



Tax

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Wyden open to near-term inversion bill as Treasury calls for immediate action

The debate over corporate inversions heated up again this week as Senate Finance Committee Chairman Ron Wyden, D-Ore., said he no longer wants to wait for tax reform to address the issue and the Treasury Department called on Congress to take immediate retroactive action.

Background

Concern over inversions in the late 1990s and early 2000s led Congress to enact section 7874 in 2004. Under that provision, if a foreign corporation acquires, directly or indirectly, substantially all of the properties of a U.S. corporation, the foreign corporation will be treated as a domestic corporation if the continuing ownership of the legacy shareholders in the U.S. corporation exceeds 80 percent by vote or value. If the ownership of the legacy shareholders in the U.S. corporation exceeds 60 percent (but is less than 80 percent), the foreign corporation will not be treated as a domestic corporation, but it will lose some U.S. tax benefits. (Section 7874 also applies to the acquisition of substantially all of the assets consisting of a trade or business of a domestic partnership.)

Critics have claimed that section 7874 is not strong enough, but Congress has not seriously revisited the issue since the current rules were enacted a decade ago. Earlier this year, President Obama’s fiscal 2015 budget included a proposal to tighten section 7874 by changing the 80 percent test to 50 percent and eliminating the 60 percent test entirely. The proposal failed to gain traction at the time, but media attention on several high-profile proposed inversion transactions involving acquisitions of or mergers with foreign companies has returned the issue to congressional attention.

Wyden’s initial response

In May, Wyden announced in a *Wall Street Journal* op-ed that he would propose legislation to tighten the current-law inversion rules by dropping the ownership test under section 7874 to 50 percent effective retroactively to May 8, 2014 – the day he talked to reporters about his plans. (For prior coverage, see *Tax News & Views*, Vol. 15, No. 8, May 9, 2014.)
URL: http://newsletters.usdbriefs.com/2014/Tax/TNV/140509_3.html

Soon thereafter, Rep. Sander Levin of Michigan, the ranking Democrat on the House Ways and Means Committee, and his brother, Sen. Carl Levin, D-Mich., introduced nearly identical companion bills in their respective chambers that would tighten the section 7874 test to 50 percent and add a management and control test for inverted foreign corporations. Both

bills would be effective for transactions completed after May 8, 2014. (The Senate version would sunset after May 9, 2016, to address the immediate concerns about inversions while giving lawmakers time to adopt a permanent solution as a part of tax reform. The House version would be in effect permanently.)

The same day those bills were introduced, Wyden stated that he wanted to tackle the inversion issue during the tax reform process rather than through stand-alone legislation. However, he reaffirmed his support for a retroactive effective date. (For prior coverage of Wyden's remarks and the Levins' bills, see *Tax News & Views*, Vol. 15, No. 20, May 23, 2014.)

URL: http://newsletters.usdbriefs.com/2014/Tax/TNV/140523_2.html

Secretary Lew's letter

Treasury Secretary Jacob Lew entered the debate in a July 15 letter to leaders and ranking members of the congressional taxwriting committees, in which he urged Congress to act on one of the Levin bills or a similar proposal. Lew acknowledged that tax reform would be the best way to deal with inversions, but noted "there are concrete steps that Congress can take now that would address this urgent issue."

URL: http://www.hatch.senate.gov/public/_cache/files/b6800ed3-979e-4edd-a832-8a1b6475b624/7-15-2014%20Final%20Hatch%20Letter.pdf

Citing recently announced inversion transactions covering "a wide range of industries," Lew criticized companies that move their legal residence out of the United States while continuing to enjoy the benefits afforded by locating operations in the United States. "The firms involved in these transactions still expect to benefit from their business location in the United States, with our protection of intellectual property rights, our support of research and development, our investment climate, and our infrastructure, all funded by various levels of government. But these firms are attempting to avoid paying taxes here, notwithstanding the benefits they gain from being located in the United States," he wrote.

To stem the wave of corporate expatriations, Lew stated that "Congress should enact legislation immediately – and make it retroactive to May 2014."

Wyden changes course

In the wake of Lew's letter, Wyden announced July 16 that he would now consider taking action on inversions ahead of the tax reform process.

