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Treasury issues anti-inversion guidance

The Treasury Department and Internal Revenue Service on April 4 released temporary regulations under Internal Revenue Code sections 304, 367, 956, 7701(l) and 7874 to address certain inversion and post-inversion transactions, and proposed regulations under section 385 to address a broader range of transactions, including certain financing transactions arising in the context of inversion and post-inversion transactions.

The temporary regulations include rules previously described in Notice 2014-52 and Notice 2015-79. The temporary regulations also provide: (1) rules for identifying a foreign acquiring corporation when a domestic entity acquisition involves multiple steps; (2) rules that disregard stock of the foreign acquiring corporation that is attributable to certain prior domestic entity acquisitions; (3) rules that require a controlled foreign corporation (CFC) to recognize all realized gain upon certain transfers of assets described in section 351 that shift the ownership of those assets to a related foreign person that is not a CFC; and (4) rules clarifying the definition of group income for purposes of the substantial business activities test.

The broadly applicable proposed regulations under section 385 would: (1) authorize the IRS to treat certain related-party interests as part stock and part debt for federal tax purposes; (2) establish contemporaneous documentation requirements that must be satisfied for certain related-party debt to be respected for federal tax purposes; and (3) treat certain related-party debt as stock for all purposes of the code when issued in connection with certain distributions and acquisitions. The proposed regulations have complex effective date provisions.

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International Tax Alerts available

Detailed discussions of the temporary regulations and the proposed regulations are available in separate International Tax Alerts from Deloitte Tax LLP's International Tax Group.
URL: http://newsletters.usdbriefs.com/2016/Tax/TNV/160408_1suppA.pdf
URL: http://newsletters.usdbriefs.com/2016/Tax/TNV/160408_1suppB.pdf

Congressional reaction

On Capitol Hill, Republican leaders of the two congressional taxwriting committees responded to the release of the new guidance by reiterating their position that the issue of inversions should be addressed through legislation – that is, through tax reform – rather than administrative rulemaking.

House Ways and Means Committee Chairman Kevin Brady, R-Texas, stated in an April 4 press release that although he was "pleased that President Obama acknowledged how our broken tax code continues to hurt our economy, it's clear that his new regulations won't solve the problem. Americans will continue to watch their jobs move overseas until Washington works together on comprehensive, pro-growth tax reform."

Senate Finance Committee Chairman Orrin Hatch, R-Utah, likewise commented that "[t]he administration continues to tinker along the regulatory edges with unilateral proposals to address the symptoms of inversions, but not the disease. …A comprehensive tax overhaul that reduces the rate, transitions to a territorial tax system with base erosion protections, and addresses earnings stripping will equip American businesses with the certainty they need to invest in a future here at home."

Additional administrative guidance possible

For his part, Treasury Secretary Jack Lew said in an April 4 conference call with reporters that the Obama administration "will continue to explore additional ways to limit inversions"; but he agreed that "the best way would be to enact business tax reform with specific anti-inversion provisions." Lew noted that in conjunction with the new regulations the administration released an updated corporate tax reform framework that "includes a comprehensive approach to reforming the international tax system that stops inversions and makes the US business tax system fairer and more pro-growth." (Specifically, the updated framework adds details to the broad outlines of the call for international tax reform in the original 2012 version by citing the proposed 19 percent minimum tax on foreign earnings, the one-time 14 percent "deemed repatriation" tax, provisions to curb earnings stripping and inversions, and base erosion provisions that were included in the fiscal year 2016 budget proposal the administration sent to Congress in February of 2015. See separate coverage in this issue for additional discussion of the updated framework and the current state of play on tax reform.)
URL: https://www.treasury.gov/resource-center/tax-policy/Documents/The-Presidents-Framework-for-Business-Tax-Reform-An-Update-04-04-2016.pdf

But Lew also repeated the administration's position that Congress should pursue targeted anti-inversion legislation now while it prepares for a larger tax code overhaul.

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“Only congressional action can fully address inversion transactions, and I urge Congress to act this year,” he said.

— Michael DeHoff
Tax Policy Group
Deloitte Tax LLP

Senate looks to tie energy tax extenders to FAA reauthorization

Senate negotiators this week appeared to be closing in on a deal to include extensions of certain expiring alternative energy provisions in the tax title of legislation that would provide a long-term reauthorization of spending authority and the dedicated revenues for the Federal Aviation Administration (FAA).

Drafting error or intentional policy?

