



Tax

## Tax News & Views

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### In this issue:

Senate taxwriters at odds on how to address inversions .....	1
Senate schedules pre-recess vote on highway funding bill .....	3
House approves education, child tax incentives .....	4
Senate subcommittee examines tax implications of structured financial products .....	6

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### Senate taxwriters at odds on how to address inversions

Members of the Senate Finance Committee agreed at a hearing on international tax issues July 22 that Congress should take action on corporate inversions; however, there was little agreement on what specific action they should take or when it should take effect.

#### Wyden seeks near-term action

Finance Committee Chairman Ron Wyden, D-Ore., opened the hearing by suggesting that inversions are one manifestation of a tax code that is “infected with the chronic diseases of loopholes and inefficiency.” The best way to address the issue, he said, would be to take immediate action to “cool down the inversion fever” and then focus on a real and long-term solution: comprehensive tax reform.

This stance marks a further refinement in Wyden’s position on how to deal with U.S.-based companies that use mergers with or acquisitions of foreign companies to move their place of residence. In early May, Wyden appeared to advocate immediate action, as he called for legislation that would significantly tighten the rules under section 7874 for determining when an inverted foreign corporation would be treated as domestic for U.S. tax purposes. Such a proposal, he said, should be effective for “transactions on or after May 8, 2014.” (For prior coverage, see *Tax News & Views*, Vol. 15, No. 18, May 9, 2014.)

**URL:** [http://newsletters.usdbriefs.com/2014/Tax/TNV/140509\\_3.html](http://newsletters.usdbriefs.com/2014/Tax/TNV/140509_3.html)

When Sen. Carl Levin, D-Mich., and House Ways and Means Committee ranking member Sander Levin, D-Mich., introduced substantially similar bills to do just that, Wyden suggested that inversions would best be addressed through comprehensive tax reform rather than freestanding legislation, although he still supported the 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](http://newsletters.usdbriefs.com/2014/Tax/TNV/140523_2.html)

In the wake of a July 15 letter from Treasury Secretary Jacob Lew to the leaders and ranking members of the taxwriting committees urging immediate action, however, Wyden stated that he was open to moving on an inversion fix now, as he has concluded that tax reform cannot happen in the near term and that something must be done about inversions in the meantime. However, he stressed that he was committed to seeking a bipartisan solution.

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

## Hatch rejects 'punitive' proposals

For his part, Finance Committee ranking member Orrin Hatch, R-Utah, said that he was concerned about inversions, but he rejected the current Democratic proposals as "punitive" and ineffective.

"Rather than incentivizing American companies to remain in the U.S., these bills would build walls around U.S. corporations in order to keep them from inverting," he said.

Echoing the comments he made in his July 17 letter to Treasury Secretary Lew, Hatch stated that the best way to tackle inversions would be through comprehensive tax reform, but that he was open to alternative suggestions for near-term action. He emphasized at the hearing, however, that his willingness to consider alternative proposals was conditional.

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

"Whatever approach we take, it should not be retroactive or punitive; and, it should be revenue neutral," Hatch said.

## Partisan split among committee members

Opinions from other members of the Finance Committee fell largely along partisan lines, with Democrats supporting near-term action and Republicans expressing reservations about doing anything outside of tax reform. For example, Sen. Charles Schumer, D-N.Y., was generally supportive of the two Levin bills, saying that if companies wanted to continue to access U.S. benefits, they needed to "pay their fair share." Schumer noted, however, that he did not support the "management and control test" for inverted companies that is included in the introduced bills.

On the other side of the aisle, Sen. John Thune, R-S.D., said the political rhetoric around inversions was not helpful, and that Congress needed to focus on the cause of the problem – a tax system that is the "worst of all worlds" – and not on the symptoms. Some Republicans also appeared to be firmly against including a management and control provision in any proposed legislative fix: Thune said it would only encourage mergers that move management overseas; Sen. Rob Portman, R-Ohio, likewise worried that it would make U.S. companies more attractive targets for foreign takeovers.

