LLB&L Client Alert

May 18, 2009

International Tax Update

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On May 4, 2009, President Obama released proposals to raise almost $200 billion from 2011 through 2019 by overhauling United States international tax policy. As expected, these proposals met with immediate and strong protests from affected multinational corporations. In addition, on May 12, 2009, the Treasury Department and the Administration released further proposals to raise a lesser amount by reforming U.S. international tax policy. A summary of certain proposals of the May 4 and May 12 releases are provided below.

Reforming Deferral Rules to Curb a Tax Advantage for Investing and Reinvesting Overseas

This proposal would prohibit deductions – with the exception of research and experimentation expenses – for expenditures on offshore investments until a company pays U.S. federal income tax on the income generated from the expenditure. The example cited as abusive by the Administration is a U.S. company deducting interest on debt incurred to finance capital expenditures, a manufacturing facility, of a foreign subsidiary. The Administration estimates this proposal would raise $60.1 billion from 2011 to 2019.

Closing Foreign Tax Credit Loopholes

This proposal would modify the foreign tax credit regime in two steps: (1) a taxpayer's foreign tax credit would be determined based on the amount of total foreign tax the taxpayer actually pays on its total foreign earnings; and (2) a foreign tax credit would no longer be allowed for foreign taxes paid on income not subject to U.S. tax. The Administration estimates this proposal would raise $43.0 billion.

Using Savings to make Permanent the Tax Credit for Investing in Research and Experimentation at Home

This proposal would use the revenue generating proposals' savings to make permanent the research and experimentation tax credit. The Administration estimates this proposal would cost $74.5 billion.

Eliminating Loopholes for "Disappearing" Offshore Subsidiaries

This proposal would require U.S. businesses that establish certain corporations overseas to treat them as corporations, i.e., modify the check-the-box rules and not allow disregarded status for many second-tier and lower tier foreign subsidiaries. If implemented, this proposal would eliminate the ability to move capital between foreign subsidiaries in different jurisdictions without paying U.S. federal income taxes. The Administration estimates this proposal would raise $86.5 billion.

Cracking Down on the Abuse of Tax Havens by Individuals

U.S. individuals with overseas accounts are required to file the Foreign Bank and Financial Account Report ("FBAR") disclosing ownership of financial accounts in foreign countries containing over $10,000. This proposal is intended to generate revenue by increasing the burden and filing requirements on the individuals and the institutions where these accounts are held, and increasing penalties for failing to file an FBAR. The Administration estimates this package would raise $8.7 billion.

Devoting New Resources for Internal Revenue Service Enforcement

To assist in enforcing both existing law and these new proposals, the Internal Revenue Service (IRS) would be given the funds to hire approximately 800 new employees devoted to international enforcement.

Dividend Substitutes

This proposal would make the majority of dividend substitutes (i.e., equity swaps and notational principal contracts) that reference U.S. stock to be U.S. source income, and thus, subject to U.S. withholding taxes. The Administration estimates that this proposal would raise $1.4 billion.

Definition of Intangible

This proposal would clarify that for purposes of Code Section 482, intangible property includes workforce in place, goodwill, and going concern value. The proposal will also authorize the IRS to value the transfer of multiple intangibles on an aggregated basis when doing so produces "more reliable results." These revisions are expected to raise $2.9 billion.

Cross-border Exchanges

This proposal would increase taxes for certain cross-border reorganizations and exchanges when the acquiring corporation is foreign and a U.S. shareholder's exchange has the practical effect of a distribution paid from earnings and profits of a foreign corporation greater than the shareholder's taxable gain from the exchange. The Administration estimates that this measure would raise $297 million.

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Corporate Expats

This proposal would minimize earnings stripping opportunities for U.S. companies that have undergone corporate inversions to reorganize as foreign surrogate entities. The Administration estimates this proposal would raise $1.2 billion.

80/20 Companies

This proposal would repeal the 80/20 regime in its entirety. The 80/20 regime provides certain exceptions from U.S. withholding taxes on interest and dividends paid by a domestic corporation that derives at least 80 percent of its gross income from a foreign active trade or business. The Administration estimates this proposal would raise $1.2 billion.

Dual Capacity Taxpayer

This proposal would clarify that the foreign tax credits in cases when a U.S. taxpayer pays a foreign levy in return for a specific economic benefit (for example, taxes only on oil and gas income) will be allowed only if the foreign country generally imposes an income tax. The Administration estimates this would raise $4.5 billion.

Locke Lord Bissell & Liddell LLP tax attorneys continue to monitor these and other Administration proposals that may affect our clients' U.S. tax liability on foreign operations. If you would like additional information or guidance on these proposed revisions, please contact one of the authors of this article.

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