

WASHINGTON TAX NEWS



Potomac Law Tax Newsletter—June 2016

Susan Rogers

The House has continued to have challenges in reaching agreement on how to move forward with the **appropriations bills** due to the ongoing dispute about the budget caps for the 12 annual spending bills. House Republicans continue to debate a budget agreement in their conference more than a month past the budget deadline, and House leadership has decided to move ahead with individual spending bills on the House Floor despite the objections of some members of their party. The Senate has been making progress on advancing spending bills with work on the energy and water infrastructure bill, and bills that would provide funding for veterans, transportation, housing and military construction, while other appropriations bills are under consideration in committee. Despite the progress in the Senate, however, it remains likely that Congress will have to pass a **Continuing Resolution** with an omnibus package of provisions in order to keep the government running when the end of the fiscal year is reached on September 30th.

A rare bipartisan House deal supported by the Obama Administration to help **Puerto Rico** manage its financial issues has been approved in committee in the House, but there is opposition from some bondholders, unions and island officials, and SFC Chairman Hatch has expressed concerns about the House bill. Progress on the **nomination of Merrick Garland to the Supreme Court** has stalled in the Senate, and it appears that Congress will likely not deal with other major issues prior to adjournment for the July political conventions. House Speaker Ryan announced that six blueprints, which are part of the **“Confident America” agenda**, will be unveiled in June and will include a tax reform blueprint.

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

The Senate is making progress on advancing appropriations bills while the House works to move individual spending bills without an approved budget deal, but weeks before the Presidential election, Congress will likely face challenges in funding the government for the new fiscal year.

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Congressional Activity — Tax Reform

House Ways & Means Committee

The Tax Policy Subcommittee held another tax reform hearing titled **“Perspectives on the Need for Tax Reform,”** and another day of hearings that focused on tax proposals introduced by Members of Congress, including legislation that would modify the timeline and procedures for US compliance with the country-by-country (CbC) reporting regime adopted by the OECD as part of the BEPS initiative.

Tax Policy Subcommittee Chairman Boustany (R-LA) said publicly that he is still committed to international tax reform and hopes to produce legislative language this year, but the prospects for any proposal depends on the outcome of the House Republicans’ work on comprehensive tax reform. House Speaker Ryan (R-WI) has decided to develop a **tax reform blueprint** under the auspices of the House Tax Reform Task Force chaired by W&M Committee Chairman Brady (R-TX) prior to the July Republican convention, which has altered the timeline.

W&M Committee Ranking Democrat Levin introduced the **Protecting the Corporate Tax Base Act of 2016**, which specifically targets two common tax avoidance practices — hopscotch lending and decontrolling — with the rules applicable to any multinational company acquired by a foreign company and not just inverted companies. W&M Committee member Buchanan (R-FL) introduced legislation aimed at ensuring parity between tax rates for corporations and pass-through businesses.

Senate Finance Committee

The Senate Finance Committee held two **hearings on the subject of corporate integration and issues related to debt and equity**. The Joint Tax Committee pamphlet issued in connection with the hearings covers distortions under the current US corporate tax system and several approaches to corporate integration including complete integration, dividend relief at the corporate level, and dividend relief at the shareholder level.

SFC Chairman Hatch expressed support for a dividends paid deduction that would deliver an effective rate cut to corporations, provide closer tax parity between debt and equity, and help with some of the international tax problems by reducing pressure on companies to invert and greatly reducing the lock-out effect. He stated that he expects to release a **draft corporate integration proposal** in the near future, and his draft is expected to propose a new, nonrefundable withholding tax on both dividend and interest payments in order to ensure tax parity between debt and equity regardless of the payment recipient’s tax status (e.g., taxable vs. tax-exempt).

SFC Ranking Democrat Wyden released a draft of a **new regime for the taxation of derivatives**, the Modernization of Derivatives Tax Act (MODA), which would prevent the use of derivatives by taxpayers to avoid taxes. The bill would require mark to market and ordinary income tax treatment for all derivative contracts and would source gains and losses to the taxpayer’s country of residence. The bill would deny taxpayers the ability to choose between various options by prescribing specific rules for treatment and consolidating those rules into a new Part IV of subchapter E for derivatives of the tax code.

Treasury/IRS/Department of Labor

Several business groups have contacted Treasury to ask that the comment period on the **proposed 385 and inversion regulations** be extended from July to October and not be made retroactive to April 4th. Groups who have been meeting with Treasury have indicated that Treasury may not be receptive to slowing down these regulations, and although Congressional Republican leadership is sympathetic to their concerns, the legislative schedule in 2016 is not conducive to this issue being addressed prior to the issuance of regulations.

Treasury announced actions intended to strengthen **financial transparency** and combat the misuse of companies to engage in illicit activities, including proposed regulations issued by the IRS to increase the reporting and record maintenance requirements of US disregarded entities owned by foreign persons.

The IRS and Treasury issued regulations concerning the **employment tax treatment of partners in a partnership that owns a disregarded entity** when such partners provide services to the disregarded entity.



Senate Finance Committee Ranking Democrat Ron Wyden (D-OR) released draft legislation called the Cost Recovery Reform and Simplification Act of 2016 ("Proposal") that would replace current tax depreciation rules with a "pooling" system for personal property. The new system would apply to large and small businesses, but Senator Wyden emphasized that it would be especially beneficial to small businesses due to the simplification of the cost recovery system.