## Witnesses weigh in

Several witnesses agreed that inversions were a symptom of bigger problems with the tax code. Professor Mihir Desai of Harvard University highlighted the high U.S. statutory rate and worldwide system of taxing foreign income as limiting the ability of U.S. multinationals to succeed against competitors in countries with low rates and territorial systems. Desai warned that inversion-specific proposals could backfire with unintended consequences and noted that the last anti-inversion legislation (enacted in 2004) probably spurred the current wave of inversions. He also contended that including a management and control test in a proposal to curb inversions could cause high-value headquarters jobs to move offshore.

Robert Stack, Treasury deputy assistant secretary for international tax affairs, agreed about the need for broader tax reform and urged the committee to take up the Obama administration's proposals for a minimum tax on worldwide income and limits on interest deductions.

But Stack also reiterated the White House's support for immediate inversion legislation with a May, 2014, effective date as outlined in Lew's letter and noted that the administration included an anti-inversion proposal in its fiscal 2015 budget. During questioning from Wyden, Stack said the cost of waiting to address the inversion issue until Congress tackles a broader reform of the tax code was too high.

## BEPS

Also testifying was Pascal Saint-Amans, director of the Centre for Tax Policy and Administration at the Organisation for Economic Co-operation and Development (OECD). Saint-Amans echoed the call for tax reform, but he also defended the OECD's ongoing project on base erosion and profit shifting (BEPS), which has raised fears among tax administrators about upsetting current international tax norms. (For prior coverage, see *Tax News & Views*, Vol. 14, No. 31, July 26, 2013.)

**URL:** [http://newsletters.usdbriefs.com/2013/Tax/TNV/130726\\_2.html](http://newsletters.usdbriefs.com/2013/Tax/TNV/130726_2.html)

Saint-Amans cautioned that not taking action to address BEPS would put "the current consensus-based international framework for dealing with cross-border tax issues . . . at risk"; create "an uneven playing field in which some businesses,

such as those which operate cross-border and have access to sophisticated tax expertise, receive unintended competitive advantages compared with enterprises that operate mostly at the domestic level or that use less aggressive tax planning techniques”; and threaten to “undermine the sovereign right of countries to set tax policy.”

Hatch reminded Saint-Amans of the U.S. government’s separation of powers, and stressed that Congress must be kept informed of what is going on with the BEPS project and would need to give its consent to any action. Hatch also cited “concerns” on the part of some U.S. lawmakers “that the BEPS project could be used by other countries as a way to increase taxes on American taxpayers” and cautioned that while the United States “should be willing to work through these issues until an international consensus is reached, we should not be rushed into accepting a bad deal just for the sake of reaching an agreement.” (House Ways and Means Committee Chairman Dave Camp, R-Mich., expressed similar concerns about the BEPS project in a press release he issued with Hatch last month that coincided with the OECD’s annual international tax conference in Washington. For prior coverage, see *Tax News & Views*, Vol. 15, No. 22, June 6, 2014.)

**URL:** [http://newsletters.usdbriefs.com/2014/Tax/TNV/140606\\_4.html](http://newsletters.usdbriefs.com/2014/Tax/TNV/140606_4.html)

## Obama speaks out

Away from Washington, President Obama on July 24 made an appeal to “economic patriotism” as he called for new curbs on inversion transactions. During a speech in Los Angeles, Obama said that inverting companies were “renouncing their citizenship” to get out of “paying their fair share” while enjoying the benefits of operating in the United States and letting the middle class pick up the bill. The president acknowledged the need for tax reform – and pointed to his own framework for overhauling the corporate tax rules – but he urged Congress to close the inversion “loophole” in the interim.

## Insourcing/outsourcing bill moves forward

In other developments, the Senate voted 93-7 on July 23 to begin debate on legislation (S. 2562) introduced by Finance Committee member Debbie Stabenow, D-Mich., and Sen. John Walsh, D-Mont., that would provide a 20 percent tax credit for certain expenses related to relocating an offshore business unit to the United States, and deny deductions for certain expenses related to eliminating a business unit located within the United States and relocating it offshore. The legislation faces additional procedural hurdles in the Senate before it can be brought up for a vote on final passage. For example, Democratic leaders still have to reach an agreement with Republicans on a process for offering amendments – something that has stymied progress on other legislation such as the tax extenders package that was approved by the Finance Committee in April.