"This inversion loophole must be plugged. As the speed of inversions increases, this will only fuel bipartisan urgency to stop companies from deserting the U.S. I'm talking with my colleagues and exploring options for addressing this in the near and long term," he said in a statement posted on the Finance Committee's Web site.

URL: <http://www.finance.senate.gov/newsroom/chairman/release?id=f8cbdf6a-f5bc-4518-9542-50af747dc5c0>

Wyden has not indicated whether he intends to take up one of the Levin proposals in the Finance Committee or unveil a proposal of his own. (Wyden did not co-sponsor Sen. Levin's anti-inversion legislation.)

Hatch hints at 'alternatives'

For his part, Finance Committee ranking Republican Orrin Hatch of Utah responded to Lew in a July 17 letter that criticized "punitive, retroactive policies designed to force companies to remain domiciled in the United States."

URL: http://www.hatch.senate.gov/public/_cache/files/df74d248-3709-4690-b8e6-4820a9ccc4e6/7.17.2014%20Letter%20to%20Secretary%20Lew.pdf

According to Hatch, "the best way to address this issue is to create a tax environment more favorable to starting, growing, and keeping businesses in this country." But he noted that "there may be steps Congress can take, short of comprehensive tax reform, to address corporate inversions and related issues" and asserted that lawmakers "can find alternatives that could easily be enacted and are less punitive and restrictive to businesses than those outlined in your letter." Hatch did not identify specific alternatives, however.

Hearing planned

The Finance Committee is expected to discuss the inversion issue at a hearing on international taxation scheduled for July 22. Among the witnesses scheduled to appear are Robert Stack, Treasury's deputy assistant secretary for international tax affairs, and Pascal Saint-Amans, director of the OECD's Centre for Tax Policy and Administration.

House OKs Highway Trust Fund patch; Senate to vote on multiple plans

The House of Representatives this week approved legislation that would replenish the rapidly dwindling Highway Trust Fund and extend its spending authority into 2015; meanwhile, Senate leaders announced that lawmakers in that chamber would vote on three competing short-term plans to keep the trust fund in the black.

House developments

The Highway and Transportation Funding Act of 2014 (H.R. 5021), which cleared the House on July 15 by a vote of 367-55, would renew Highway Trust Fund spending through May 31, 2015, through an infusion of approximately \$10 billion from the general fund and another \$1 billion from the Leaking Underground Storage Tank Trust Fund.

The transfer from the general fund would be offset by:

- A “pension smoothing” provision that would modify the interest rate that employers must use to calculate their pension plan liabilities for purposes of determining their annual minimum funding obligations. (The change would have the effect of lowering an employer’s plan funding payments and reducing the value of its deductions for those payments.)
- A one-year extension of Customs user fees (through September 30, 2024).

According to estimates from the Joint Committee on Taxation (JCT) staff, the pension smoothing provision would increase federal revenues by approximately \$6.4 billion from 2014-2024 and the extension of Customs user fees would reduce the deficit by roughly \$3.5 billion over the same period.

URL: <https://www.jct.gov/publications.html?func=startdown&id=4653>

Additional details on these provisions are available in a JCT staff publication describing the bill.

URL: <https://www.jct.gov/publications.html?func=startdown&id=4644>

White House backing – In a Statement of Administration Policy issued July 14, the White House expressed its support for the legislation, noting that it “would provide for continuity of funding for the Highway Trust Fund during the height of the summer construction season and keep Americans at work repairing the nation’s crumbling roads, bridges, and transit systems.” The administration noted, however, that the bill provides only a short-term solution for keeping the Highway Trust Fund solvent and called on Congress “to pass a long-term reauthorization bill well before the expiration date set forth in H.R. 5021.”

URL: http://www.whitehouse.gov/sites/default/files/omb/legislative/sap/113/saphr5021r_20140714.pdf

Senate to vote on competing plans

Across the Capitol, Senate Majority Leader Harry Reid, D-Nev., told reporters July 15 that his chamber would hold votes in the coming days on three competing plans to patch the trust fund: the House-approved bill, a funding package approved by the Senate Finance Committee, and a competing proposal currently being developed by Environment and Public Works Committee Chairman Barbara Boxer, D-Calif.

