# WASHINGTON TAX NEWS

**Potomac Law Tax Newsletter—July 2016** **Susan Rogers**

The main focus in Washington continues to be the **Presidential race** with the political conventions to be held in July, and the presumptive nominees of each party now determined. The **new GOP blueprint for tax reform** was overshadowed by the **Brexit vote** in favor of the UK leaving the European Union. The House and Senate continue to work this week prior to adjourning for a nearly 2-month recess. After passing legislation aimed at helping Puerto Rico address its fiscal crisis, issues that remain for action this week include the FAA reauthorization and gun control in the House, and Zika funding and the defense funding bill in the Senate.

The threat of a government shutdown when Congress returns in September now appears to be increasing, since Senate Democrats have indicated they will block individual spending bills in the Senate because they believe that Republican leaders are not honoring the 2015 bipartisan budget deal. This will likely lead to consideration of a **Continuing Resolution to fund the government** when the fiscal year expires on September 30th.

There is increasing disagreement between the Treasury Department and the business community over the impact and cost of the **proposed Treasury rules on Section 385 and inversions**. Lawmakers have written Treasury and continue to schedule meetings with them on behalf of the business community. Despite requests to extend the comment period due date, Treasury intends to move ahead with the July hearing on the proposed rules and finalization of the rules.

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

***Congress will take a break from legislating in Washington to attend the two political conventions. When they return in September, they will face issues that must be addressed before the November elections including funding the government for the next fiscal year.***

***Susan Rogers***

## In This Issue


- Congressional Activity
- Tax Reform and Treasury Action on 385/Inversions
- International Tax Issues
- Treasury/IRS update
- GOP Tax Reform Blueprint

## Congressional Activity — Tax Reform/Treasury Action on 385 and Inversions

### House Ways & Means Committee

House Republicans released a **blueprint for comprehensive tax reform** as a result of the work done by the House GOP task force on tax reform. See a detailed summary on pages 3-4. The report states that the proposed reforms overall, including the 20 percent tax rate, change to a territorial system and border adjustments, will address the issue of "corporate inversions."

W&M Committee Ranking Democrat, Sander Levin (D-MI), issued a June 24th press release in which he commented that the proposal would "significantly decrease the tax burden on the wealthiest households, with no relief for hardworking American families." He questioned the plan's use of "dynamic scoring" and criticized the plan for not including any proposals to prevent erosion of the corporate tax base in conjunction with the shift to a territorial system. SFC Ranking Democrat, Ron Wyden (D-OR), agreed that serious, bipartisan tax reform is needed but commented that the "House GOP's framework goes in the opposite direction, allowing the privileged few to push what they rightfully owe onto the backs of middle class families."

### Senate Finance Committee

The Senate Finance Committee held a hearing to review current **tax policies affecting energy exploration, development and conservation** with SFC Chairman Hatch (R-UT) commenting that he supports an "all-of-the-above approach" to energy development. Ranking Democrat Wyden (D-OR) outlined his support for eliminating all energy tax expenditures and creating three technology-neutral tax incentives directed at clean power, clean transportation and energy efficiency.

Democrats on the Senate Finance Committee are working on a **package of anti-inversion and other international tax reform measures**, which will likely be released this summer.

The IRS issued two sets of corrections to temporary regulations issued earlier this year to address **corporate inversions** – the first set of corrections is a brief list of changes to words and phrases in the initial April regulations, and the second set of corrections includes 15 changes ranging from clarified references to new explanatory language for the several examples outlined in the original regulations. The IRS scheduled a public hearing on July 14th on the **earnings stripping/section 385** rules that were issued in conjunction with the inversion regulations with written comments due by July 7th. Eleven Democrats on the W&M Committee have written to Secretary Lew requesting a meeting to discuss the earnings stripping rules with specific reference to the financial services, insurance and utilities industries.

### International Tax Issues

The OECD Council approved the amendments to the **Transfer Pricing Guidelines** for Multinational Enterprises and Tax Administrations ("Transfer Pricing Guidelines") as set out in the 2015 BEPS Report on Actions 8-10 (Aligning Transfer Pricing Outcomes with Value Creation) and on Action 13 (Transfer Pricing Documentation and County-by-Country Reporting). Given the way in which the Transfer Pricing Guidelines are integrated into the domestic law of certain countries, including by direct reference to the Guidelines, this action further clarifies the status of the BEPS changes to the Transfer Pricing guidelines.

The European Parliament announced that it passed the European Commission's proposal for an **EU anti-tax avoidance directive**, which will reflect the OECD's action plan to limit base erosion and profit shifting (BEPS) and follows recommendations made by the European Parliament in late 2015.

## Treasury/IRS

The IRS and Treasury issued temporary (TD 9770) and proposed regulations (REG-126452-15) that address certain transfers of property to **regulated investment companies (RICs) and real estate investment trusts (REITs)**. The temporary regulations, which are effective June 7th, impose a corporate level tax on certain transactions in which property of a C corporation becomes the property of a REIT.

The IRS and Treasury issued final regulations (TD 9771) under section 108 relating to the exclusion from gross income of **discharge of indebtedness income** of a grantor trust or an entity that is disregarded as an entity separate from its owner, applicable to discharge of indebtedness income occurring on or after June 10th.

The IRS issued Notice 2016-39, providing guidance on whether **pension payments** to employees moving to part-time status on the path to full retirement are treated as an annuity under section 72.

