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A Broader Perspective

Alert

Tax Advice and Controversy Client Service Group

To: Our Clients and Friends May 7, 2009

President Obama Calls for Crackdown on International Tax Transactions

On May 4, 2009, President Obama unveiled his Administration's plan to reform the country's international tax laws and improve their enforcement.

The following is a summary of the Administration's policy positions and proposals:

- Businesses currently investing overseas can claim current deductions on their U.S. income tax returns for expenses incurred in supporting their overseas investments but nevertheless defer paying U.S. taxes on the profits they make from those investments. The deferral is achieved by the company investing overseas through a foreign subsidiary (usually located in a low tax or no tax jurisdiction), thus not having to pay U.S. taxes on overseas profits until those profits are repatriated (brought back to the U.S.). The Administration's plan would provide that with the exception of research and experimentation expenses, companies will no longer be able to claim deductions on their U.S. income tax returns for expenses incurred in support of their offshore investments until they pay taxes on their offshore profits. This proposal would take effect in 2011.

- Since the implementation of the so-called "check-the-box" rules, companies have been allowed to make their foreign subsidiaries "disappear" for tax purposes – permitting them to legally shift income to tax havens without incurring U.S. income tax. The Administration's plan would eliminate the ability to "check-the-box" and would disallow entity classification elections to treat certain foreign subsidiaries as disregarded entities for U.S. tax purposes. This proposal would take effect in 2011.

- Currently, U.S. companies that pay foreign taxes on overseas profits can claim a credit against their U.S. income taxes for the foreign taxes paid. Some U.S. companies use existing law to artificially inflate or accelerate these credits. The

Administration's plan would reform the foreign tax credit by making sure that the foreign tax credit will no longer be allowed for foreign taxes paid on income not subject to U.S. tax. This proposal would take effect in 2011.

- The Administration's plan would make it more difficult to hide foreign investments from U.S. taxation by cracking down on financial institutions that enable and profit from international tax evasion. This proposal would require foreign financial institutions that have dealings with the U.S. to sign an agreement with the Internal Revenue Service ("IRS") to become a "Qualified Intermediary" ("QI") and share as much information about their U.S. customers as do U.S. financial institutions. Any financial institution that does not agree to be a QI and adhere to the information reporting requirements will be presumed to be facilitating tax evasion. QIs will also face enhanced information reporting obligations.

- The Administration's plan would require U.S. financial institutions to withhold 20%-30% of U.S. payments to individuals who use Non-QIs. To get a refund of the amounts withheld, investors must disclose their identities and demonstrate they are obeying the law.

- The Administration's plan would set the statute of limitations on international tax enforcement at six years after the taxpayer submits required information and authorize the IRS to hire 800 new staff to increase international enforcement.

If these proposals are enacted into law they will significantly alter current international tax planning. Although these proposals have not been drafted into legislation they should be given serious consideration in planning cross-border transactions.

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To discuss this issue further please contact a member of Bryan Cave's Tax Advice and Controversy Client Service Group or the author:

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