Foreign Tax Credits

### Issue

Unlike the regular tax, which allows companies a credit of 100 percent of the foreign taxes on income earned abroad, the alternative minimum tax's 90 percent limitation on the use of foreign tax credits unfairly causes double taxation of income earned abroad. Prevention of double taxation has long been a fundamental principle of U.S. tax policy.

### Background

The alternative minimum tax ("AMT") was enacted under the Tax Reform Act of 1986 ("TRA 86") to achieve "fairness" based on a perception that some corporations did not pay enough tax or were able to zero out their tax liability prior to TRA 86. Tax law provisions which allowed this, such as safe harbor leasing, completed contract method, investment tax credit, and the accelerated cost recovery system, have been either eliminated or substantially modified as part of TRA 86 or prior to it.

In fact, the Joint Committee on Taxation Staff's April 2001 Study (JCX-27-01, 4/25/01) recommended that the corporate AMT be eliminated. The report concluded, "The original purpose of the corporate AMT is no longer served in any meaningful way." Furthermore, it has been estimated that the cost of tax compliance alone for the complexities costs companies many times the amount of AMT collected.

In many cases, the AMT has not worked as planned: as a short-term prepayment recoverable as a credit against future regular tax. Companies now find themselves stuck virtually indefinitely in AMT unable to recover earlier prepayments and paying higher amounts than regular tax.

At the end of 2001, the House passed tax stimulus legislation embodying many of the recommendations of the Administration and in particular specifically repealed the corporate AMT. The legislation got bogged down in the Senate and has not been enacted. The House has twice since passed stimulus legislation retaining the corporate AMT and instead reforming key elements. Among these currently proposed reforms is a repeal of the 90 percent limitation. However, the Senate has also rejected these bills.

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### **Background (cont.)**

In July 2002, House Ways and Means Committee Chairman Bill Thomas (R-CA) introduced an international tax reform bill (H.R. 5095, 107th Congress) that included a proposal to repeal the AMT foreign tax credit limitation. Chairman Thomas is expected to reintroduce H.R. 5095 during the 108th Congress. In addition, Rep. Amo Houghton (R-NY) has introduced an international tax reform bill (H.R. 285) that includes a proposal to repeal the AMT foreign tax credit limitation. Separately, a Senate Finance Committee working group led by Sen. Orrin Hatch (R-UT) and Sen. Bob Graham (D-FL) is developing international tax reform recommendations.

### **Policy Considerations**

A persuasive case can be made for the repeal of the corporate AMT because of its punitive effects which create disincentives for new investment and hitting companies hard in an economic downturn when they can least afford it. An even more compelling case can be made for the immediate repeal of the 90 percent foreign tax credit limitation under the AMT on the basis of unfairness and being a major breach of a bedrock U.S. tax policy to prevent double taxation of foreign source income.

The AMT has a perverse effect of penalizing U.S. global companies for bringing overseas earnings back to the U.S. to support domestic operations. Because of the AMT's limit on foreign tax credits, earnings repatriated from abroad are effectively taxed at a higher rate than domestic earnings, and certainly at a higher rate than non-U.S. competitors operating in those same foreign markets. For example, this provision raises the effective tax rate on a U.S. company doing business in Germany from 39 percent, which a local German company or a French competitor operating in Germany has to pay, to 41 percent. This puts U.S. companies in this position at a competitive disadvantage vis-à-vis their foreign competitors in overseas markets.

### **Recommendation**

The SVTDG recommends the immediate repeal in the 108th Congress of the 90 percent foreign tax credit limitation in the corporate AMT.