— Jon Almeras  
Tax Policy Group  
Deloitte Tax LLP

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## Senate schedules pre-recess vote on highway funding bill

Senate Majority Leader Harry Reid, D-Nev., announced July 23 that lawmakers in his chamber would vote some time during the week of July 28 on legislation to replenish the rapidly dwindling Highway Trust Fund.

Reid explained that he will bring to the Senate floor legislation approved in the House July 15 that 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 raise revenue by lowering an employer’s plan funding payments and therefore reducing the value of its deductions for those payments.)
- A one-year extension of Customs user fees (through September 30, 2024).

(For prior coverage, see *Tax News & Views*, Vol. 15, No. 27, July 18, 2014.)

**URL:** [http://newsletters.usdbriefs.com/2014/Tax/TNV/140718\\_2.html](http://newsletters.usdbriefs.com/2014/Tax/TNV/140718_2.html)

Under an agreement reached with Republicans in the chamber, the Senate will be allowed to consider four amendments to the House-passed bill, including:

- A substitute amendment approved by the Senate Finance Committee on July 10 that is similar to the House-passed legislation but includes narrower provisions related to pension smoothing and Customs user fees and proposes several taxpayer-compliance offsets that are not in the House bill. (For additional details on the Finance Committee bill, see *Tax News & Views*, Vol. 14, No. 26, July 11, 2014.)  
[URL: http://newsletters.usdbriefs.com/2014/Tax/TNV/140711\\_1.html](http://newsletters.usdbriefs.com/2014/Tax/TNV/140711_1.html)
- An \$8 billion substitute amendment from Senate Environment and Public Works Committee Chairman Barbara Boxer, D-Calif., and Finance Committee member Tom Carper, D-Del., that would extend the Highway Trust Fund's spending authority only through December 31 of this year. (Boxer and Carper 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.) The amendment includes all the Finance Committee offsets except for the pension smoothing provision.
- A proposal from Sen. Mike Lee, R-Utah, that would, among other things, replenish the Highway Trust Fund through fiscal year 2019 (subject to certain limitations), eliminate the trust fund's mass transit account, phase-in a reduction of federal motor fuel taxes, and transfer (on a phased-in basis) greater discretionary authority and fiscal responsibility for surface transportation infrastructure to the states.
- A nontax amendment from Finance Committee member Pat Toomey, R-Pa., that would ease environmental and permitting requirements for reconstruction of roads, highways, bridges, or transit facilities that are damaged in a natural disaster.

The agreement sets a 60-vote threshold for passage of any amendment and of the underlying House bill.

Spending authority for the trust fund officially expires September 30; but the Transportation Department has projected that the fund could run dry by August as expenditures continue to outstrip revenues. That leaves the House and Senate with little time to agree on a funding patch and send it to the president before they adjourn for their traditional summer recess on August 1. This tight timeline, coupled with the Obama administration's recent statement of support for the House-approved legislation, has led some observers to believe that the Senate may eventually recede to the House bill.

[URL: http://www.whitehouse.gov/sites/default/files/omb/legislative/sap/113/saphr5021r\\_20140714.pdf](http://www.whitehouse.gov/sites/default/files/omb/legislative/sap/113/saphr5021r_20140714.pdf)

— Michael DeHoff  
Tax Policy Group  
Deloitte Tax LLP

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## House approves education, child tax incentives

The House of Representatives this week approved two unpaid-for bills that would consolidate certain education tax incentives and expand the child tax credit.

### Education incentives

The Student and Family Tax Simplification Act (H.R. 3393), which was approved on July 24 by a vote of 227-187, would replace the Hope Credit, the Lifetime Learning Credit, and the now-expired deduction for qualified tuition expenses with a permanent – but modified – version of the American Opportunity Tax Credit (AOTC). The AOTC is currently scheduled to expire at the end of 2017.

The modified AOTC would be available to taxpayers on a per-student basis (rather than a per-taxpayer basis) at a rate of 100 percent for the first \$2,000 per year of eligible higher-education expenses and 25 percent for the next \$2,000. The maximum annual credit amount would be \$2,500 for up to four years of tuition, fees, and course materials. The credit for the first \$1,500 of eligible expenses would be refundable.

