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Permanent research credit clears House

The House of Representatives voted 274-131 on May 9 to approve legislation that would permanently extend a modified version of the now-expired alternative simplified method for calculating the research and experimentation (R&E) tax credit effective for tax years beginning after 2013.

Under the American Research and Competitiveness Act of 2014 (H.R. 4438) the R&E credit going forward would equal:

- 20 percent of qualified research expenses for the tax year that exceed 50 percent of a taxpayer's average qualified research expenses in the three preceding tax years, plus
- 20 percent of basic research expenses for the tax year that exceed 50 percent of a taxpayer's average basic research expenses in the three preceding tax years, plus
- 20 percent of all expenses (without regard to a base amount) paid to an energy research consortium for research conducted for the taxpayer.

A taxpayer that has no qualified research expenses in any of the preceding three tax years would be permitted to claim a reduced research credit at a rate of 10 percent.

The traditional 20 percent credit that was calculated using a base period would be repealed.

Notably, the approved bill does not include a provision from the tax reform discussion draft House Ways and Means Committee Chairman Dave Camp, R-Mich., released earlier this year that would eliminate the R&E credit for research related to computer software.

H.R. 4438 is not offset and would reduce federal revenues by an estimated $155.5 billion over 10 years, according to the Joint Committee on Taxation (JCT) staff. The lack of offsets was a point of contention for Democratic taxwriters when the legislation was marked up in the Ways and Means Committee and prompted most Democrats – and one Republican – to vote against the measure when it was brought to the House floor.

Passage part of House extenders strategy

Passage of the measure advances the plan devised by Ways and Means Committee Chairman Camp for addressing the fate of expired and expiring temporary tax extenders provisions. Camp has proposed making certain extenders provisions permanent and eliminating others from the code as part of fundamental tax reform. But he noted at a Ways and Means

hearing last month that "making some tax policies permanent now will open the door for the economic growth we need by giving consistency and stability to businesses small and large." (For prior coverage, see *Tax News & Views*, Vol. 15, No. 16, Apr. 11, 2014.)
URL: http://newsletters.usdbriefs.com/2014/Tax/TNV/140411_1.html

H.R. 4438 cleared the Ways and Means Committee on April 29 along with five other bills – also unoffset – that would permanently extend the subpart F exception for active financing income, lookthrough rules for payments between related controlled foreign corporations (CFCs), the five-year recognition period for built-in gains tax for S corporations, the basis adjustment for stock of an S corporation making charitable contributions of property, and the enhanced expensing limit and phase-out threshold for small businesses under section 179. Like the research credit, all of these provisions expired at the end of last year. House Republican leaders have not yet indicated when the five other Ways and Means-approved bills – which the JCT staff estimates would have a combined 10-year cost of $154.5 billion – will be brought to the floor.

Camp plans to hold additional hearings and mark-ups on other discrete extenders provisions in the coming months but has not announced which ones might be taken up next.

On to the Senate

H.R. 4438 now heads to the Senate, where it is unlikely to survive in its current form. Senate Majority Leader Harry Reid, D-Nev., plans to hold a vote the week of May 12 on competing legislation (S. 2260) approved in the Finance Committee last month that would retroactively extend through 2015 most – but not all – of the 55 extenders provisions that expired at the end of last year. (Among other things, the Finance Committee bill would temporarily extend an expanded version of research credit; the subpart F active financing exception and CFC lookthrough rule; increased section 179 expensing limits; the beginning-of-construction date for renewable power facilities eligible to claim the electricity production credit or investment credit in lieu of the production credit; and 15-year straight-line cost recovery for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements.)

The Finance Committee measure includes no significant revenue offsets and would cost upwards of $86 billion over 10 years, according to the JCT staff. (For prior coverage, see *Tax News & Views*, Vol. 15, No. 15, Apr. 4, 2014.)
URL: http://newsletters.usdbriefs.com/2014/Tax/TNV/140404_1.html

To adhere to the constitutional requirement that all revenue bills originate in the House, Reid is expected to delete the language of the House-passed research credit extension once that legislation is sent to the Senate and substitute the text of the Finance Committee bill. Assuming the amended bill wins approval in the Senate, it would be sent back to the House for further consideration.

