

WASHINGTON TAX NEWS



Potomac Law Tax Newsletter—May 2016

Susan Rogers

While the focus on the Presidential primaries continues to heat up ahead of the July political conventions, Congress continues to work to achieve progress on **budget and spending issues**, a **Puerto Rico debt crisis bill** and important issues such as the **Federal Aviation Administration reauthorization** – with questionable success. There is increasing uncertainty about the likelihood that the Republican leadership in Congress will be able to produce a budget agreement this year, with the House continuing to have challenges finding a majority for a budget agreement and the Senate unwilling to move without cooperation from the House. A budget agreement is unnecessary this year because of the 2015 agreement late in the year on spending targets for a 2 year period, and the Senate appears willing to move ahead with appropriations bills using those targets, while there is disagreement in the House over the spending levels. A continuing resolution that would keep the government operating past the end of the fiscal year on September 30th seems nearly inevitable at this point.

The release of the aggressive **new Treasury Department rules on inversions and earnings stripping** have heightened the debate in Congress and the business community about corporate tax reform with additional hearings and proposed legislation expected in 2016 in preparation for post-election comprehensive tax reform action. In conjunction with the Senate Finance Committee hearing on business tax reform, Ranking Democrat Wyden released proposed legislation that would **replace the current depreciation rules** with a “pooling” system designed to reduce complexity for both large and small businesses.

For more information on these issues, please contact Susan Rogers at srogers@potomaclaw.com or 202.492.3593.

Presidential primaries and the November elections continue to dominate politics and the policy agendas in Washington, while Congress works to achieve progress on spending and budget issues, and the Congressional tax-writing Committees focus on the new Treasury rules on inversions and debt/equity.

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Congressional Activity — Tax Reform

House Ways & Means Committee: Ways & Means Committee Chairman Brady announced that he plans to produce a **consensus blueprint for comprehensive tax reform** in June.

The W&M Tax Policy Subcommittee held a hearing on April 13th to review tax reform bills introduced by House lawmakers that make fundamental reforms within the context of an income-based system, including the comprehensive reform bill that was introduced by former Chairman Camp in late 2014.

Senate Finance Committee: The SFC held a hearing titled “**Navigating Business Tax Reform**” on April 26th, which is the first hearing this year on tax reform in the Committee. SFC Chairman Hatch began work in 2015 on a corporate tax integration reform proposal, as a first step to broader tax reform, while decreasing incentives for inversions. He is currently working with the Joint Tax Committee on an analysis and revenue estimate of the proposal, which is expected to be released in June. Ranking Democrat Wyden released his proposed “Cost Recovery Reform and Simplification Act” in conjunction with the hearing, which he specifically pitched as beneficial to small business.

Congressional Activity — Miscellaneous

W&M Committee Chairman Brady and SFC Chairman Hatch introduced identical **technical corrections bills** in the House and Senate that would make a number of technical changes and clarifications to seven previously enacted tax laws. The majority of the changes address the Consolidated Appropriations Act of 2016/Protecting Americans from Tax Hikes Act of 2015 (PATH Act), which was the appropriations and extenders legislation enacted late in 2015. Included in the legislation are changes to the permanent research credit and the bonus depreciation rules. There was some discussion of adding this legislation to the current work on the Federal Aviation Administration (FAA) reauthorization legislation, but no deal to do so was reached.

The SFC approved a bill that would require the IRS to increase security measures to combat identity theft and refund fraud, but rejected a Wyden amendment that would have imposed minimum standards of competence on paid tax return preparers, removed the IRS from the regulatory process, and placed the authority under Treasury’s Office of Professional Responsibility. The Wyden amendment would have overturned the US Court of Appeals decision in the case of *Loving v. Internal Revenue Service* that blocked an effort to certify and regulate tax return preparers. Chairman Hatch said he supported the concept of **regulating tax return preparers**, but several Senators were concerned about the broad authority to be given to the Treasury. He promised to work with Senator Wyden on a more acceptable compromise.