Finance Committee bill – The Preserving America’s Transit and Highways Act was approved in the Finance Committee on July 10. Like the House-passed bill, it calls for transferring roughly \$10 billion to the Highway Trust Fund from the general fund and another \$1 billion from the Leaking Underground Storage Tank Trust Fund. The Finance Committee bill does not include a specific expiration date for Highway Trust Fund spending authority, however, and instead provides that spending authority would continue until funds run out.

The Finance Committee bill would be offset by a pension smoothing provision and an extension of Customs user fees, although those provisions are narrower than their counterparts in the House legislation. The JCT staff estimates that the

Finance Committee's pension smoothing provision would increase federal revenues by only \$2.7 billion over 10 years. The extension of Customs user fees plus a short-term extension of a related fee on merchandise entered or released into the United States (a provision not in the House bill) would reduce the deficit by a combined \$3 billion over 10 years.

URL: <https://www.jct.gov/publications.html?func=startdown&id=4649>

The Finance Committee package also includes several tax compliance offsets not in the House bill that would (1) require financial institutions to provide enhanced information reporting on mortgages, (2) clarify rules on overstatement of cost or basis for purposes of the six-year statute of limitations for omission of gross income, (3) provide a 100 percent continuous levy authority on payments to Medicare providers and suppliers to collect unpaid taxes, and (4) impose a penalty on tax return preparers that fail to meet due diligence requirements with respect to the child tax credit. The JCT staff estimates these provisions would increase federal revenues by a combined \$4.25 billion over 10 years.

Complete details on the provisions in the bill are available in a publication from the JCT staff.

URL: <https://www.jct.gov/publications.html?func=startdown&id=4648>

House Ways and Means Committee Chairman Dave Camp, R-Mich., has indicated that the tax compliance provisions in the Finance Committee bill are not acceptable to Republicans in his chamber. But in remarks to reporters on July 16, Wyden pushed back against GOP claims that the provisions amount to a tax increase.

"This is enforcing existing law," he said.

Boxer to propose patch through year-end – Although no specific details were available at press time, Sen. Boxer is said to be preparing an \$8 billion package that would extend the Highway Trust Fund's spending authority only through December 31 of this year. Boxer and some other congressional Democrats – including Senate Finance Committee member Tom Carper of Delaware and House Ways and Means Committee ranking member Sander Levin of Michigan, among others – have argued that the prospect of the trust fund going broke at year-end would put pressure on Congress to act on a long-term solution in a lame duck session after the November midterm elections.

But leaders of the two congressional taxwriting committees have already rejected that approach. Finance Committee Chairman Wyden had called for extending Highway Trust Fund spending authority only through December 31 in a proposal he released late last month; but he explained to reporters July 15 that he ultimately opted for a longer extension once it became clear that "it wasn't possible to get a bipartisan bill around that."

For his part, Ways and Means Chairman Camp cautioned colleagues during the July 10 committee mark-up of the House highway bill that a lame duck deal might come together with only minimal input from taxwriters. "Maybe one or two of us will be consulted, but they are often leadership deals with the committees on the outside looking in." Patching the trust fund through next May would give taxwriters "time to deliberate and produce a longer-term solution," he said.

Procedural details unclear – At press time, Reid had not laid out specific plans for bringing the three bills to the Senate floor, nor had he indicated how he would avoid the assorted procedural hurdles that have stymied progress on other Senate legislation such as the extenders bill that cleared the Finance Committee in April.

Time running out

Congress has only a few legislative days left to resolve this issue before lawmakers adjourn for their traditional August recess. The current authorization for the trust fund is set to expire September 30. However, according to projections by the Department of Transportation, funding could dry up as early as August as spending continues to outstrip revenue coming into the fund.

— Michael DeHoff
Tax Policy Group
Deloitte Tax LLP

House approves permanent charitable giving extenders

The House of Representatives on July 17 approved unpaid-for legislation that would permanently extend the now-expired deduction for charitable contributions of food inventory, provisions related to qualified charitable distributions from retirement accounts, and special rules for qualified contributions of conservation easements. The America Gives More Act of 2014 (H.R. 4719) also would give taxpayers additional flexibility in claiming their deductions for charitable contributions and simplify the excise tax on investment income of private foundations.

The legislation combines into one package several bills related to charitable giving that were approved in the House Ways and Means Committee on May 29. (For prior coverage, see *Tax News & Views*, Vol. 15, No. 21, May 30, 2014.) It cleared the House by a vote of 277-130.

