

April 29, 2021

The Honorable Ron Wyden  
Chairman  
Senate Committee on Finance  
219 Dirksen Senate Office Building  
Washington, DC 20510

Dear Chairman Wyden:

The Semiconductor Industry Association (SIA) appreciates the opportunity to provide the following comments regarding the international tax proposals outlined in *Overhauling International Taxation: A framework to invest in the American people by ensuring multinational corporations pay their fair share* (the “Framework”).<sup>1</sup> This is a critical time for the U.S. semiconductor industry. In 2020, the U.S. accounted for only 12% of global semiconductor manufacturing capacity, down from 37% in 1990. Federal revitalization of the semiconductor industry in the U.S. along with smart tax policy has the potential to restore American leadership in advanced manufacturing, secure vital supply chains, grow well-paying jobs, tackle the climate crisis, contribute to our national security, and ensure long-term technological and economic competitiveness by driving innovation across many different sectors for decades to come. As you know, semiconductors enable advancements in artificial intelligence, quantum computing, clean energy, medical technologies, and 5G.

The semiconductor industry is extraordinarily capital-intensive, and tax policy is essential to ensuring the competitiveness of the U.S. semiconductor industry. Other locations, including China and Europe, provide generous tax incentives to attract new semiconductor manufacturing, with no commensurate federal incentives in the U.S. For reasons like these, the cost to build and operate a fab in the U.S. is 25-50% more expensive than alternative locations abroad and government incentives directly account for 40-70% of the U.S. cost disadvantage. Still, semiconductors are a significant U.S. export. More than 80% of U.S. semiconductor industry revenue comes from sales to customers outside the United States, making semiconductors America’s fourth-largest export. In an effort to maintain U.S. leadership in innovation, the U.S. semiconductor industry invests approximately one-fifth of its annual revenue into research and development, a higher share than almost any other industry, amounting to nearly \$40 billion in 2019. We must have tax policies which encourage technologically advanced, competitive exports to our customers wherever they may be.

While SIA believes that all aspects of the Framework are important, our comments are focused on the proposed changes to the foreign-derived intangible income regime (“FDII”). We believe that FDII is critically important to supporting innovation in the United

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<sup>1</sup> *Overhauling International Taxation: A framework to invest in the American people by ensuring multinational corporations pay their fair share* (April 2021); available at <https://www.finance.senate.gov/imo/media/doc/040121%20Overhauling%20International%20Taxation.pdf>.

States, which in turn promotes domestic jobs in research and development, manufacturing, and other productive activities. As you look to reconsider FDII, SIA and its member companies are well situated to assist you in weighing various options to improve the system and its impact on U.S. innovation and investment, and we would appreciate the opportunity to do so.

## **FDII – Background and Purpose**

Before specifically addressing the proposals in the Framework, we believe that it would be helpful to provide some context by highlighting the considerations that led to the proposals that were proffered for Congress’s consideration prior to development of FDII. As you know, FDII was enacted as part of the Tax Cuts and Jobs Act<sup>2</sup> (the “2017 Act”) following years of discussions on reforming the U.S. international tax rules. While the 2017 Act was passed without bipartisan support, many of the international tax provisions of the 2017 Act emanated from proposals that were developed through significant bipartisan discussion and collaboration, as reflected in the Final Report of the Senate Finance Committee’s International Tax Bipartisan Working Group (the “2015 Bipartisan Report”).<sup>3</sup> The 2015 Bipartisan Report outlined reasons for reforming the international tax rules, proposals put forward by then-Ways & Means Committee Chairman Camp in 2014 and President Obama in 2015, and a potential bipartisan framework for international tax reform. Many of the major reforms outlined in the 2015 Bipartisan Report<sup>4</sup> were enacted by the 2017 Act.

The 2015 Bipartisan Report also considered the then-emerging international norms regarding the taxation of intangible business income. Various U.S. trading partners, such as the United Kingdom, France, and Italy, had enacted or were considering enacting mechanisms to promote the “onshoring” of intangible property into their jurisdictions by providing a preferential rate to certain intangible income. At the same time, the OECD was developing standards to ensure that such regimes applied only where substantial business activities, such as research and development, that gave rise to the intangible income were conducted in the jurisdiction offering the preferential rate.<sup>5</sup> Taken together, these developments had the potential to attract intangible income, and the associated research and development and other innovation activities, away from the U.S. In

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<sup>2</sup> P.L. 115-97.

