

# **The Obama International Tax Proposals**

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# **The Obama International Tax Proposals**

- **Released May 2009 (green book)**
- **Proposed effective date: generally TYs ending after 12/31/2010**

# **The Obama International Tax Proposals**

- **Outbound**
- **Inbound**
- **Compliance**

# **The Obama International Tax Proposals – Outbound**

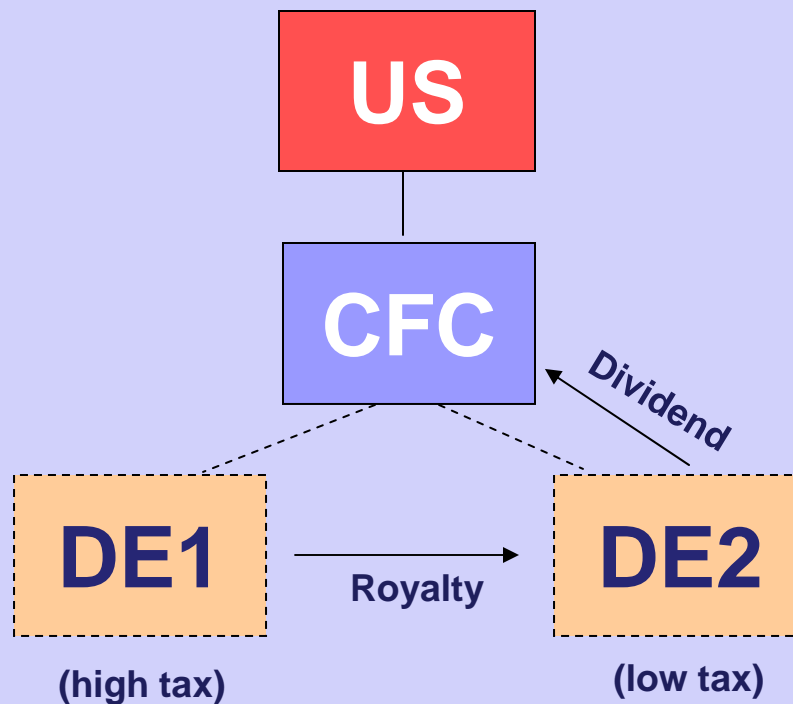
<b>Present System:</b>	<b>Deferral with Limitations (Subpart F)</b>
<b>Alternatives:</b>	<b>Territorial System Full Inclusion</b>
<b>Obama Proposal:</b>	<b>Deferral with Even More Limitations</b>

# **The Obama International Tax Proposals - Outbound**

## **Major Changes**

- **Check-the-Box Changes**
- **Loss of Deductions Associated with Deferral**
- **Foreign Tax Credit Pooling**
- **Treatment of Intangible Property**