The tax extenders legislation enacted into law last December – the Consolidated Appropriations Act, 2016/Protecting Americans from Tax Hikes Act of 2015 (P.L. 114-113) – made a number of expired business, individual, and charitable giving incentives permanent; extended a handful of provisions for five years; and renewed others through the end of 2016. (A complete list of the provisions addressed in last year’s extenders package is available from Deloitte Tax LLP.)
URL: http://newsletters.usdbriefs.com/2015/Tax/TNV/151218_1suppA.pdf

In recent weeks, prominent Senate Democrats including Finance Committee ranking member Ron Wyden of Oregon and Minority Leader Harry Reid of Nevada have argued that a handful of alternative energy incentives that are scheduled to expire at the end of 2016 – the investment tax credits under section 48 for combined heat and power property, fuel cell property, small wind property, and geothermal property – were supposed to receive longer-term renewals in the December deal but were left out of the final package due to what they claim was an inadvertent drafting error in the legislative language. As a result, Wyden and Reid have pushed to include extensions of these provisions in the tax title of the must-pass FAA legislation, which is generally regarded as one of the very few tax bills expected to move through Congress this year. (Spending authority for the FAA and the dedicated excise taxes levied on passengers, cargo, and fuel that provide the bulk of the agency’s funding, are currently slated to expire after July 15.)

But the notion of attaching extenders to an FAA reauthorization has met with resistance from Republicans, particularly in the House, with Ways and Means Committee Chairman Kevin Brady, R-Texas, noting recently that lawmakers “dealt with the extenders as a Congress last December” and Ways and Means Tax Policy Subcommittee Chairman Charles Boustany, R-La., saying that “[a]ll of the extenders were on the table” late last year and that “[t]hings that were left out were left out for a reason.”

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Stop-gap FAA measure creates opening for extenders

Last month, House Republicans attempted to foreclose the possibility of using an FAA bill as an extenders vehicle this year by passing and sending to the Senate a stop-gap reauthorization that would have renewed FAA spending authority through July 15, 2016, but renewed the agency's dedicated taxes through March 31, 2017. After a number of senators reportedly objected to those staggered renewal periods – at least in part because they were looking for an opportunity to move an extenders package in 2016 – the Senate on March 17 approved amendments to extend the spending and revenue provisions through mid-July, sent the revised measure back to the House, and a few hours later adjourned until early April for the spring recess. That move essentially forced House lawmakers to either accept the Senate's changes or risk an FAA shutdown on March 31. (For prior coverage, see *Tax News & Views*, Vol. 17, No. 13, Mar. 25, 2016.)
URL: http://newsletters.usdbriefs.com/2016/Tax/TNV/160325_1.html

Now, a united front on the part of Senate Democrats to withhold support for a long-term FAA bill that does not deal with the energy provisions appears to be having an impact on key Senate Republican negotiators.

Minority Leader Reid announced on April 6 that he and Senate Majority Leader Mitch McConnell, R-Ky., had "very productive discussions on the FAA bill and the associated tax title" and that, as a result, the Democratic caucus would vote with Republicans to clear a procedural hurdle that would allow the Senate to begin debate on the legislative vehicle that will carry the FAA reauthorization. Later that day, the so-called "cloture" vote passed 98-0.

Senate taxwriter John Thune, R-S.D., who also chairs the Commerce, Science, and Transportation Committee – the committee with jurisdiction over the FAA legislation – indicated April 6 that he would not object to including energy extenders in the tax title if it helped the broader legislation get across the finish line.

"I think it's significant that the leaders…agree on the revenue piece of this and that allows it go forward," Thune said.

Details in flux

The Senate adjourned for the week on April 7 and the details of any deal in that chamber – both with respect to tax extenders and the renewal period for FAA-related excise taxes – may not emerge until the week of April 11.

In addition to the expiring section 48 alternative energy extenders, incentives for biofuels and carbon capture and sequestration are also reported to be under discussion, as are several other non-energy tax items that certain lawmakers would like to hitch to what could be the last tax vehicle likely to be enacted this year.

House response uncertain

Although Senate Minority Leader Reid told reporters on April 5 that House Speaker Paul Ryan, R-Wis., "has said that he will go along with whatever we send him," it remains unclear how the

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House Republican Caucus would react to the inclusion of a tax extenders section in an FAA bill sent over by the Senate.

The House was adjourned this week for its Easter recess and will be back in session on April 12.