<sup>3</sup> United States Committee on Finance, *International Tax Bipartisan Working Group: Final Report (July 2015)*; available at <https://www.finance.senate.gov/imo/media/doc/The%20International%20Tax%20Bipartisan%20Tax%20Working%20Group%20Report.pdf>. The Bipartisan Working Groups co-chairs were Senators Portman and Schumer, the former of whom was also a member of the Committee during the consideration and enactment of the 2017 Act.

<sup>4</sup> E.g., ending the lock-out effect endemic to the former deferral regime, implementing a special regime for taxing intangible business income, providing for a minimum level of tax on a subset of CFC earnings to mitigate base erosion, and imposing stricter interest expense limitation measures.

<sup>5</sup> See OECD/G20 Base Erosion and Profit Shifting Project, *Action 5: Agreement on Modified Nexus Approach for IP Regimes* (2015), available at <https://www.oecd.org/ctp/beps-action-5-agreement-on-modified-nexus-approach-for-ip-regimes.pdf>.

recognition of such a likelihood, the 2015 Bipartisan Report concluded that legislative action was needed.<sup>6</sup>

There is long-standing, bipartisan recognition of the need to encourage the development and ownership of intangible assets that generate highly mobile income in the U.S., and FDII was the mechanism through which Congress believed that such activity would best be promoted, and in turn, spur investment in related U.S. innovation, manufacturing, and jobs. FDII provides a preferential rate on intangible income earned by U.S. corporations from the exploitation of foreign markets. The statutory rate is equal to that applied to the intangible income of CFCs (taking into account the 80% credit for foreign taxes), with the intention of removing U.S. tax as a factor in intangible property location decisions. Unlike the similar regimes of most U.S. trading partners, intangible income is determined in an objective, formulaic manner to avoid disputes and provide certainty. This formulaic approach defines intangible income as an amount over and above a measure of “normal” or “non-intangible” income, equal to ten percent of the value of the taxpayer’s tangible, depreciable asset base. The asset base upon which this amount is calculated is commonly referred to as “QBAI” (qualified business asset investment), and the ten percent return is a proxy for an appropriate routine return on the taxpayer’s active business operations. Anything over and above this amount is deemed to be a “supernormal” return attributable to intangible ownership, and thus an appropriate measure of intangible income. FDII should be understood in the context of similar regimes maintained by U.S. trading partners, as well as other U.S. rules such as the research and experimentation credit, other general business credits, and accelerated cost recovery, all of which provide incentives to invest in productive activities in the United States.<sup>7</sup>

## **Framework Proposals**

The Framework is critical of FDII and asserts that by providing a preferential rate on intangible income determined in a formulaic manner, FDII encourages the offshoring of tangible assets. The Framework proposes to refocus FDII by providing a benefit measured by reference to domestically incurred innovation expenses, such as those related to research and development and worker training. An amount equal to a share of innovation expenses will be treated as deemed innovation income, a concept that will replace that of deemed intangible income currently contained in the FDII provision. We acknowledge that the Framework is necessarily preliminary in nature, and while it outlines

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<sup>6</sup> See 2015 Bipartisan Report, at 76 (“The co-chairs agree that we must take legislative action soon to combat the efforts of other countries to attract highly mobile U.S. corporate income through the implementation of our own ... regime that *encourages the development and ownership of IP in the United States, along with associated domestic manufacturing.*”) (emphasis added).

<sup>7</sup> As of 2020, 14 of the 27 member European Union countries had regimes in place that incentivized domestic development of intangible property and offered preferential tax rates on the income that intellectual property generated. Many of these countries, like the U.S., offer additional tax benefits to spur research and development and capital investment, including cash grants, tax credits and accelerated depreciation deductions. See Tax Foundation, *Patent Box Regimes in Europe* (November 2020), available at [https://taxfoundation.org/patent-box-regimes-in-europe-2020/#:~:text=Patent%20box%20regimes%20\(also%20referred,on%20income%20derived%20from%20IP.&text=The%20aim%20of%20patent%20boxes,locate%20IP%20in%20the%20country](https://taxfoundation.org/patent-box-regimes-in-europe-2020/#:~:text=Patent%20box%20regimes%20(also%20referred,on%20income%20derived%20from%20IP.&text=The%20aim%20of%20patent%20boxes,locate%20IP%20in%20the%20country). Based on the data, it is clear that retaining both FDII and the other, long-standing Code provisions offering preferential treatment for research and development expenditures would be consistent with the approach taken by many of the U.S.’s trading partners.