The credit would begin to phase out for joint filers with modified adjusted gross income (MAGI) of \$160,000 (\$80,000 for all other taxpayers) and would be fully phased out at MAGI of \$180,000 for married-joint filers (\$90,000 for all other taxpayers).

The credit amounts and phase-out ranges would be indexed for inflation for taxable years beginning after 2018.

The bill was sponsored by House taxwriters Diane Black, R-Tenn., and Danny Davis, D-Ill., who led the Ways and Means Committee's bipartisan tax reform working group on education and family benefits in 2013. A substantially similar version of the bill was incorporated into the comprehensive tax reform discussion draft that Ways and Means Committee Chairman Dave Camp, R-Mich., released in February. Despite his support for the policies in the bill, Davis joined most of his Democratic colleagues in opposing the measure because it includes no offsets. The Joint Committee on Taxation staff estimates that the bill would increase deficits by \$96.5 billion over the next decade.

**URL:** <https://www.jct.gov/publications.html?func=startdown&id=4657>

### **Child tax credit**

The Child Tax Credit Improvement Act of 2014 (H.R. 4935), which cleared the House on July 25 by a vote of 237-173, would modify the current-law credit by:

- Indexing the \$1,000 credit amount for inflation in calendar years beginning after 2014;
- Increasing the beginning of the phase-out range from \$110,000 to \$150,000 for married-joint filers (\$75,000 for all other taxpayers); and
- Indexing the beginning point of the income phase-outs for inflation to the nearest \$1,000 in calendar years beginning after 2014.

However, the bill also would eliminate eligibility for the credit for some lower-income families and includes language denying the credit to children who do not have valid Social Security numbers – provisions that most House Democrats were reluctant to embrace. Democrats also took issue with the cost of the bill – the JCT staff estimates that it will increase deficits by \$90.4 billion over 10 years – and by the fact that the measure includes no offsets.

**URL:** <https://www.jct.gov/publications.html?func=startdown&id=4658>

### **Next steps**

Passage of the two bills in the House advances Ways and Means Committee Chairman Camp's 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. Only two of the permanent extenders that have been approved in the Ways and Means Committee since May still await votes by the full House. Those provisions would permanently extend the subpart F exception for active financing income and the lookthrough rules for payments between related controlled foreign corporations. (House leaders had not scheduled votes on the two provisions at press time.)

None of the House-passed extenders bills is expected to be taken up in the Democratic-controlled Senate. Legislation approved by the Senate Finance Committee in April that would retroactively extend most of the 55 now-expired tax extenders provisions through 2015 remains in limbo due to an ongoing partisan dispute over amendments. Senate Majority Leader Harry Reid, D-Nev., has stated that the issue is unlikely to be resolved until the post-election lame duck session later this year.

The White House, for its part, continues to state that it opposes House efforts to permanently extend expiring tax provisions without providing offsets.

### **Ryan proposes EITC expansion**

In related news, House Budget Committee Chairman – and Ways and Means Committee member – Paul Ryan, R-Wis., unveiled a draft proposal on July 24 that would expand the Earned Income Tax Credit (EITC) for childless workers by:

- Lowering the minimum eligibility age for the credit to 21 (from 25 under current law);
- Increasing the phase-in and phase-out rates to 15.3 percent (from 7.65 percent), thereby doubling the maximum credit to just over \$1,000; and
- Increasing the beginning of the income phase-out range to \$11,500 (from \$8,220) and increasing the end of the phase-out range to \$18,070 (from \$14,790).

Workers would remain eligible for the credit through age 64. That provision is unchanged from current law. The proposal would not apply to a childless worker that can be claimed by another taxpayer as a dependent or qualifying child.

The proposal is similar to one included in President Obama's FY 2015 budget blueprint, although the administration would raise the maximum eligibility age for the credit to 66. (For prior coverage, see *Tax News & Views*, Vol. 15, No. 11, Mar. 7, 2014.)

**URL:** [http://newsletters.usdbriefs.com/2014/Tax/TNV/140307\\_1.html](http://newsletters.usdbriefs.com/2014/Tax/TNV/140307_1.html)

Ryan's EITC proposal is part of a larger discussion draft of a plan to improve the effectiveness of federal anti-poverty programs.

