



State of Play: International Tax Policy in the 111th Congress

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The 111th Congress will soon return from its summer recess to complete legislative work around a potentially decisive mid-term election. With international tax policy playing an increasingly prominent role in the debate over economic and budget priorities, we take a look back on international tax policy developments during this Congress, and highlight some key tax legislative trends that have emerged as Congress faces the dawn of a potentially momentous era in tax policy generally and international tax policy in particular. With our “scorecard” of pending international tax proposals below, we also take stock of the suddenly changing international tax landscape.

Background

The current cycle of international tax legislative activity can be traced back primarily to comprehensive tax reform legislation that then-House Ways and Means Committee Chairman Charles B. Rangel (D-NY) first introduced in October 2007—the Tax Reduction and Reform Act of 2007 (H.R. 3970). Among other things, this legislation would have reduced the corporate income tax rate from 35 percent to 30.5 percent. In part, the corporate rate reduction would have been offset by a provision that would (1) defer the deduction of expenses associated with foreign-sourced income until that income is repatriated to the U.S. or otherwise recognized for U.S. tax purposes, and (2) require the limitation on foreign tax credits that can be claimed to be based upon the average foreign tax rate on all foreign income of the taxpayer. The legislation also contained other, more targeted international tax revenue increases to offset the cost of the corporate income tax rate reduction.

The first budget of the Obama Administration (FY 2010) submitted to Congress in May 2009 put into play a number of international tax revenue increases—including proposals similar to those contained in H.R. 3970—which collectively would raise approximately \$150.5 billion over 10 years, according to Joint Committee on Taxation estimates. Much of the business community responded to these proposals by arguing that the proposals should not be enacted in isolation but, rather, should be considered only as part of a broader discussion about comprehensive tax reform. Congress took no action on these proposals in 2009.

President Obama’s FY 2011 budget submitted to Congress in February 2010 contained most (but not all) of the international tax revenue increases that were included in the FY 2010 budget, as well as a few new proposals. In total, these proposals would raise about \$119.5 billion over 10 years, according to Joint Committee on Taxation estimates. The main reason for the difference in revenue estimates between the FY 2010 and FY 2011 budgets is the absence from the FY 2011 budget of a proposal in the FY 2010 budget that would have eliminated the ability of U.S. companies to disregard foreign subsidiaries through use of the so-called “check-the-box” entity classification rules.

Unlike 2009, Congress in 2010 has included international tax revenue increases in several legislative tax vehicles—such as the recently House-passed Small Business Tax Relief Act of 2010 (H.R. 5982)—leading up to the recent enactment of the Education Jobs and Medicaid Assistance Act (H.R. 1586), which included targeted foreign tax credit and other international tax provisions to offset the cost of providing funding to states for Medicaid and other purposes. During what remains of the 2010 legislative session, it is expected that Congress will consider legislation addressing the 2001 and 2003 tax cuts and attempt to complete work on small business legislation and an extension of temporary tax provisions that expired at the end of 2009, any of which could include additional international tax revenue increases.

What lies ahead for international tax policy? It remains to be seen whether the provisions enacted in H.R. 1586 are merely “low-hanging (transactional) fruit” that is separate and apart from a comprehensive discussion and debate about fundamental international tax policy or, rather, the beginnings of “reform by a thousand cuts”. What is clear, however, is that Congress and the Obama Administration have embarked on a course that will require both U.S. and foreign multinational companies to pay close attention to a changing international tax policy landscape during the remaining days of the 111th Congress, the 112th Congress, and beyond.

“Scorecard” of pending international tax proposals

The table on the following pages provides information on the various international tax legislative proposals currently under consideration by Congress and the Obama Administration, including associated revenue estimates (and ranges of estimates where there are multiple versions of a proposal), legislative status, and other comments.