Senate Minority Leader Reid and Ranking SFC Democrat Wyden spearheaded an effort to add several **alternative energy extenders** that are due to expire at the end of 2016 to the FAA reauthorization legislation, but the effort ultimately failed when it was determined that the FAA bill became “must-pass” legislation. Due to the fact that it appeared to be one of the few bills that would advance in 2016 to which tax provisions could be attached, lawmakers started to attempt to attach a variety of tax issues to it, which threatened failure, so Senate leaders opted to move a “clean” FAA bill.

Treasury/IRS/Department of Labor

Treasury and the IRS issued proposed regulations providing guidance on the amount and timing of a **deemed distribution under section 305(c)** that result from adjustments to rights to acquire stock. The proposed regulations also provide additional guidance to withholding agents regarding their current withholding and information reporting obligations with respect to these deemed distributions.

The IRS issued final regulations effective March 28th that limit the **importation of net built-in losses** under sections 334(b)(1)(B) and 362(e)(1) of the Code. The final regulations adopt proposed regulations issued in September 2013, with a few changes. These regulations apply to certain non-recognition transfers of loss property to corporations subject to certain taxes, and they affect corporations receiving such loss property.

The Department of Labor issued its **Final Fiduciary Rule** which covers the rules for brokers providing investment guidance on a retirement account.



Treasury and the IRS issued temporary and proposed regulations to further reduce the benefits of and limit the number of corporate tax inversions including by addressing earnings stripping. Treasury Secretary Lew announced that the new rules will have an important effect on but cannot stop these transactions, so he urged Congress to move ahead with anti-inversion legislation this year. Treasury believes that inversions are not driven by genuine business strategies and economic efficiencies, but rather a desire to shift the tax residence of a parent entity to a low-tax jurisdiction in order to reduce or avoid US taxes.

The reaction from the business community and business trade groups to the new rules was swift with the rules being criticized by groups such as the Chamber of Commerce and the Business Roundtable as counter-productive and ultimately self-defeating. Business leaders called the rules “punitive” and likely to result in driving companies out of the US. The new rules are affecting the number of deals moving ahead including the proposed Pfizer/Allergan transaction, which has now been abandoned.

Inversions, Earnings Stripping and the new 385 Regulations

The new rules will limit inversions by disregarding foreign parent stock attributable to recent inversions or acquisitions of US companies, thereby preventing a foreign company from using the resulting increase in size to avoid the current inversion thresholds for a subsequent US acquisition. The regulations implement new rules not previously included in the prior notices, including a rule to address so-called “serial inversions,” where a foreign corporation combines with a series of US corporations and where section 7874 would otherwise have applied if the acquisitions had been made at the same time or pursuant to a plan or series of related transactions.

They also address “earnings stripping,” which Treasury posits is often used after a corporate inversion to minimize US taxes by the US subsidiary taking a loan from the foreign parent and paying interest that is deducted from the US company’s taxable income to their new foreign parent in a low-tax country. Review of the new rules, however, shows that they go well beyond inversions and are also intended to apply to a broad range of related-party transactions, so that they would impact many ordinary business transactions and restructurings of domestic and foreign corporations.

Congressional Reaction and Activity

W&M Chairman Brady called the new rules “punitive regulations that will make it even harder for American companies to compete and will further discourage businesses from locating and investing in the US.” He has suggested that he believes that Treasury overstepped its authority, stating that the W&M Committee continues to review the regulations. **House Minority Leader Pelosi** responded that Chairman Brady and his fellow Republicans should “stop enabling corporate inversions and stop preserving special interest tax handouts that do nothing but increase the deficit.”