— Alex Brosseau
Tax Policy Group
Deloitte Tax LLP

Commentary: Level-setting on the prospects for tax reform

Estragon: I can't go on like this.
Vladimir: That's what you think.

— *Samuel Beckett, Waiting for ~~Tax Reform~~ Godot*

Still waiting

As Congress gets back in gear following its spring recess – the Senate returned on April 4, and the House reconvenes on April 12 – we wanted to provide this update, albeit one that some may find frustrating, on the latest developments in tax reform.

Like the characters in Beckett's absurdist play, we wait for the fulfillment of a promise. We look for hopeful signs that the wait might be nearing an end, only to discover that a resolution is unlikely to come anytime soon. And the wait continues…

Where we stand

Congress arguably made a significant down payment on tax reform late last year with the passage of a combined extenders/appropriations package that made permanent a number of expired business, individual, and charitable giving tax incentives, such as the research credit, the subpart F exception for active financing income, and tax-free IRA distributions for charitable contributions by individuals age 70-1/2 and older. The legislation also retroactively renewed a handful of provisions – such as bonus depreciation, the work opportunity and new markets credits, and production and investment tax credits for wind and solar energy – for five years (through 2019) and gave retroactive two-year extensions (through 2016) to the expired provisions that did not get a permanent or long-term renewal.

Republican lawmakers – particularly in the House – have contended that building extenders into the budget baseline by making many of them permanent will make an eventual tax code overhaul much easier because it will lower revenue targets and, in turn, give taxwriters more flexibility as they make decisions about which base broadeners would be necessary to achieve the desired level of rate reduction.

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At the same time, however, passage of legislation in 2015 that addressed the most critical extenders for the long term means that there is less pressure for Congress to move an extenders package this year – a situation that, in essence, deprives lawmakers of a must-pass tax bill in 2016 that they otherwise might have tried to use as a vehicle to move tax reform. (Passage of a long-term highway spending bill in 2015 likewise means that there is one less inflection point on this year's tax legislative agenda that could compel action on tax reform.)

Leadership transitions at the House Ways and Means Committee have also had an impact on the panel's operations as Chairman Kevin Brady, R-Texas, took the gavel in November after former Chairman Paul Ryan, R-Wis., became House speaker. Brady has been fine-tuning his agenda and has hired key staff – including new chief tax counsel Barbara Angus, whose long resume includes service as an international tax counsel at the Treasury Department during the George W. Bush administration and as a business tax counsel for the Joint Committee on Taxation.

But even as a confluence of circumstances – including the continued disagreements between the parties over exactly what tax reform should look like and the increasingly long shadow cast by the looming 2016 elections – has further reduced the chances for passage of tax reform in 2016, other forces are adding to the sense of urgency to revamp the tax code to make US businesses more competitive internationally. Notable examples of these include:

- The growing number of transactions which result in foreign ownership of formerly US-domiciled corporations. Congressional leaders as well as the Treasury Department have stated that this issue is best addressed through tax reform. Because the prospect of near-term legislative action appears unlikely, however, Treasury has continued to pursue administrative measures – including the release of new regulations on April 4 that are intended to curb redomestications and earnings-stripping transactions. (See separate coverage in this issue for details.)
- Recommendations by the OECD's Base Erosion and Profit Shifting (BEPS) project.
- Ongoing attempts by the European Commission (EC) to claw back certain corporate tax incentives provided by European Union nations – including incentives to some US companies – that, in the EC's view, amount to illegal "state aid."

What we have seen so far in 2016: Laying the groundwork

Congressional Republicans acknowledge that comprehensive tax reform as they envision it is off the table until there is a change in the White House, but they have characterized this year as an opportunity to lay the groundwork for what they hope will be a successful legislative effort under a new presidential administration in 2017.

House developments: The House is taking what Speaker Paul Ryan has called a "bottom-up" approach to tax reform that involves rank-and-file members as well as the Ways and Means Committee. Ryan hopes to have a tax policy "blueprint" of some sort completed before the House breaks in July for the GOP convention. Although the contours of the blueprint are currently unclear, Ryan's plan could serve two useful purposes for House Republicans. First, it would give GOP lawmakers a unified tax policy platform that they can use on the campaign trail as a concrete example of what they would like to achieve if the Republicans control the House, the Senate, and the White House. Second, it would offer an eventual GOP president a ready-made agenda to govern on – something that could be a critical tool if campaign

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promises of very large tax cuts are not achievable in what is expected to be a closely divided 115th Congress.