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INTERNATIONAL TAX POLICY “SCORECARD”

Provision	Summary	Affected companies	Revenue estimate	Legislative action	Comment
Deferral of expenses related to deferred foreign income	Matches timing of when deductions related to foreign income may be claimed with timing of when such foreign income is subject to U.S. tax (e.g., repatriated).	U.S. companies with foreign operations	\$35.5-\$51.5 billion	<ul style="list-style-type: none"> • H.R. 3970 (Tax Reduction and Reform Act introduced by Rep. Rangel in Oct. 2007) • FY 2010 Obama budget • FY 2011 Obama budget 	<ul style="list-style-type: none"> • H.R. 3970 would apply to <u>all</u> expenses. • FY 2010 would apply to all expenses <u>except R&D</u>. • FY 2011 would only apply to <u>interest expense</u>.
Eliminate use of foreign disregarded entities using “check-the-box” entity classification rules	Prevents avoidance of U.S. tax on certain foreign income through use of lower-tier foreign entities that are fiscally transparent (i.e., disregarded) for U.S. tax purposes.	U.S. companies with foreign operations	\$31 billion	<ul style="list-style-type: none"> • FY 2010 Obama budget 	

INTERNATIONAL TAX POLICY “SCORECARD”

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Foreign tax credit determined based upon average worldwide foreign taxes	Prevents selective cross-crediting of foreign tax credits against foreign income by abandoning limitations on cross-crediting in favor of aggregating and averaging foreign taxes across foreign operations.	U.S. companies with foreign operations	\$45.5-49.2 billion	<ul style="list-style-type: none"> • H.R. 3970 • FY 2010 Obama budget • FY 2011 Obama budget 	<ul style="list-style-type: none"> • H.R. 3970 would apply to taxes paid by both foreign branches and subsidiaries. • FY 2010 and 2011 would apply only to taxes paid by foreign subsidiaries.

INTERNATIONAL TAX POLICY “SCORECARD”

Provision	Summary	Affected companies	Revenue estimate	Legislative action	Comment
Prevent splitting of foreign tax credits from foreign income to which they relate	Matches creditable foreign taxes with associated foreign income by permitting foreign tax credits to be claimed only when and to the extent the associated foreign income is subject to U.S. tax in the hands of the company claiming the credit.	U.S. companies with foreign operations	\$4.25 billion (as enacted)	<ul style="list-style-type: none"> • FY 2010 Obama budget • FY 2011 Obama budget • H.R. 4213 (American Jobs and Closing Tax Loopholes Act of 2010 passed by the House in May 2010) • H.R. 5893 (Investing in American Jobs and Closing Tax Loopholes Act of 2010 introduced by Rep. Levin in July 2010) • H.R. 5982 (Small Business Tax Relief Act of 2010 introduced by Rep. Levin in July 2010) • H.R. 1586 (Education Jobs and Medicaid Assistance Act enacted on August 10, 2010) 	ENACTED , effective for foreign income taxes paid or accrued after 2010.

INTERNATIONAL TAX POLICY “SCORECARD”

Provision	Summary	Affected companies	Revenue estimate	Legislative action	Comment
Deny foreign tax credit for foreign income from covered asset acquisitions	Prevents foreign tax credits from certain foreign acquisitions that result in higher asset basis for U.S. tax purposes than foreign tax purposes (e.g., corporate 338 elections and partnership 754 elections).	Foreign acquisitions by U.S. companies	\$3.65 billion (as enacted)	<ul style="list-style-type: none"> • H.R. 4213 • H.R. 5893 • H.R. 5982 • H.R. 1586 	ENACTED , effective for covered asset acquisitions after 2010.
Separate application of foreign tax credit limitation to income resourced under treaties	Prevents foreign tax credits associated with income that would be treated as U.S. income but is resourced as foreign income by a tax treaty.	U.S. companies with foreign investments in treaty countries	\$250 million (as enacted)	<ul style="list-style-type: none"> • H.R. 4213 • H.R. 5893 • H.R. 5982 • H.R. 1586 	ENACTED , effective for tax years beginning after August 10, 2010.
Limitation on foreign tax credits for deemed repatriation of foreign earnings	Prevents companies from maximizing foreign tax credits by “hopscotching” (i.e., bypassing) a foreign subsidiary in a low-tax jurisdiction when distributing a dividend through a chain of foreign corporations.	U.S. companies with foreign operations that include low-tax jurisdictions	\$704 million (as enacted)	<ul style="list-style-type: none"> • H.R. 4213 • H.R. 5893 • H.R. 5982 • H.R. 1586 	ENACTED , effective for deemed repatriations after 2010.