# Check-the-Box Changes

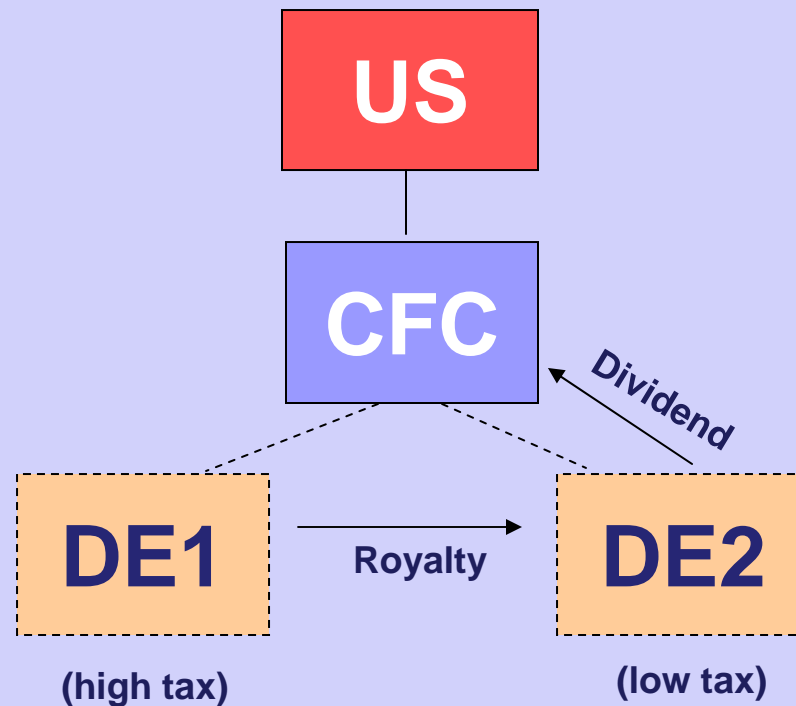


**Today, taxpayers can use lower-tier pass-through entities to maximize deferral and minimize foreign taxes.**

# Check-the-Box Changes

- **Unsuccessful IRS challenges (Notice 98-11; “check-and-sell” regulations; *Dover* case)**
- **Temporary legislative relief even for CFC-to-CFC payments (Section 954(c)(6))**

# Check-the-Box Changes

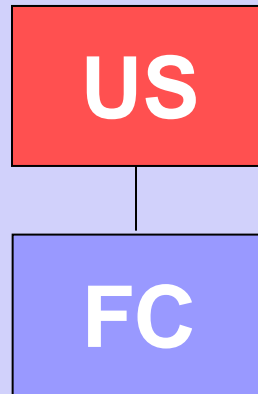


**Under the proposal, DE1 and DE2 will be treated as corporations unless created under same country as CFC, thereby creating present inclusion to US owner from intra-group payments.**

# Check-the-Box Changes

- **Exception adds little to existing same-country relief.**
- **Section 954(c)(6) would be allowed to expire (after extension through 2010).**
- **First-tier foreign entities allowed CTB except in cases of tax avoidance.**
- **Query whether intended revenue effect (unwinding, increased foreign taxes).**

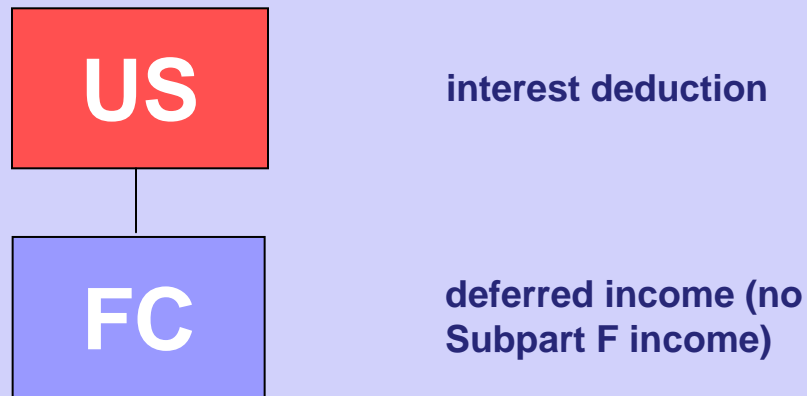
# Loss of Deductions Associated with Deferral



**Today, US can deduct expenditures even if properly allocated or apportioned against foreign-source income.**

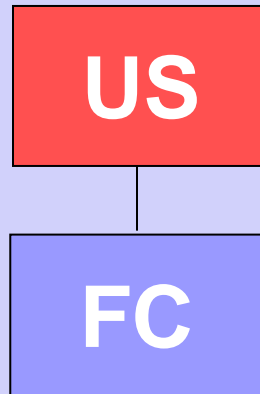
- **Possible reduction of foreign tax credits, overall foreign loss recapture.**
- **Possible transfer pricing issue (compare new Section 482 services regs.)**