- **Tax reform task force –** Ryan announced in early February that Ways and Means Chairman Brady will head up a task force on tax reform designed to "create jobs, grow the economy, and raise wages by reducing rates, removing special interest carve-outs, and making our broken tax code simpler and fairer." The tax reform task force is one of six that are charged with further refining the policy agenda that House Republicans outlined during their member retreat in Baltimore earlier this year. (The other five are focusing on national security; reducing regulatory burdens; health care reform; poverty, opportunity, and upward mobility; and restoring constitutional authority.)

  Ryan explained that the task forces "will seek input from all [House] members and their constituents." He did not publicly set a specific deadline for the task forces to complete their work, stating only that the groups would flesh out the Republican agenda and present it to the country "in the months ahead."

- **International tax reform discussion draft –** House Ways and Means Tax Policy Subcommittee Chairman Charles Boustany, R-La., is taking the lead on developing an international tax reform discussion draft that is expected to include (1) a shift from the current worldwide system to a territorial system for taxing foreign-source income of US multinationals, (2) a "deemed repatriation" provision that would tax – at a lower rate than the statutory corporate rate – profits that US multinationals currently hold overseas, (3) an "innovation box" that would provide a lower tax rate on certain business profits related to intellectual property, and (4) various base-erosion safeguards. It is currently unclear whether the eventual proposal will also include a lower corporate tax rate, something that Ways and Means Chairman Brady and others have said is critical to increasing the competitiveness of US firms.

  Boustany has acknowledged that "international tax reform separate from a large comprehensive package" is "unlikely" to become law this year, but Brady has indicated that he views the committee's work on international reform as "a down payment that clears the way to focus on the work [of] lowering rates and simplifying the tax code for all businesses and individuals, so that we are ready to enact comprehensive tax reform in 2017."

  Although Boustany had originally targeted a March release for his proposal, Brady recently commented that there is no "specific schedule for the committee to consider international tax reform legislation this year" and that "consensus in the policy [will] drive the timetable."

- **Ways and Means tax reform hearings –** House taxwriters have already held two hearings on tax reform this year – one on international tax issues and one "members day" hearing on consumption-based and cash-flow proposals. Additional hearings are in the works, including a members day session on "1986-style" reform scheduled for April 13.

Senate developments: Across the Capitol, Senate Finance Committee Chairman Orrin Hatch, R-Utah, is working on a discussion draft of a corporate integration proposal that reportedly will call for giving corporations a deduction for dividends paid out to shareholders. Such a change, if proposed, also would likely revise the tax treatment of dividends received by corporate shareholders, including currently tax-exempt entities. The proposal is still being drafted and details of exactly how it would work, what it would cost, and whether other changes would be

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made to keep the legislation revenue neutral are unclear. Hatch had initially suggested that his draft would be released in March, but later stated that a more likely target date is sometime in May.

White House developments: For its part, the Obama administration on April 4 released an updated framework for corporate tax reform that hews closely to the original 2012 version in its calls for lowering the corporate tax rate to 28 percent while eliminating or revamping many current-law business tax expenditures, creating new incentives to promote domestic manufacturing (that would have the effect of reducing the income tax rate for US manufacturers below 28 percent), and overhauling the international tax rules – including the imposition of a new minimum tax on multinationals.
URL: https://www.treasury.gov/resource-center/tax-policy/Documents/The-Presidents-Framework-for-Business-Tax-Reform-An-Update-04-04-2016.pdf

The updated framework includes a discussion of circumstances – such as the increasing number of corporate redomestications – that make the need for tax reform even greater now than it was in 2012. It also provides specific details – drawn from recent White House budget blueprints – to describe how some of the elements of the framework would operate. For example, it fills in the broad outlines of the 2012 call for international tax reform by citing the proposed 19 percent minimum tax on foreign earnings, the one-time 14 percent "deemed repatriation" tax, provisions to curb earnings stripping and corporate redomestications, and base-erosion provisions that were included in the fiscal year 2016 budget proposal the administration sent to Congress in February of 2015.

The updated framework reiterates the administration's belief that tax reform should be revenue neutral and that one-time revenue generated from deemed repatriation should be allocated to infrastructure spending. However, the administration goes beyond that and also calls on Congress to offset the cost of the permanent extenders provisions that were enacted into law last year.