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Provision	Summary	Affected companies	Revenue estimate	Legislative action	Comment
Treatment of certain redemptions by foreign subsidiaries	Prevents companies from using section 304 deemed dividends to avoid U.S. tax on dividends from foreign subsidiaries of U.S. subsidiaries.	Foreign companies with U.S. operations that, in turn, have foreign operations	\$250 million (as enacted)	<ul style="list-style-type: none"> • H.R. 4213 • H.R. 5893 • H.R. 5982 • H.R. 1586 	ENACTED , effective for transactions after 2010.
Modification of rules for allocating interest expense between U.S. and foreign income	Expands an existing Treasury regulation that treats certain foreign subsidiaries as members of the U.S. affiliated group for purposes of the foreign tax credit interest expense allocation rules.	U.S. companies with foreign operations that incur interest expenses	\$390 million (as enacted)	<ul style="list-style-type: none"> • H.R. 4213 • H.R. 5893 • H.R. 5982 • H.R. 1586 	ENACTED , effective for tax years beginning after August 10, 2010.

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Provision	Summary	Affected companies	Revenue estimate	Legislative action	Comment
Termination of rules for interest/dividends received from U.S. companies with primarily foreign income (“80/20 companies”)	Repeals rules exempting from U.S. withholding tax dividends and interest paid by certain U.S. companies with 80-percent active foreign business income.	U.S. companies with foreign operations	\$153 million (as enacted)	<ul style="list-style-type: none"> • FY 2010 Obama budget • FY 2011 Obama budget • H.R. 4213 • H.R. 5893 • H.R. 5982 • H.R. 1586 • H.R. 4849 (Small Business and Infrastructure Jobs Tax Act of 2010 passed by the House in March 2010) 	ENACTED , effective for tax years beginning after 2010, with grandfathering for certain existing 80/20 companies.

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Provision	Summary	Affected companies	Revenue estimate	Legislative action	Comment
Statute of limitations for failing to disclose foreign transactions	Technical correction to provision enacted in March 2010—that tolls the statute of limitations for corporations which fail to provide certain information on cross-border transactions and foreign assets—to clarify that the provision does not apply if the failure is due to reasonable cause and not willful neglect.	U.S. companies with foreign operations	None (as enacted)	<ul style="list-style-type: none"> • H.R. 4213 • H.R. 5893 • H.R. 5982 • H.R. 1586 	ENACTED , effective for returns filed after March 18, 2010 and for any other return with respect to which the statute of limitations has not closed.

INTERNATIONAL TAX POLICY “SCORECARD”

Provision	Summary	Affected companies	Revenue estimate	Legislative action	Comment
Limit shifting of income through transfers of intangibles offshore	Makes changes to existing rules for outbound transfers of intangibles (i.e., transfer pricing and section 367(d) “commensurate with income” recognition rules), including application to workforce in place, goodwill and going concern value, aggregation of multiple intangible property transfers, and codification of the “realistic alternative principle”.	U.S. companies with foreign operations	\$500 million-\$1 billion	<ul style="list-style-type: none"> • FY 2010 Obama budget • FY 2011 Obama budget 	

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Provision	Summary	Affected companies	Revenue estimate	Legislative action	Comment
Tax excess returns from transfers of intangibles offshore	Creates new subpart F and foreign tax credit limitation categories for certain transfers of intangible property from a U.S. company to a foreign subsidiary located in a low-tax jurisdiction.	U.S. companies with foreign operations that include low-tax jurisdictions	\$10.2 billion	<ul style="list-style-type: none"> • FY 2011 Obama budget 	<ul style="list-style-type: none"> • Joint Committee on Taxation <i>Description of Revenue Provisions Contained in the President’s Fiscal Year 2011 Budget Proposal</i> (JCS-2-10), August 16, 2010, describes how this proposal could be modified to achieve “a limited repeal of deferral” (pp. 254-55). • FY 2011 effective for taxable years beginning after 2010, which the JCT Description explains could apply retroactively for certain types of transfers (pp. 266-67).