# Loss of Deductions Associated with Deferral



**Example: US purchases FC stock with debt, paying deductible interest. FC's income qualifies for deferral.**

# Loss of Deductions Associated with Deferral



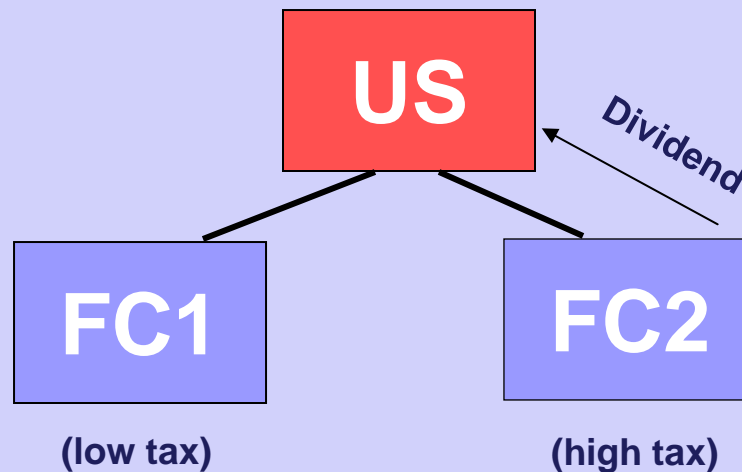
deferral of interest  
deduction until foreign  
earnings subject to US  
tax

Under the proposal, deductions for these expenses (other than R&E) would be deferred to the extent the associated foreign-source income is not currently subject to US tax.

# **Loss of Deductions Associated with Deferral**

- **Major targets**
  - **G&A (may cause relocation abroad)**
  - **Interest (Section 864(f) worldwide interest allocation deferred until at least 2011)**
- **Loss of benefit of deferral for some taxpayers**
- **Little effect on others**

# Foreign Tax Credit Pooling



Today, taxpayers can pay dividends from foreign subsidiaries with higher-taxed earnings, minimizing the US tax cost by triggering Section 902 credits for the underlying foreign taxes.

# Foreign Tax Credit Pooling

## Dividend from FC1 (low tax):

Effective foreign tax rate 5%

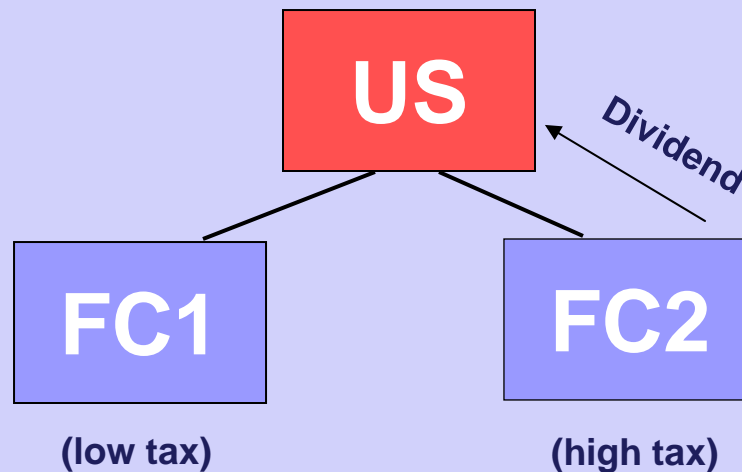
Residual US tax rate 30%

## Dividend from FC2 (high tax):

Effective foreign tax rate 35%

Residual US tax rate 0%

# Foreign Tax Credit Pooling



**Under the proposal, FTC would be determined on a consolidated basis (aggregating E&P and foreign taxes of all subsidiaries).**

# Foreign Tax Credit Pooling

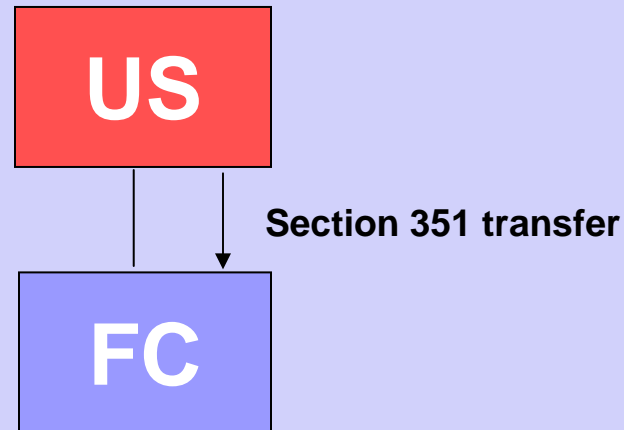
## Dividend from FC1 or FC2:

Effective foreign tax rate      20%  
(blended)

Residual US tax rate              15%

- This is the result even if the dividend comes from FC2.
- This may increase the stakes of repatriation.