these potential conceptual changes to FDII, it does not fully define innovation expenses, provide what share of such expenses will be deemed innovation income subject to a preferential rate, or provide the preferential rate. Accordingly, our comments are also at a conceptual level.

We share the goals of the Framework, which are to encourage productive U.S. investments and activity. However, we believe the key elements of FDII provide a critical incentive to engage in productive domestic activities, with substantial positive spillover effects on U.S. investment and jobs. Providing a preferential rate on intangible income, consistent with the aforementioned systems of major U.S. trading partners, encourages and rewards successful research and development and other productive activities that result in innovation without prescribing the specific types of activities that merit a benefit. Innovation can result not only from research and development, but also from design, engineering, marketing, management, and other activities related to the operation of a business, all of which incidentally produce advances and positive externalities. These advances generate the supernormal profits that are widely recognized to be attributable to intangible property creation and ownership. Providing an incentive to develop and own intangible property in the U.S. provides positive effects on the domestic economy by encouraging and supporting the location of related activities, including manufacturing of products utilizing the intangible property. In this respect, FDII complements the expenditure-based preferences already enshrined in the tax Code, such as the research and experimentation credit, other general business credits, and accelerated cost recovery. Income-based benefits and expenditure-based benefits incentivize productive activities and investment in different ways, and together can contribute to a positive tax environment that encourages productive U.S. activities and investment.

We would like to address directly the assertion in the Framework that FDII's formulaic calculation of intangible income results in an incentive to offshore tangible assets, such as factories and buildings. We understand that the formulaic rules for calculating intangible income under FDII reflected Congress's conclusion that alternative standards (e.g., arm's length transfer pricing principles) did not provide the desired certainty in this context. A key consideration was that the fact-intensive nature of such analyses could yield variable results that might operate to provide uneven and inconsistent tax benefits across similarly situated taxpayers. Moreover, the fact-intensive nature of a non-formulaic approach would increase the administrative burden on both taxpayers and the IRS, again calling into doubt the efficacy and efficiency of the desired tax benefit. Finally, we note that formulaic rules for isolating intangible income are increasingly being considered in other contexts, such as in the OECD's work on the taxation of the digital economy.<sup>8</sup>

The formulaic rules represent a good-faith effort to design a workable system to encourage the development and ownership of intangible property in the U.S.; they were not intended to influence location decisions regarding tangible property. In fact, in the experience of SIA and its member companies, these formulaic rules have not impacted

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<sup>8</sup> See OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS* (October 2020), available at <https://www.oecd-ilibrary.org/sites/beba0634-en/index.html?itemId=/content/publication/beba0634-en>.

location decisions regarding tangible property. We do not know of a single case in which a decision to locate a facility outside the U.S. was made on the basis of maximizing the FDII benefit. We also know of no evidence, anecdotal or otherwise, from other industries supporting the assertion that FDII encourages the offshoring of tangible assets. However, we are aware that some taxpayers decided to locate tangible property, intangible property, and jobs in the United States based on the benefits provided by FDII. Location decisions involving factories or other large capital investments are influenced by many commercial factors, not the least of which include proximity to raw materials, educated workforces, and customers. To the extent tax plays a role, the expected taxation of the capital investment itself (e.g., cost recovery, investment tax credits, or cash grants) would play a much larger role than the marginal and indirect effects such investment decisions would have on FDII QBAI calculations.

In furtherance of sound tax policy objectives of stability, certainty, and ease of administration, we urge the Finance Committee to retain the current framework. If a change is warranted, we would be pleased to discuss other methodologies for isolating intangible income in the FDII context.

We commend you for leading the way by inviting public comments on your Framework and look forward to working with you and the Committee as substantive details are developed and considered.

Sincerely,



David Isaacs  
Vice President, Government Affairs

cc: Senator Sherrod Brown  
Senator Mark Warner