URL: http://newsletters.usdbriefs.com/2014/Tax/TNV/140530_1.html

Charitable contributions of food inventory

The legislation would permanently extend the deduction for charitable contributions of food inventory and expand it by:

- Increasing the contribution limit for C corporations to 15 percent (from 10 percent) of the taxpayer's net income for the taxable year, and increasing the limit for a taxpayer that is not a C corporation to 15 percent of the taxpayer's aggregate net income for the taxable year from all trades or businesses from which such contributions were made for the taxable year;
- Providing a five-year carryforward for qualifying food inventory contributions that exceed the 15 percent limit; and
- Adding presumptions that certain taxpayers may use in determining the tax basis and the fair market value of donated food inventory.

The provision would be effective for contributions made after December 31, 2013, in taxable years ending after that date. The JCT estimates it would decrease federal revenues by \$1.9 billion over 10 years.

URL: <https://www.jct.gov/publications.html?func=startdown&id=4655>

Charitable retirement account distributions, conservation easements

H.R. 4719 also includes provisions that would:

- Permanently extend the exclusion from gross income for qualified charitable distributions from an individual retirement account for individuals age 70-1/2 and older, effective for distributions in taxable years beginning after December 31, 2013. The JCT staff estimates it would decrease revenues by \$8.4 billion over 10 years.
- Permanently extend the increased percentage limits and extended carryforward period for qualified conservation contributions effective for contributions made in taxable years beginning after December 31, 2013. The JCT staff estimates the provision would reduce revenues by \$1.2 billion over 10 years.

Deadline for charitable deductions, private foundation excise tax rate

In addition to addressing these expired extenders provisions, the legislation includes two new permanent tax provisions that would:

- Provide individual taxpayers an election to deduct charitable contributions made after the close of their tax year but before the due date of the tax return, effective for contributions made in taxable years beginning after December 31, 2013. The JCT staff estimates the provision would decrease federal revenues by \$2.8 billion over 10 years.
- Simplify the excise tax on investment income of private foundations by replacing the current two-tiered rate structure with a single rate of 1 percent. The provision would be effective for taxable years beginning after the date of enactment, and the JCT staff estimates it would decrease federal revenues by \$1.91 billion over 10 years.

Baseline building for tax reform

Passage of the bill in the House advances Ways and Means Committee Chairman Dave Camp's, R-Mich., strategy of modifying the budget baseline by making selected tax extenders provisions permanent and allowing others to remain expired in advance of comprehensive tax reform.

Camp's tax reform discussion draft, which he released in late February, specifically called for repealing the enhanced deduction for contributions of food inventory and did not mention the gross income exclusion for qualified charitable distributions from individual retirement accounts; but it did propose a permanent extension of the qualified conservation easement provisions. The discussion draft also included the two non-extendors provisions – related to flexibility in claiming charitable deductions and the reduced excise tax rate on investment income of private foundations – that were approved as part of H.R. 4719. (For additional details on Camp's tax reform discussion draft, see *Tax News & Views*, Vol. 15, No. 9, Feb. 27, 2014.)

URL: http://newsletters.usdbriefs.com/2014/Tax/TNV/140227_1.html

Next steps

The chamber has now approved eight permanent extendors provisions that have cleared the Ways and Means Committee since May. Others include the research credit, bonus depreciation, enhanced section 179 expensing limits, and two smaller provisions benefiting S corporations.

Senate action unlikely – H.R. 4719, like the other House-approved extendors bills, is not expected to be taken up in the Democratic-controlled Senate. The Senate Finance Committee approved legislation in April that would retroactively extend for two years most of the 55 tax extendors provisions that expired at the end of last year; but Senate leaders have been unable to move it through the chamber due to a partisan dispute over amendments. Majority Leader Harry Reid, D-Nev., has indicated that final action is unlikely until Congress convenes in a lame duck session after the November midterm elections.

White House veto threat – For its part, the Obama administration issued a Statement of Administration Policy July 17 in which it expressed its willingness to “work with Congress to make progress on measures that strengthen America's social sector,” but argued that H.R. 4719 “represents the wrong approach” and noted that the president's senior advisors would recommend that he veto the bill if it reaches his desk in its current form.