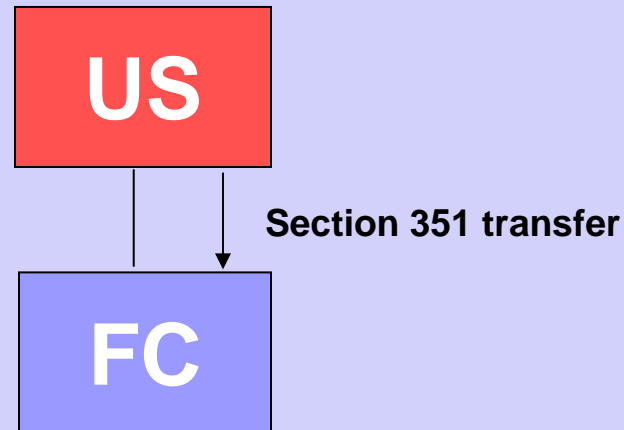
# Treatment of Intangible Property



At present, foreign goodwill and going concern value can be transferred tax-free to foreign subsidiaries under the active trade or business exception of Section 367(a)(3).

- Not treated as transfer of intangible property subject to Section 367(d) deemed royalty.

# Treatment of Intangible Property



The proposal would “clarify” that intangible property for purposes of Sections 367(d) and 482 includes workforce-in-place, goodwill and going concern value.

# Treatment of Intangible Property

- **Effect on branch incorporations, business migrations.**
- **IP must be valued at highest and best use.**
- **Related development: new Section 482 cost-sharing regulations (January 2009), making it harder to get IP value offshore.**

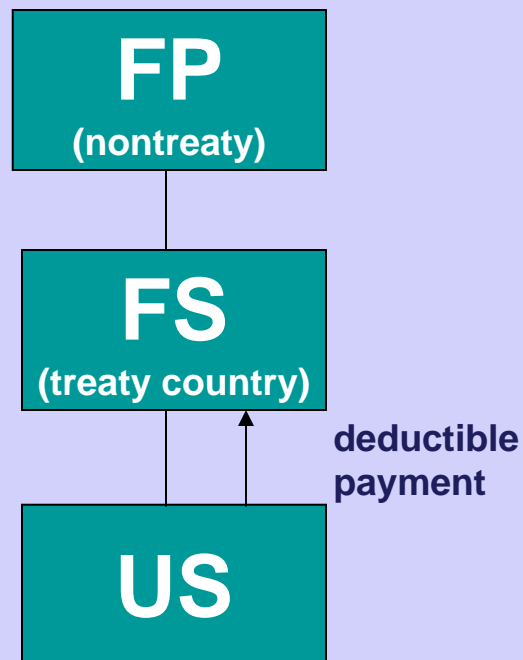
# **Obama International Tax Proposals – Outbound**

- **Other Changes:**
  - **Shut down FTC splitters**
  - **Modify FTC rules for dual capacity taxpayers**
  - **Establish separate FTC basket for oil and gas income (replacing Section 907)**
  - **Prevent repatriation of earnings in foreign reorgs (repeal “boot within gain” limitation of Section 356(a))**

# **Obama International Tax Proposals – Inbound**

- **Major Changes:**
  - **Attack use of equity swaps to avoid dividend withholding taxes (along with revocation of Notice 97-66 for stock lending transactions)**
  - **Repeal 80/20 company rules**
  - **Tighten earnings stripping rules for expatriated entities**

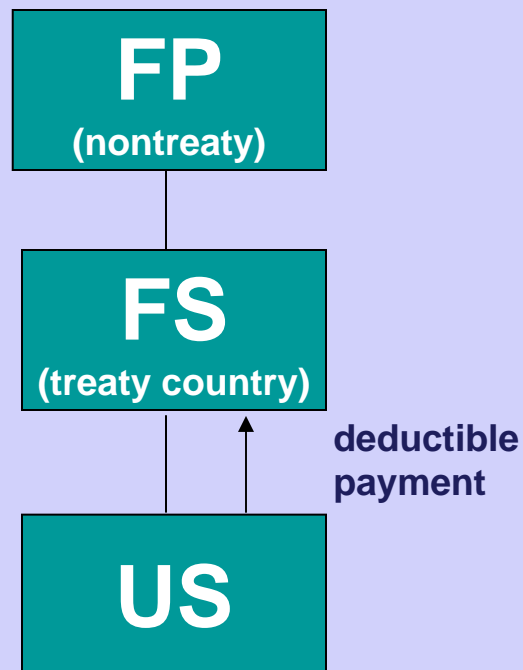
# Other Inbound Proposal (Health Care Legislation)