It was unclear at press time whether or not Reid intends to allow senators to offer amendments to the extenders package once it comes to the floor. If he does not allow senators to offer amendments, it is likely that Republicans will seek to deny the bill the 60 votes needed to overcome various procedural hurdles.

White House veto threat

For its part, the Obama administration issued a Statement of Administration Policy May 6 criticizing the House approach to extenders and promising that the president would veto the House-passed R&E bill if it reached his desk in its current form.
URL: http://www.whitehouse.gov/sites/default/files/omb/legislative/sap/113/saphr4438r_20140506.pdf

"By making the [R&E] credit permanent without offsets, H.R. 4438 would add $156 billion to the deficit over the next 10 years. Moreover, if this same, unprecedented approach of making major traditional tax extenders permanent without offsets were followed for the other traditional tax extenders, it would add $500 billion or more to deficits, wiping out most of the deficit reduction achieved through the American Taxpayer Relief Act of 2013," the statement said.

A statement posted on the Ways and Means Committee Web site in response to the administration's veto threat argues that "the White House has forgotten that tax extenders have historically not been paid for. In fact, in both 2006 and 2008, then-Senator Obama voted to extend the [R&E] tax credit without paying for it. And, in 2010 and 2013 he signed into law unpaid-for extensions of tax extenders. Most recently, the Democrat-controlled Senate Finance Committee…approved an $85 billion tax extender package that was not paid for, a position that Democrats have maintained for years."
URL: http://waysandmeans.house.gov/news/documentsingle.aspx?DocumentID=379127

The partisan standoff over how to address expired tax provisions makes final action on extenders unlikely until much later this year – probably in a lame duck session after the November 4 elections.

— Michael DeHoff
Tax Policy Group
Deloitte Tax LLP

Senate taxwriters steer clear of tax reform revenue offsets at highway infrastructure hearing

Members of the Senate Finance Committee discussed tax-based approaches to averting the insolvency of the Highway Trust Fund at a May 6 hearing; but they focused largely on fuel taxes and tax-preferred bond provisions and steered clear of advocating revenue offsets that have recently been included in proposals to reform the tax code.

Highway funding shortfall

Finance Committee Chairman Ron Wyden, D-Ore., noted in his opening statement that annual federal spending on highways and transit has outstripped collections from taxes on gasoline, diesel fuel, and other transportation-related activities that provide the revenue stream for the Highway Trust Fund. To remain solvent, the trust fund will require approximately $8 billion through the end of the current calendar year, another $10 billion through fiscal year 2015, and approximately $100 billion over six years, he said.

Authorization for the trust fund is set to expire September 30.

Wyden laid out two priorities for taxwriters to address at the hearing: a short-term solution to reauthorize the trust fund and fix the immediate funding problem and a longer-term solution "to find a sustainable source of funds that will keep this crunch from happening again."

In his prepared testimony, Joseph Kile of the Congressional Budget Office (CBO) explained that Congress could address the pending revenue shortfall through some combination of increased rates for existing Highway Trust Fund taxes or the imposition of new taxes, reduced spending for highway and transit projects, and continued supplements from the Treasury general fund. He noted that "[i]f lawmakers chose to meet obligations projected for the trust fund solely by raising revenues, they would need to increase motor fuel taxes by an amount between 10 cents and 15 cents per gallon, starting in fiscal year 2015." Relying on transfers from the general fund would require Congress to reduce other spending, increase broad-based taxes, or add to the deficit through increased borrowing, he stated.

Possible revenue solutions

During testimony from invited witnesses, Finance Committee members Debbie Stabenow, D-Mich., Bill Nelson, D-Fla., and Johnny Isakson, R-Ga., expressed an interest in Virginia Transportation Secretary Aubrey L. Layne's discussion of how that state eliminated its 17.5 cents per gallon tax on gasoline and diesel fuel and replaced it with a sales tax of 3.5 percent on gas and 6 percent on diesel (based on wholesale prices).

Layne explained that the tax was designed so that revenues would "rise with future economic activity" and included a "legislative floor" to ensure that revenues never dropped below a certain level. He also told taxwriters that the new sales tax on motor fuels was not a cure-all for the state's transportation funding issues; rather, it was part of a package of changes enacted in Virginia that included an increase in the statewide retail sales tax (with the additional revenue dedicated to transportation improvements and maintaining the highway network) and a phased-in increase in the motor vehicle sales tax.