Legislative action on this Proposal is unlikely this year, but it is possible that a Senate Finance Committee hearing could be held. Senator Wyden stated that this Proposal is a step that Congress should consider either as part of comprehensive tax reform or ahead of broad reform, as the depreciation rules have not been updated since the Tax Reform Act of 1986.

The Summary states that comments are requested on all aspects of the Proposal as well as other areas of cost recovery and capital investment. It states that the following areas are of specific interest: Transition Rules; Abandoned and Certain Low Disposition Value Property; Small Business Expensing; Alternative Minimum Tax; Like-Kind Exchanges; Broader Interaction in the Tax Code.

Wyden Discussion Draft on Cost Recovery Reform & Simplification

Proposed Mass Asset Cost Recovery and Reinvestment System

The Discussion Draft Summary ("Summary") states that the Proposal would replace the current Modified Accelerated Cost Recovery System (MACRS) and the Alternative Depreciation System (ADS) with the "Accelerated Mass Asset Cost Recovery and Reinvestment System" (A-MACRRS), which replaces the more than 100 current depreciation schedules with six pools on a revenue neutral basis as compared with MACRS. Under the A-MACRRS system, a taxpayer would calculate depreciation, E&P and AMT adjustments only once under a unified schedule. Assets would be assigned to pools based on their current MACRS property class assignments.

Under the Proposal, businesses would transition to the new system by transferring the remaining adjusted basis of all capital assets into each of the six respective pools. Each pool's balance would then be increased by the amount of any assets placed in service in such year assigned to each respective pool. In addition, each pool's balance would be reduced by the proceeds of any asset dispositions from the pool in such year, and by previous depreciation deductions. At year-end, each final pool balance is multiplied by its applicable declining balance percentage to determine the year's depreciation deductions.

The Summary states that the pooling system also significantly simplifies depreciation for businesses that manage large fleets of assets, where current tax rules generally require a taxpayer to annually calculate depreciation deductions on each capital asset separately. The pooling system would expand a simplified version of mass- or general-asset accounting to all assets.

Asset Assignment

The Proposal would give the Treasury Department authority, subject to Congressional oversight, to update asset pool assignments based on economic assessments of an asset's useful life and technical obsolescence, under the accelerated depreciation schedule. It would also require Treasury to conduct a review of the overall depreciation system and submit a report to Congress every 5 years.

Dispositions and Like-Kind Exchanges

Current law generally requires taxpayers who dispose of an asset to recapture as ordinary income any proceeds that relate to previously claimed depreciation deductions with capital gain treatment for any proceeds beyond that amount, unless the proceeds are reinvested in "like-kind" property, which allows the recapture and capital gain to be deferred.

Under the Proposal, dispositions would no longer be subject to the "recapture" tax. Instead, the taxpayer would reduce the pool balance by the amount of disposition proceeds. The Summary states that under this rule, the deferral currently provided under the like-kind rules is available to all transactions involving depreciable personal property on a simplified basis provided the acquired replacement property is in the same asset pool and the pool balance does not go below zero.

Simplified Placed-in-Service Rules

Under current law, a taxpayer is generally required to use the half-year convention on personal property placed in service in any given year, and assets placed in service in the last quarter of a year are subject to the mid-quarter convention. The Proposal repeals both the half-year and mid-quarter conventions, allowing a taxpayer to claim a full first-year depreciation deduction. The Summary states that this not only increases the deduction for the year an asset is placed in service, but also simplifies tax compliance and increases certainty for business investment decisions.

Wyden Discussion Draft on Cost Recovery Reform and Simplification (cont.)

Special Issues and Personal Use

Current law includes a number of special rules, especially when assets are used for both personal and business purposes. There are special rules for “listed property” and mixed-use passenger autos, called “luxury autos”.

The Proposal would replace many of the special rules with a simplified framework. The Summary states that assets with 50 percent or more business use would be eligible for depreciation under normal rules. A taxpayer using a specific asset less than 50 percent for business use in any given year would continue to use the pooling system, but would only claim the proportionate business use of that asset’s depreciation deduction for such year. In addition, the complex “luxury autos” rules would be replaced with a simple limit on the depreciable basis of any such vehicle. Finally, the draft would remove laptop computers used primarily in a business from the list of “listed property.”

Expiring Provisions – Bonus Depreciation and Section 179 Expensing

The tax legislation passed at the end of 2015 extended or made permanent a number of cost recovery provisions, including a five-year extension and expansion of bonus depreciation, permanent expansions of small business expensing and 15-year depreciation for certain restaurant property, and leasehold and retail improvement property. In addition, the bill extended for two years various depreciation preferences including those related to race horses, motorsports entertainment facilities, preferences for energy-efficient investments, and renewable energy. The Proposal would preserve those provisions and their expirations, and a number of provisions would be modified to conform to the pooling regime.

International Issues

The OECD held the tenth meeting of the **Forum on Tax Administration** with the heads of 44 tax administrations in attendance. At the meeting, Canada, Iceland, India, Israel, New Zealand and the People’s Republic of China all signed the Multilateral Competent Authority Agreement for the automatic exchange of country-by-country reports, and Israel and the Russian Federation signed the Common Reporting Standard (CRS) Multilateral Competent Authority Agreement.

The OECD issued a **discussion draft that would revise existing bilateral treaties** to conform to changes under the BEPS project, and it requested comments by June 30th, with a public hearing scheduled for July 7th.

For additional information and advice on these issues, please contact:

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