SFC Chairman Hatch commented that the “Administration continues to tinker along the regulatory edges with unilateral proposals to address the symptoms of inversions, but not the disease.” He stated that a comprehensive tax overhaul is a better course to follow. Several SFC Democrats, including **SFC Ranking Member Wyden**, have introduced or are working on legislation targeting inversions and earnings stripping.

Treasury Activity

In conjunction with the issuance of the new proposed rules, the Treasury Department also issued an updated version of the **President’s Framework for Business Tax Reform**, which reviews developments since the issuance of the original Framework in 2012, and details specific administration tax proposals without changing its key elements.

In a statement to the IMF, **Secretary Lew** said that Treasury is finalizing new rules that take aim at shell companies by proposing a regulation that would require the beneficial owners of single-member limited liability companies to identify themselves to the IRS, thus closing a loophole that Treasury posits some have been able to exploit.

Robert Stack, Deputy Assistant Secretary for International Affairs, recently commented publicly about the new anti-inversion rules stating that Treasury is open to suggestions about how to tweak the rules, but that Treasury does not feel that it overstepped its authority in this area. He also added that he believes that corporate executives should pay more attention to what the G20 and other international organizations are doing on international tax matters.

Business Community Reaction: Several business trade groups, including the **NFTC, OFII, TEI, USCIB**, are forming a coalition on the new section 385/related-party financing rules in an effort to persuade the Treasury Department to defer the public comment date past July 7th -- arguing that the proposed rules are significant changes and will require extensive review and analysis before comments can be submitted. Treasury has said that it plans to issue the final rule quickly.

International Tax Policy and BEPS

Congress, Treasury and the EU State Aid Investigations: Margrethe Vestager, European Commissioner for Competition, met with several Members of Congress, including SFC Chairman Hatch, Ranking SFC Democrat Wyden and Treasury Secretary Lew, to discuss the EU's state aid investigations of US companies. Senators Hatch and Wyden made it clear to her that they believe the EU has gone too far with the investigations, while Commissioner Vestager responded that while she takes their concerns very seriously, she does not agree with them, but she promised US officials that the EU would be more open with them in the hope of avoiding "misunderstandings" about the inquiries.

OECD Base Erosion and Profit Shifting (BEPS) Project: The OECD issued its standard electronic format for sharing information under the **Country-by-Country (CbC) reporting regime** approved as part of the BEPS initiative. CbC reports will be electronically transmitted between Competent Authorities in accordance with the CbC XML Schema, included in the released material along with a User Guide. The OECD issued a consultation draft under BEPS Action 6 (covering the use of tax treaties and limitation on benefit/LOB provisions) on the **tax treaty entitlement of non-Collective Investment Funds (non-CIVs)**. The following consultations are also upcoming with discussion drafts published first and comments due in summer: attribution of profit to permanent establishment; BEPS Action 2 (hybrid mismatches); and BEPS Action 4 (interest deductions).

EU/Tax Disclosure Rules: The European Commission issued a proposal that would require multinationals operating in the EU with global revenues exceeding EUR 750 million a year to publish key information on where they make their profits and where they pay their tax within the EU on a country-by-country basis. The EU was already looking at this type of rule, and the release of the so-called Panama Papers helped to accelerate the issuance of the new proposal.

G20 and Tax Havens: The G20 Finance Ministers called on the OECD to report by July on the countries and jurisdictions that have not yet signed up to international standards on tax transparency and information sharing. This issue has been a G20 priority for several years but has gained more prominence of late due to the leak of the so-called Panama Papers.

Platform for Collaboration on Tax: The IMF, OECD, UN and World Bank announced a new joint effort to intensify their cooperation on tax issues: the Platform for Collaboration on Tax. The Platform will not only formalize regular discussions between the four international organizations on the design and implementation of standards for international tax matters, it will strengthen their capacity-building support, deliver jointly developed guidance, and share information on operational and knowledge activities. Among the Platform's first tasks will be the delivery of a number of "toolkits" designed to help developing countries implement the measures developed under the G20/OECD BEPS project.

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