At present, deductible payments to intermediate foreign entities may qualify for treaty relief subject to:

- treaty LOB provisions
- conduit financing regulations

# Other Inbound Proposal (Health Care Legislation)



Under the proposal, these payments could not qualify for treaty relief if nontreaty parent.

- No application if parent qualifies for treaty relief (even if less favorable)
- Serious treaty override issues

# **The Obama International Tax Proposals – Compliance**

- **Background**
  - Abuse of Qualified Intermediary Rules
  - “John Doe” Summons to UBS re Swiss accounts
  - Offshore Voluntary Compliance Program
    - September 23 deadline
  - Revised FBAR Instructions
    - Notice 2009-62 relief for foreign commingled funds, persons with only signature authority

# **The Obama International Tax Proposals – Compliance**

- **FDAP Withholding**
- **Foreign Financial Accounts (FBAR)**
- **Third-Party Information Reporting**
- **Extend Statute of Limitations**
- **Foreign Trust Reporting Penalty**

# FDAP Withholding

## Present Rules:

- **Presumptive 30-percent withholding on FDAP payments to foreign persons.**
- **Prior certification can avoid withholding.**
- **Qualified intermediaries (QIs) can assume withholding responsibility.**
  - **Foreign financial institution entering into agreement with IRS**

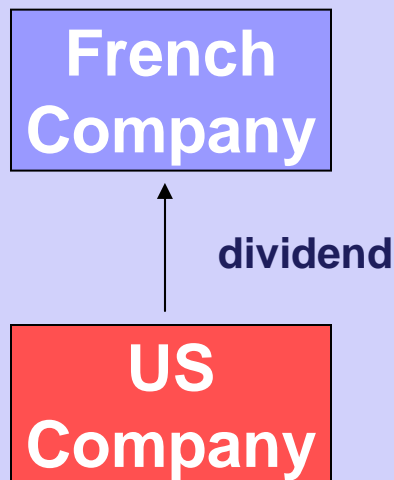
# FDAP Withholding

## Proposed Changes:

- **Greater reporting by QIs re US account holders (Forms 1099).**
- **Withholding on FDAP/gross proceeds payments to certain nonqualified intermediaries (remedy of refund).**
- **Required documentation of ultimate beneficial ownership.**

# FDAP Withholding

## Example:



Under the proposal, US company would need to ascertain beneficial owners of French company or withhold at 30 percent.

# **Foreign Financial Accounts (FBAR)**

## **Present Rules:**

- **Persons with more than \$10,000 aggregate balance.**
- **File Treasury Department Form 90-22.1 by June 30 of following year.**
- **Separate from tax return.**
- **Potential civil and criminal penalties.**

# **Foreign Financial Accounts (FBAR)**

## **Proposed Changes:**

- **Disclosure of FBAR accounts with tax return (doubling of accuracy-related penalty).**
- **Taxpayer and financial institution reporting of transfers to/from foreign financial accounts.**
- **Evidentiary presumptions against taxpayers failing to file FBARs.**

# **Third-Party Information Reporting**

**Persons forming or acquiring foreign entities on behalf of U.S. individuals (and controlled entities) would be required to file information returns.**

# **Extend Statute of Limitations**

## **Current Law:**

- **Under Section 6501(c)(8), statute on foreign transactions does not run until three years after proper information reporting made (e.g., Form 5471).**

# **Extend Statute of Limitations**

## **Proposed Changes:**

- **3-year statute extended to 6 years.**
- **Applies to more reporting failures (including FBAR).**
- **Extends statute on entire tax return, not just foreign items.**

# **Foreign Trust Reporting Penalty**

**Initial penalty presently 35 percent of the gross reportable amount.**

**Proposed addition of \$10,000 minimum penalty.**