



Tax

## Tax News & Views

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### In this issue:

Inversion debate resumes with no clear path forward.....	1
Congressional committees announce tax-related hearings.....	4

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### Inversion debate resumes with no clear path forward

Democrats and Republicans in Congress renewed the debate over how – or whether – to address corporate inversions this week as lawmakers returned to Capitol Hill from their summer recess; but consensus remained elusive and prospects for significant legislative action during the short pre-election work period appeared poor. Meanwhile, the Treasury secretary indicated that the Obama administration is still weighing its options for a possible regulatory response.

#### Schumer releases earnings-stripping proposal

As anticipated, Senate Finance Committee member Charles Schumer, D-N.Y., on September 10 introduced legislation that would tighten the earnings-stripping rules of 163(j) and require prefiling agreements for inverted companies. The Corporate Inverters Earnings Stripping Reform Act (S. 2786) appears intended to supplement the broad anti-inversion legislation that Sen. Carl Levin, D-Mich., introduced on May 20. (For details on Levin’s bill, the Stop Corporate Inversions Act of 2014, see *Tax News & Views*, Vol. 15, No. 20, May 23, 2014. Sen. Levin’s brother, Ways and Means Committee ranking Democrat Sander Levin of Michigan, introduced a substantially similar companion bill in the House.)

**URL:** [http://newsletters.usdbriefs.com/2014/Tax/TNV/140523\\_2.html](http://newsletters.usdbriefs.com/2014/Tax/TNV/140523_2.html)

Schumer’s bill would apply to an “applicable entity,” which is defined as the member of an expanded affiliated group of a foreign acquirer of a domestic target under section 7874, but would reduce the ownership continuity required under that section to more than 50 percent (from at least 60 percent under current law).

For these entities, the bill would tighten the section 163(j) earnings-stripping rules by:

- Limiting the amount of related-party interest expense allowed under section 163(j)(2)(A)(ii) to 25 percent of adjusted taxable income (down from 50 percent under current law);
- Removing the carryforward of any excess related-party interest expense under section 163(j)(1)(B) (as opposed to the unlimited carryforward provided under current law);
- Removing the 1.5:1 debt-to-equity safe harbor under section 163(j)(2)(A)(ii); and
- Removing the carryforward for unused limitation under section 163(j)(2)(B).

These new limits would apply to all taxable years of applicable entities with no 10-year sunset (as is the case for the new prefiling rules discussed below or the current-law rules for inversion gains under section 7874).

**Prefiling rules** – Each applicable entity would be required to file with Treasury an application for an approval agreement for each taxable year beginning after the bill’s enactment or on becoming an applicable entity, for the 10 taxable years starting with that year.

The approval agreement means a prefiling, advance pricing, or other agreement specified by the Treasury, which contains provisions the Treasury determines necessary to ensure that sections 163(j), 267(a)(3), 367, 482, and 845, and any other provision of the code applicable to transactions between related persons and specified by the Treasury, are met.

If a taxpayer fails to file an application or receives a notice of a failure to file in good faith or with substantial compliance, then (1) a deduction, or addition to basis or cost of goods sold, for amounts paid or incurred, or losses incurred, by reason of a transaction between the entity and a foreign related person would be disallowed, (2) any transfer or license of intangible property (as defined in section 936(h)(3)(B)) between the entity and a foreign related person would be disregarded, and (3) any cost sharing arrangement between the entity and a foreign related person would be disregarded.

**Effective date** – The bill would be effective for taxable years beginning on or after enactment, and would cover entities that were acquired by a foreign parent before enactment of section 7874 or in compliance with section 7874. (A draft version of the bill that was circulating earlier in the week proposed to cover inversion transactions completed after April 17, 1994.)

### **Swift Senate action on inversions unlikely**

Schumer’s bill does not appear to be on a fast track to a mark-up in the Senate Finance Committee, where Chairman Ron Wyden, D-Ore., has indicated that he still hopes to release a bipartisan anti-inversion proposal of his own that includes earnings-stripping provisions.

Wyden stated in a September 9 news release that he and his staff “continue to work closely” with Finance Committee ranking Republican Orrin Hatch of Utah and his staff “to protect the American taxpayer by taking the juice out of these transactions and limiting tax preferred leverage.”

**URL:** <http://www.finance.senate.gov/newsroom/chairman/release/?id=ad027410-7ffd-4c9a-b9bf-6e3238139275>

**Hatch sets a ‘high bar’** – Although Hatch has indicated that he and Wyden did not discuss inversions over the August recess, he told reporters September 9 that his staff is working “assiduously” with Wyden’s staff “so that hopefully we’ll have a bipartisan approach.”

But in a speech at the U.S. Chamber of Commerce on September 11, Hatch hinted that a bipartisan compromise might not come together quickly. He acknowledged that inversions represent “a serious problem that deserves serious consideration” but stated that he has deliberately set “a pretty high bar” for any potential legislative fix outside of fundamental tax reform. That high bar comes in the form of his “non-negotiable” conditions that any proposal must (1) serve as a bridge to tax reform, (2) not take effect retroactively, (3) move the United States toward a territorial system for taxing domestic multinationals, and (4) be revenue neutral.

**URL:** <http://www.finance.senate.gov/newsroom/ranking/release/?id=8a1eb589-3ef0-4f12-bd93-df9c488d4e8d>

Hatch rejected the Democratic proposals to address inversions that have been released so far, stating that none of them “come close to meeting these four essential criteria” and that all of them appear to be “driven more by the politics of the moment than by any real desire to improve America’s tax climate.” (Hatch’s stance on retroactivity also could present an obstacle in his negotiations with Wyden, who has consistently stated that changes to the section 7874 rules should take effect “for all inversions taking place on or after May 8, 2014, the date Wyden publicly announced his intention to pursue anti-inversion legislation.)

