

Changing The Landscape On International Taxes

Ramon Camacho

WTAS LLC

On Monday, May 4, 2009, the Obama administration proposed significant changes to the taxation of international investments. These proposals, together with proposals from Senator Carl Levin of Michigan and Senator Max Baucus, chair of the Senate Finance Committee, will likely form the basis for major international tax reforms that may be enacted this year or next. These proposals could significantly impact individual and corporate taxpayers with offshore bank accounts and foreign business operations. In this article, we examine key provisions of the proposals.

The President's Proposals

The administration's proposals address two perceived loopholes. First, the proposals address the deferral of foreign income with the objectives of encouraging domestic job creation and funding a permanent research and experimentation credit. Second, the administration proposes to eliminate advantages for income earned through tax haven jurisdictions by both individual and corporate taxpayers. While no bill language has been proposed, the key provisions of an outline

Ramon Camacho is a Managing Director in the National Tax office of WTAS, where he leads the International Tax Practice. He may be reached at (571)-382-0049.

unveiled by the administration would:

Disallow deductions for expenses attributable to income earned through foreign corporations while such income remains in foreign corporate solution. This proposal would take effect in 2011 and is similar to a rule contained in Section 3201 of H.R. 3701 proposed by Chairman Rangel on October 25, 2007. Under the Rangel bill, deductions for interest and other expenses allocable to deferred foreign income would themselves be deferred until the related deferred income is taken into account for U.S. federal income tax purposes. In addition, under H.R. 3701 the amount of the allowable foreign tax credits would be calculated by reference to deferred income of the taxpayer's CFCs. This provision, if adopted, could severely reduce the tax available for credit against the taxpayer's nondeferred income because any low-taxed deferred income would result in a scale back of the credit under the statutory formula.

Tax the income of so-called tax haven "check the box" entities that are disregarded for U.S. but not for foreign tax purposes. This proposal would significantly increase the effective tax burden on many multinational enterprises, both public and private, that have tax haven finance centers and would likely nullify assertions that offshore earnings are "permanently reinvested" under APB 23. As a result, the proposal could significantly decrease corporate share value by permanently reducing the after-tax cash flows of an

enterprise with non-U.S. income.

The administration has also proposed several other initiatives including enhanced disclosure, enforcement and penalties with respect to the use of offshore accounts, a shift in the burden of proof for individuals that use tax haven jurisdictions, and allowing foreign tax credits only when the income giving rise to the foreign tax is currently taken into account. Funding for 800 new international examiners would also be provided.

The Stop Tax Haven Abuse Act (S. 506)

As proposed by Senator Levin in March, 2009, S. 506 would have far-reaching effects on a variety of international tax activities and is by far the most comprehensive proposal being considered. Among other things, the bill would:

Treat certain foreign corporations as domestic corporations fully subject to U.S. corporate taxes. The bill would apply to foreign corporations that are either (i) publicly traded or (ii) have gross assets of \$50 million or more and are "managed and controlled" in the U.S. For this purpose, a foreign corporation is "managed and controlled" in the U.S. if substantially all of the executive officers and senior management of the corporation who exercise day-to-day responsibility for making strategic, financial and operational decisions and policies of the corporation are located primarily in the U.S. Corporations primarily holding investment assets are managed and controlled in the U.S. if the assets of

such corporations consist primarily of assets being managed on behalf of investors and investment decisions are made in the U.S. *This proposal could significantly increase the overall tax burden on (i) U.S. multinational corporations that have "inverted" to a foreign parent structure where senior management continues to reside in the U.S. (e.g., in a U.S. subsidiary) and (ii) offshore funds and their investors where the funds' assets are principally managed from the U.S.*

Treat substitute dividends and dividend equivalents on derivative transactions as arising from U.S. sources to the extent such payments are determined by reference to actual U.S. dividends. This provision could result in substantial withholding taxes for non-U.S. investors (including offshore funds and individual investors) who use derivative products to obtain exposure to U.S. equities.

Senator Baucus offers a much more moderate alternative to Senator Levin's proposals. Baucus' bill provides enhanced penalties and reporting obligations but does not contain any of the substantive provisions contained in Senator Levin's or the President's proposals. While it is far from clear what action Congress will take, the administration's and Senator Baucus's proposals offer hope that any final legislation will be less sweeping and more moderate in scope than the provisions of S. 506. Only time will tell.

Please email the author at ramon.camacho@wtas.com with questions about this article.