URL: http://www.whitehouse.gov/sites/default/files/omb/legislative/sap/113/saphr4719h_20140717.pdf

“If this same, unprecedented approach of making certain tax extendors permanent without offsets were followed for the other traditional tax extendors, it would add \$500 billion or more to deficits over the next 10 years, wiping out most of the deficit reduction achieved through the American Taxpayer Relief Act of 2013,” the statement said.

The White House has threatened similar action on the other permanent extendors bills approved in the House so far.

More extendors floor votes ahead

The House plans to vote the week of July 21 on Ways and Means-approved legislation that would permanently extend the American Opportunity Tax Credit and enhance the child tax credit.

Extendors legislation approved by the Ways and Means Committee that still awaits action on the House floor would make permanent the subpart F exception for active financing income and lookthrough rules for payments between related controlled foreign corporations.

— Michael DeHoff
Tax Policy Group
Deloitte Tax LLP

House approves permanent Internet tax moratorium

The House of Representatives on July 15 approved legislation that would permanently extend the current-law moratorium on state and local Internet access taxes and multiple and discriminatory taxes on electronic commerce. The Permanent Internet Tax Freedom Act (H.R. 3086) cleared the chamber by voice vote.

In addition to making the Internet tax moratorium permanent, the legislation also would allow for the expiration of protections for certain Internet access taxes that were levied before October 1998 and grandfathered into the moratorium. The grandfathering protections apply to taxes imposed by South Dakota, North Dakota, Wisconsin, New Mexico, Hawaii, Texas, and Ohio.

The Internet tax moratorium and related grandfathering provisions have been in effect since 1998 and were last extended in 2007. They are scheduled to expire on November 1 of this year.

No Senate action yet

A Senate companion bill, the Internet Tax Freedom Forever Act (S. 1431), currently awaits action in the Senate Finance Committee. The measure is sponsored by Finance Committee Chairman Ron Wyden, D-Ore., but Wyden has not yet announced plans for a committee mark-up.

Wyden's efforts to move his bill could be complicated by the introduction of competing legislation on July 15 that would couple a 10-year extension (through November 1, 2024) of the Internet tax moratorium and the grandfather rules with provisions from the Marketplace Fairness Act that would make it easier for a state to capture sales and use tax revenue from transactions involving online and other "remote" vendors that do not have an in-state physical presence. The new bill, known as the Marketplace and Internet Tax Fairness Act, is sponsored by Finance Committee member Mike Enzi, R-Ohio, and Senate Majority Whip Richard Durbin, D-Ill., among others.

Wyden opposed the Marketplace Fairness Act when it came up for a vote in the Senate in May of last year. (It cleared the Senate but a companion House bill remains stuck in the House Judiciary Committee.) He recently told reporters that he hopes to keep the Internet tax moratorium separate from the issue of collecting state and local sales tax on remote transactions – a message he reiterated in a July 15 press release issued after the House approved its permanent ban on state and local Internet taxes.

"The principle that no one can discriminate against businesses just because they're on the Internet is one that benefits consumers, employers, and start-ups and should be enshrined in our tax code. That is why it is so important to reject approaches like the Marketplace Fairness Act that passed the Senate last year, which would fundamentally discriminate against states that do not levy a sales tax and against U.S. companies versus their foreign competitors. It would amount to a body blow to online retailers and services across the country," the release said.

— Michael DeHoff
Tax Policy Group
Deloitte Tax LLP

Long-term debt, deficit approaching unsustainable levels, CBO says

Estimates from the Congressional Budget Office (CBO) released July 15 suggest that if current tax and spending laws remain in effect, U.S. debt and deficit levels will drop slightly as a percentage of gross domestic product (GDP) in the near term but will be on the increase by 2024 and reach levels by 2039 that "could not be sustained indefinitely."

The CBO's 2014 Long-Term Budget Outlook looks beyond the current 10-year budget window (2014-2024) covered by its regular baseline projections and extrapolates those projections through 2039 – and, "with even greater uncertainty," through 2089.