For his part, Wyden touted the potential benefits of using tax-preferred bonds to encourage investment of private capital in federal infrastructure projects. In his opening statement he noted specifically that the now-expired Build American Bonds program, which was enacted as part of the American Recovery and Reinvestment Act of 2009, "helped finance more than $180 billion of projects in Oregon and from one end of America to the other."

No apparent traction for tax reform revenue

Proposals included in tax reform plans put forward by the Obama administration and House Ways and Means Committee Chairman Dave Camp, R-Mich., that would dedicate certain revenue from a tax code overhaul to federal infrastructure projects generated little discussion at the hearing.

Camp's tax reform discussion draft, which was released in February, calls for imposing a one-time repatriation tax on permanently reinvested offshore income of U.S. multinational firms as part of the transition to a territorial system for taxing U.S. multinationals and dedicating the revenue to the Highway Trust Fund. But Finance Committee ranking Republican Orrin Hatch of Utah rejected recent suggestions from some congressional Democrats that Congress should pursue a repatriation tax now to address current infrastructure funding needs.

"Make no mistake, I believe we should have a robust discussion as to how our tax system should deal with overseas earnings. However, given the economic implications of any changes to this system, that discussion should take place in the context of a broader debate about tax reform, not as part of an ad hoc effort to pay for a highway bill," Hatch said.

Finance Committee members made no mention of a proposal in the Obama administration's 2012 corporate tax reform framework – and included in a draft transportation funding reauthorization plan that the Department of Transportation recently sent to Congress – that calls for making a one-time investment in infrastructure using $150 billion in temporary revenue that the White House estimates would be generated from the transition to a reformed business tax system. The temporary revenue would result from the repatriation of certain offshore income as well as various tax timing-related changes such as repealing the LIFO method of accounting and lengthening depreciation schedules. (For prior coverage, see *Tax News & Views*, Vol. 15, No. 17, May 2, 2014.)
URL: http://newsletters.usdbriefs.com/2014/Tax/TNV/140502_2.html

Next steps

Senate Environment and Public Works Committee Chairman Barbara Boxer, D-Calif., who testified at the hearing, said her committee would mark up legislation the week of May 12 that would call for funding surface transportation programs at current levels plus inflation, likely for five or six years. It remains up to the Finance Committee to address the anticipated shortfall in revenue to fund the proposal.

As of press time, Wyden had not announced plans for additional hearings or mark-ups on the issue.

— Victoria Glover
Tax Policy Group
Deloitte Tax LLP

Wyden to propose retroactive anti-inversion rules

Senate Finance Committee Chairman Ron Wyden, D-Ore., announced this week that he intends to propose retroactive legislation to discourage U.S. corporations from reincorporating overseas in so-called inversion transactions to reduce their U.S. income tax liability.

Wyden had revealed that he would offer anti-inversion legislation in remarks to reporters on May 8, but provided few details on how his plan would work. In an op-ed published in *The Wall Street Journal* on May 9, Wyden explained that his proposal will require a U.S. company that reorganizes in an inversion transaction to ensure that at least 50 percent of its stock is owned by the new foreign partner. Current law sets that floor at 20 percent. Wyden did not indicate when he would unveil a proposal but stated that the legislation would be effective "for all inversions taking place from May 8, 2014, on."

"I don't approach retroactivity in legislation lightly, but corporations must understand that they won't profit from abandoning the U.S.," Wyden wrote.

Levin proposal forthcoming

In a related development, Senate Permanent Subcommittee on Investigations Chairman Carl Levin, D-Mich., announced May 8 that he intends to introduce his own anti-inversion legislation "soon."

Levin argued in a news release that companies engaging in inversion transactions "benefit from the protections and services the federal government provides, including patent protection, research and development tax credits, national security and more; they shouldn't be allowed to shift their tax burden onto others."

According to press reports, Levin's brother, House Ways and Means Committee ranking Democrat Sander Levin of Michigan, will introduce an identical proposal in the House.

Outlook

It is unclear whether Congress will act on anti-inversion measures in this election year, but Wyden's op-ed and Levin's announcement appear designed to have a chilling effect on transactions that their colleagues may be unable or unwilling to stop through the legislative process.

— Michael DeHoff
Tax Policy Group
Deloitte Tax LLP