*House Republicans released a 35-page blueprint on tax reform as part of the GOP agenda, which Speaker Paul Ryan has called "a vision for a Confident America." The report proposes to lower corporate and pass-through business rates, reduce individual tax rates, provide full expensing for business costs, adopt a territorial system for taxing foreign-source income of US multinationals and move toward a cash-flow tax system without adopting a consumption levy.*

*House W&M Committee Chairman Kevin Brady chaired the Tax Reform Task Force launched in January 2016, which solicited policy ideas from Republican members. Committee members and staff will work on soliciting comments from the public and will then develop legislation that will "encapsulate the policies and provisions reflected in the Blueprint," which will be ready for legislative action in 2017.*

*The report states that "it envisions tax reform that is revenue neutral" by measuring revenue neutrality according to a "current policy baseline" under which temporary tax provisions are assumed to be extended permanently and by including the positive revenue effects from economic growth, i.e. "dynamic scoring."*

## The GOP Tax Reform Blueprint

The release of the House GOP plan for tax reform gives the business community an opportunity to provide input into the development of tax reform proposals in 2016 that will become the basis for tax reform legislation in 2017. **W&M Committee Chairman Brady said, "Tax reform only happens once a generation, and it can too easily be hijacked by Washington and special interests … House Republicans believe it's time for a change. It's time, America, to let your voice be heard."**

### Business Tax Reform Proposals

The top corporate tax rate would be reduced from 35 percent to 20 percent. The corporate AMT would be repealed.

Pass-through business income (e.g., sole proprietorships, partnerships, LLCs, subchapter S corporations) would be taxed at a top rate of 25 percent.

Full expensing is allowed for business costs (in lieu of depreciation and amortization) for investments in both tangible property (such as equipment and buildings) and intangible assets (such as intellectual property), but not land.

The plan eliminates the current deduction for net business interest expense associated with debt incurred to finance the investments, which will enjoy full expensing. Businesses will be allowed to deduct interest expense only against interest income, with an indefinite carryforward period for disallowed net interest expense deductions, and special rules for industries such as banking, insurance, and leasing, will be developed.

The plan repeals net operating loss (NOL) carrybacks but allows NOLs to be carried forward indefinitely adjusted for inflation but limited in any one year to 90 percent of taxable income.

The plan would repeal most business tax preferences, but does not provide many specifics other than to cite the Section 199 deduction for domestic production activities income as a candidate for repeal.

The plan retains the research and experimentation credit and the last-in-first-out (LIFO) method of accounting, but notes that they could undergo changes upon review.

The report does not include any proposals for special tax incentives related to "patent box" or "innovation box" income.

### International Tax Reform

The Blueprint proposes moving toward a territorial system with a 100 percent tax exemption on dividends from foreign subsidiaries. This would replace the current system which taxes US companies on their worldwide income, subject to deferral and an allowance for foreign tax credits.

Deferred foreign earnings generated prior to enactment would be subject to a mandatory "deemed" repatriation tax at a rate of 8.75 percent if held as cash or cash equivalents, or 3.5 percent if held in another form – with an election available to pay over 8 years.

The plan provides for border adjustments exempting exports and taxing imports, which will be consistent with World Trade Organization rules regarding indirect taxes. These rules are intended to eliminate US tax on products, services and intangibles exported abroad, and to impose US tax on the same imported into the US. The mechanism for the border adjustments is not specified in the report.

The report calls for repealing most of the subpart F rules except for those on foreign personal holding company income (with possible changes). No new base erosion protections are included.

## The GOP Tax Reform Blueprint (cont.)

### Individual Tax Reform

The current multiple tax brackets would be replaced with three tax brackets set at 12 percent, 25 percent, and 33 percent.

Investment income including net capital gain, dividend, and interest income would be taxed as ordinary income, but subject to a 50 percent exclusion resulting in effective tax rates of 6 percent, 12.5 percent, and 16.5 percent depending on the taxpayer's marginal rate.

The individual AMT would be repealed.

The estate tax and the generation-skipping tax would be repealed.

The current law standard deductions and personal exemption would be consolidated into a new standard deduction -- $24,000 for married individuals filing jointly, $18,000 for single individuals with a child and $12,000 for other single individuals.

The child tax credit and personal exemption for dependents would be combined into an enhanced "child and dependent tax credit."

The report states that the Committee will continue to work to "simplify and consolidate" current-law education benefits.

The report states that all itemized individual deductions would be eliminated except for the mortgage deduction and the charitable donation deduction with the possibility of options to modify both deductions (while not affecting current mortgages or refinancing of current mortgages).

The plan would retain current law tax incentives for retirement and financing higher education but the Committee intends to look for ways to consolidate and reform these benefits.

The report states that the Earned Income Tax Credit would be retained but possibly modified.

The report notes that health-related provisions in the tax code, such as the exclusion of employer-provided health insurance, HSAs and flexible spending arrangements are covered in the task force report on health care.

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

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**Susan Rogers has 30 years of experience in the tax policy field in Washington including several years as Majority Tax Counsel to the House Ways & Means Committee and extensive experience managing global tax issues for a Fortune 100 multinational. Ms. Rogers' practice focuses on providing information and strategic advice to clients on US and international tax policy issues and advice on how to manage tax policy risks.**