URL: <http://www.cbo.gov/sites/default/files/cbofiles/attachments/45471-Long-TermBudgetOutlook.pdf>

Deficits & debt

According to the CBO, the deficit is on track to shrink to 3 percent of GDP in 2014 – one-third of its peak of nearly 10 percent in 2009. But the CBO projects that the combined pressures of an aging population, rising health care costs, expanding federal subsidies for health insurance, and growing interest payments on federal debt will push deficit levels to nearly 4 percent toward the end of the 10-year budget window and to 6.5 percent of GDP by 2039.

With deficits expected to remain close to their current percentage of GDP for the next few years, federal debt held by the public is projected to stay between 72 percent and 74 percent of GDP from 2015 through 2020. Thereafter, larger deficits would boost debt to 78 percent of GDP by the end of 2024 and to 106 percent of GDP in 2039, the CBO says.

Outlays

The CBO projects that federal spending would increase to 26 percent of GDP by 2039 under the assumptions of the extended baseline, up from 21 percent in 2013 and an average of 20.5 percent over the past 40 years.

A major driver of the spike in outlays is spending for Social Security and the major health care programs (Medicare, Medicaid, the Children's Health Insurance Program, and subsidies to be provided through health insurance exchanges under the Patient Protection and Affordable Care Act), which the CBO projects will rise to a total of 14 percent of GDP by 2039, twice the 7 percent average seen over the past 40 years.

In contrast, the report notes that federal spending on items other than Social Security, the major health care programs, and net interest costs is projected decline to 7 percent of GDP by 2039 – well below the 11 percent average of the past 40 years and a smaller share of the economy than at any time since the late 1930s.

Debt service costs

CBO expects interest rates to rebound in coming years from their current unusually low levels. As a result, the government's net interest costs are projected to more than double relative to the size of the economy over the next decade – from 1.25 percent of GDP in 2014 to more than 3 percent by 2024 – even though, under current law, federal debt would be only slightly larger relative to GDP at the end of the 10-year budget window than it is today. CBO estimates that the government's net interest payments would grow to 4.5 percent of GDP by 2039, compared with an average of 2 percent over the past four decades. Net interest payments would be larger than that average mainly because federal debt would be much larger.

Revenues

The CBO projects that federal revenues would also increase relative to GDP under current law, but much more slowly than federal spending. In the next 10 years, revenues are projected to rise to 18.5 percent of GDP, from 16.5 percent last year, reflecting structural features of the tax system and the ongoing economic recovery. Beyond 2024, revenues are expected to increase as a share of GDP as individual income growth outstrips inflation and more individuals are pushed into higher tax brackets over time. Revenues are projected to reach 19.5 percent of GDP by 2039, compared with an average of 17.5 percent over the past four decades.

Higher deficits possible under alternative scenario

The CBO cautioned that its long-term budget projections assume that Congress will not renew various temporary spending and revenue provisions – including tax extenders – and notes that deficits would be substantially larger under an alternative fiscal scenario in which these provisions are extended.

Difficult choices for policymakers

According to the CBO, the unsustainable nature of the federal tax and spending policies embedded in current law presents lawmakers and the public with difficult choices. To put the federal budget on a sustainable path for the long run, the CBO says, "lawmakers would have to make significant changes to tax and spending policies – letting revenues rise more than

they would under current law, reducing spending for large benefit programs below the projected levels, or adopting some combination of those approaches.”

To illustrate the magnitude of the policy changes that would be necessary to ensure sustainability, the CBO observes that reducing federal debt by 2039 to 39 percent of GDP (its average over the past 40 years) would require a combination of revenue increases and noninterest-spending cuts totaling 2.6 percent of GDP a year beginning in 2015. (In 2015, 2 percent of GDP would equal about \$465 billion.) Limiting those policy changes to revenues alone would require an increase of 14 percent over the revenues projected for 2015-2039; making those changes entirely on the spending side would require a 13 percent cut in noninterest spending over the same period, according to the CBO.

The CBO also cautions that the timing of policy changes can introduce additional challenges for policymakers. Delaying changes would lead to “a greater accumulation of debt, which would represent a greater drag on output and income in the long term and increase the size of the adjustments needed to put the budget on a sustainable course.” Increasing taxes or cutting spending quickly, however, would leave people with “little time to plan and adjust to the policy changes, and those changes would weaken the economic expansion during the next few years,” the report says.

— Shruthi Hiremath & Simmy Sharma
Tax Policy Group
Deloitte Tax LLP

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