**URL:** [http://budget.house.gov/uploadedfiles/expanding\\_opportunity\\_in\\_america.pdf](http://budget.house.gov/uploadedfiles/expanding_opportunity_in_america.pdf)

In a speech at the American Enterprise Institute, Ryan explained he would pay for the expanded EITC by eliminating "ineffective programs and corporate welfare, like subsidies to energy companies." The discussion draft does not identify specific subsidies that would be eliminated but it does refer to programs that "subsidize corporations' efforts to commercialize favored energy technologies and sources picked by Congress and the bureaucracy." The discussion draft also calls for "reducing fraud in the Additional Child Tax Credit by requiring the use of Social Security numbers."

— Michael DeHoff  
Tax Policy Group  
Deloitte Tax LLP

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## Senate subcommittee examines tax implications of structured financial products

The Senate Committee on Homeland Security and Governmental Affairs' Permanent Subcommittee on Investigations (PSI) held a hearing July 22 to examine what subcommittee leaders contend is a financial product that allows sophisticated investors to get long-term capital gains treatment on short-term investment returns.

### How the transactions work

According to a report issued by the subcommittee in conjunction with the hearing, the transaction at issue arises when a hedge fund enters "into a contract with the bank to purchase an 'option' on the performance of an unspecified basket of assets placed in a designated account" operated by the bank's own proprietary trading account. According to the report, the hedge fund is usually required to deposit a "premium," typically 10 percent of the total capital to be invested in the account. The bank would finance the remaining 90 percent of the capital to be invested.

Upon exercise, the option holder would benefit from the option if the value of the securities had increased during the option period. If those options were exercised more than one year from the date of their creation, the profits are treated as long-term capital gains, even if some or all of the assets in the basket were purchased within the one-year holding period.

According to the report, the bank appoints the general partner of the hedge fund to act as the investment advisor for the trading account, and that individual exercises control over the securities included in the option account. According to PSI Subcommittee Chairman Carl Levin, D-Mich., this structure is tantamount to direct ownership by the hedge fund of the securities and therefore should receive short-term capital gains treatment.

### Hedge fund, bank reps respond

Several witnesses at the hearing, including those representing banks and hedge funds who had engaged in similar transactions, disagreed with the conclusions reached in the PSI report. Those witnesses noted that a key benefit of the basket option structure was that it featured loss protection for the hedge fund and that the average holding period was not one year but in fact much longer – a result one would not expect if the goal of the holder is to quickly turn short-term trading profits into long-term capital gains. They also stressed that the structures were fully compliant with the law and applicable regulations.

## Recommendations

Based on the subcommittee investigations, the report made a number of recommendations, including:

- Collecting additional taxes owed on basket option profits;
- Stopping bank participation in abusive tax structures;
- Revamping the partnership procedures adopted as part of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA); and
- Stopping the circumvention of leverage limits.

Steven M. Rosenthal, a senior fellow at the Urban-Brookings Tax Policy Center, also suggested during questioning from lawmakers that Congress should consider a proposal in the tax reform discussion draft released February 26 by House Ways and Means Committee Chairman Dave Camp, R-Mich., that generally would require all taxpayers to mark derivative contracts to market and recognize gain or loss as if they were sold for fair market value on the last day of the taxable year. The resulting gain or loss would be treated as ordinary. Chairman Camp's comprehensive draft also would repeal and overhaul the current TEFRA rules.

PSI Subcommittee Chairman Levin and ranking member John McCain, R-Ariz., also called on the IRS and regulators to review the rules of options trading and increase the number of audits for large partnerships, including hedge funds.

James White, director of tax issues for the GAO, stated that less than 1 percent of all large partnerships were audited by the IRS in 2012, compared to 27 percent of large corporations. White said the GAO is expected to release a full report on large partnerships later this fall.

## Outlook

Levin told reporters July 21 that the proposal in Camp's tax reform discussion draft to replace the current TEFRA regime was a practical option, but argued that TEFRA reforms should not be delayed to coincide with a tax code overhaul. Ways and Means Committee Chairman Camp, however, has argued that the proposals in his draft should be considered in the context of fundamental tax reform and not on a piecemeal basis.

— Victoria Glover  
Tax Policy Group  
Deloitte Tax LLP

### Have a question?

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