**Lowering expectations?** – Wyden had indicated before the August recess that he hoped to have inversion legislation in place this month, but he has since appeared to tamp down expectations that the Finance Committee would hold a mark-up before the Senate adjourns for a final round of campaigning in advance of the November 4 midterm elections. (The Senate’s target adjournment date is September 23.)

Speaking to reporters on September 10, Wyden remarked that “[i]t’s always been clear that it’d be a challenge for these two weeks.” He also noted that a number of senators have “expressed an interest in doing a stop-gap, inversion-only bill during the lame duck session” after the elections.

**Floor action not expected** – Majority Leader Harry Reid, D-Nev., meanwhile, apparently does not intend to bring any inversion legislation directly to the Senate floor this month. When asked by reporters whether the Senate would vote on an inversion bill during the September work period, Reid replied: “I kind of doubt it.”

### House developments: Camp, Levin weigh in

Signs of the partisan split over inversions were also evident in comments from the two top taxwriters in the House.

**Camp** – Ways and Means Committee Chairman Dave Camp, R-Mich., who has made few public comments on inversion legislation, reiterated his preference for addressing inversions through comprehensive tax reform. During a moderated discussion with White House Council of Economic Advisers Chairman Jason Furman at an event sponsored by the Business Roundtable September 10, Camp dismissed the approach taken by congressional Democrats, noting that “we did it in 2004 and it doesn’t work.”

“What we really need to do is lower rates and modernize our international tax system,” Camp said.

The Ways and Means chairman, who put forward a detailed tax reform discussion draft in February, urged the Obama administration to flesh out the corporate tax reform framework it unveiled in 2012. Camp restated his case in a subsequent news release, noting that “[u]ntil we address the root of the problem, we will continue to read regular reports of companies leaving the U.S.”

**URL:** <http://waysandmeans.house.gov/news/documentsingle.aspx?DocumentID=392984>

For his part, Furman stuck to the administration’s position that although tax reform is the preferred long-term solution to addressing inversions, Congress should act in the near term to curb inversion transactions through targeted legislation.

“If you are a majority U.S. company, it is pretty common sense that you should have a U.S. tax address and that’s something we’d like to see legislated,” Furman said.

**Levin** – In remarks at a breakfast forum sponsored by the *Christian Science Monitor* on September 12, Rep. Sander Levin, the ranking Democrat on Ways and Means, continued his push for immediate congressional action. Levin is preparing legislation intended to make inversions less attractive by tightening the earnings-stripping rules, although he did not indicate when he would release an official discussion draft. (For details on a preliminary draft of the bill that was circulating last month, see *Tax News & Views*, Vol. 15, No. 30, Sep. 5, 2014.)

**URL:** [http://newsletters.usdbriefs.com/2014/Tax/TNV/140905\\_1.html](http://newsletters.usdbriefs.com/2014/Tax/TNV/140905_1.html)

### Lew mulls regulatory action

In other developments, Treasury Secretary Jacob Lew, speaking at a conference sponsored by the Tax Policy Center and Urban Institute in Washington September 8, argued that “we cannot wait to complete business tax reform before taking action to fix [the inversion] problem” and urged Congress in the short term to pursue retroactive legislation such as the bills offered by the Levin brothers.

But Lew added that if Congress does not act at all or act quickly enough, the administration would pursue regulatory options. Lew said Treasury “is completing an evaluation of what we can do to make these deals less economically appealing, and we plan to make a decision in the very near future.” Lew provided no specifics on how the administration intends to address the issue or when Treasury might act; but he noted that any such action would not be a “substitute for meaningful legislation,” and would only address the economics of inversions.

“Only a change in the law can shut the door, and only tax reform can solve the problems in our tax code that leads to inversions,” Lew said.

Rep. Levin noted during his remarks at the *Christian Science Monitor* breakfast forum that Lew shed no additional light on how he would approach inversions when he met with Ways and Means Committee Democrats later in the week. According to Levin, Lew repeated his call for a congressional response to inversions but said that Treasury would act “as soon as they were ready.”

## Congressional committees announce tax-related hearings

Two Senate committees this week scheduled hearings on issues related to tax reform as well as audits of large partnerships, and a House Ways and Means subcommittee announced plans to examine issues affecting private employer defined benefit plans.

- The Senate Finance Committee will hold a hearing to examine retirement savings incentives in the context of fundamental tax reform. The hearing will be held September 16 at 10:00 a.m. in Room 215 of the Dirksen Senate Office Building. A witness list is available on the Finance Committee Web site.  
**URL:** <http://www.finance.senate.gov/hearings/hearing?id=9bcd48e6-5056-a032-520c-a6994823568d>
- The Finance Committee has also scheduled a hearing on tax reform and energy policy for September 17 at 10:15 a.m. in Room 215 of the Dirksen Senate Office Building. A witness list is available on the Finance Committee Web site.  
**URL:** <http://www.finance.senate.gov/hearings/hearing?id=cfd3ba55-5056-a032-5258-2751125c414c>
- The Senate Permanent Subcommittee on Investigations will examine issues related to IRS audits of large partnerships at a hearing scheduled for September 18 at 2:30 p.m. in Room 342 of the Dirksen Senate Office Building. A witness list was not available at press time.
- The House Ways and Means Select Revenue Measures Subcommittee will hold a hearing on defined benefit pension plans offered by private-sector employers, including both multiemployer plans and single employer plans. The hearing is set for September 17 at 10:15 a.m. in Room 1100 of the Longworth House Office Building. A witness list was not available at press time.

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### Have a question?

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