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Provision	Summary	Affected companies	Revenue estimate	Legislative action	Comment
Disallow deduction for excess non-taxed reinsurance premiums paid to affiliates	Denies deductions for reinsurance premiums paid by certain foreign-owned U.S. insurance companies to affiliated foreign reinsurance companies.	U.S. insurance and foreign reinsurance operations of foreign insurance companies	\$2.3 billion	<ul style="list-style-type: none"> • FY 2011 Obama budget • H.R. 3424 (introduced by Rep. Neal on July 30, 2009) 	
Limit earnings stripping by expatriated (i.e., inverted) companies	Tightens existing earnings stripping rules applicable to certain formerly U.S. companies that expatriated as of taxable years beginning after July 10, 1989 by, among other things, eliminating the debt-equity ratio threshold for the applicability of the rules.	U.S. operations of expatriated foreign companies	\$1.5-\$1.7 billion	<ul style="list-style-type: none"> • FY 2010 Obama budget • FY 2011 Obama budget 	<ul style="list-style-type: none"> • <i>JCT Description</i> describes previous legislation and budget proposals to tighten the earnings stripping rules—both for expatriated companies only and, in some cases, for all foreign-owned U.S. companies—dating back to 2004 (pp. 312-13). • FY 2010 and FY 2011 apply to companies that expatriated prior to the March 4, 2003 effective date of the 2004 expatriation legislation.

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Prevent repatriation of foreign income using certain reorganizations (Repeal gain limitation for dividends received in reorganization exchanges)	Repeals rule that limits taxation of dividends (including deemed dividends) received in a corporate reorganization to the amount of overall gain on the transaction.	Foreign operations of U.S. companies	\$410-\$460 million	<ul style="list-style-type: none"> • FY 2010 Obama budget • FY 2011 Obama budget • H.R. 4213 	FY 2010 limited to cross-border reorganizations, while FY 2011 also would apply to purely domestic reorganizations.
Modify foreign tax credit rules for certain “dual capacity” companies	Changes foreign tax credit rules that determine the amount of a creditable tax when an economic benefit is received from the country imposing the foreign tax (of primary, but not exclusive, interest to the oil and gas industry).	Foreign operations of U.S. companies	\$7.2-\$8.2 billion	<ul style="list-style-type: none"> • FY 2010 Obama budget • FY 2011 Obama budget 	JCT <i>Description</i> describes previous budget proposals to change the “dual capacity” rules dating back to 1997 (p. 321).

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Source rule for loan guarantee fees	Provides for loan guarantee fees to be sourced to the residence of the payor rather than the recipient.	Foreign operations of U.S. companies <u>and</u> U.S. operations of foreign companies	\$2 billion	<ul style="list-style-type: none"> • H.R. 4213 • H.R. 5893 • H.R. 5982 • H.R. 5297 (Small Business Jobs Act of 2010 Reid-Baucus-Landrieu substitute amendment which the Senate will consider in September) 	Reverses <i>Container Corporation v. Commissioner</i> , 134 T.C. No. 5 (Feb. 17, 2010).
Modify foreign currency translation rules	For purposes of determining the foreign tax credit for certain taxes paid in a foreign currency, provides that the earnings and profits of U.S. companies be translated into dollars using an average exchange rate.	Foreign operations of U.S. companies	\$2 million	<ul style="list-style-type: none"> • H.R. 3970 	

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Repeal worldwide allocation of interest expense	Repeals rules now scheduled to take effect in 2021 that would change the allocation of interest expense between U.S. and foreign sources by including foreign subsidiaries in the allocation ratio.	Foreign operations of U.S. companies	\$26.2 billion	<ul style="list-style-type: none"> • H.R. 3970 	Rules enacted in 2004 and originally scheduled to take effect in 2009 have since been postponed to 2011 (in 2008), 2018 (in 2009), and 2021 (in March 2010).
Apply reduced treaty withholding tax rates based on residency of foreign parent	Disallows treaty reductions of U.S. withholding taxes on payments by U.S. companies to related foreign companies if the related companies are both controlled by a foreign parent located in a tax-advantaged jurisdiction or other non-treaty country.	U.S. operations of foreign companies	\$6.4 billion	<ul style="list-style-type: none"> • H.R. 3970 • H.R. 4849 	Although narrowed from previous legislation that also would have applied to foreign parents located in U.S. tax treaty partners, is not limited to tax-advantaged jurisdictions and could apply to foreign parents located in countries that have comprehensive tax systems but no tax treaty with the U.S., such as virtually all of Latin America.