It's worth noting that while the framework outlines the White House's vision for business tax reform, the provisions affecting passthrough entities fall short of a rate cut. This could prove to be a point of contention for passthroughs and small businesses, who have made clear (through their advocates in Washington) that they would not support a tax reform plan that provides a rate reduction for corporations but not for businesses that are taxed on the individual side of the code.

The case for optimism

Although the tax reform process can best be described as being in a state of flux, there are some compelling reasons to be optimistic that a tax code overhaul can be accomplished sometime after the upcoming elections:

- There is general (but not unanimous) agreement in both parties on the need to lower the corporate tax rate and reform international tax rules.
- The sense of urgency related to BEPS, the EC's actions on state aid, and the stepped-up pace of transactions that result in foreign ownership of formerly US-domiciled firms is only increasing, not abating. (But see below for a different perspective on that same issue).

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- The current Democratic leader in the Senate – Harry Reid of Nevada – is retiring at the end of the 114th Congress. Sen. Charles Schumer of New York – Reid's presumptive successor as Senate Democratic leader – has been one of his party's greatest advocates of international tax reform. (Last summer, Schumer worked with Sen. Rob Portman, R-Ohio, and Paul Ryan – who at the time was House Ways and Means Committee chairman – on a plan to attach an international reform proposal to long-term highway funding legislation that was moving through Congress. Those negotiations fell apart largely because of disagreements over the appropriate spending level to include in the highway component.)
- As we learned from the process that resulted in the Tax Reform Act of 1986, a successful tax reform effort requires a president who is committed to overhauling the tax code and is willing to engage the public and work with Congress to make that happen. In 2016, the current contenders for the Republican and Democratic presidential nominations have definite ideas for remaking the tax code and appear intent on making tax reform a priority as chief executive, although their visions vary widely in key respects, and the plans that some candidates are calling "tax reform" might be viewed quite differently by others. (But see below for a counterargument.)

The case for pessimism

There are, however, equally compelling reasons why the outlook for tax reform may remain mired in uncertainty:

- The 2016 presidential campaign has exposed, even more deeply, the differences between Democrats and Republicans over what a reformed tax code should look like, particularly in the areas of progressivity and overall revenue levels.
- As already noted, the hoped-for international reform package in 2015 was predicated on Democrats securing a large increase in infrastructure spending. But the GOP balked at that in 2015, and it is hard to imagine Republicans wanting to find other ways to increase taxes on international corporations or other businesses to finance additional spending sought by congressional Democrats.
- International tax reform may be hard to "sell" politically, especially at a time when we have seen leading presidential contenders in both parties campaign against free trade agreements. While international tax reform is of course not the same thing as the pending Trans Pacific Partnership trade agreement, the thematic similarities should not be overlooked.
- Moreover, if Congress cannot see its way clear to cut marginal tax rates for individuals in addition to corporations – an issue that is a continuing source of angst – it will be hard to explain to individuals and small businesses just why their tax concerns are not being addressed while large corporations are getting what many may see as significant tax relief (even if it is, in reality, a revenue-neutral rewriting of the rules).
- Time will tell whether the far-reaching regulations released by Treasury on April 4 with respect to both "inversions" and "earnings stripping" could substantially alter marketplace behavior. If they do, that may have the undesired effect of reducing the urgency with which some in Congress have been viewing international tax reform.
- Although the presidential contenders each embrace a vision of tax reform, it may be difficult for any of them to get their proposals enacted in their current form without an electoral outcome that gives one party or the other control of the White House plus substantial (and perhaps filibuster-proof) majorities in both the House and Senate, something few are expecting to see.

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What to watch for

Finally, here are some significant tax reform milestones to watch for in the near term:

- An effort to tie some energy-related extenders to legislation reauthorizing the Federal Aviation Administration – the only must-do tax bill on the immediate horizon. (See related story in this issue.)
- A blueprint on tax reform from the House GOP by mid-July.
- A Senate Finance Committee discussion draft on corporate integration – likely by late spring or early summer.
- Possible discussion drafts on elements of tax reform in the next two months from Finance Committee ranking Democrat Ron Wyden of Oregon.
- The selection of the Republican and Democratic presidential nominees and the tax platforms those individuals embrace.

We remain convinced that the need for tax reform is as high now, if not higher, than it has been at any time since 1986. We don't see that need abating on its own, so the question remains as to when the pressure builds to the point that Congress can no longer ignore it. The evidence does not point to that happening in the short term.

— Jon Traub
Managing Principal, Tax Policy
Deloitte Tax LLP

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