

# Federal Tax Reform: Relevance for High Tech Industries

**Tax Policy Conference**

**February 3, 2012**

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## What's driving the push for corporate tax reform now?

- High statutory rate
- High effective rate
- Lockout effect of current “worldwide” system
- Complexity and uncertainty of current system
- Sense that U.S. system is an outlier

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## Other Factors Affecting Tax Reform

- Unemployment
- Income inequality
- Long-term budget deficits
- Complexity of the tax system

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## Recent major changes to the corporate tax

- Economic Recovery Tax Act of 1981
  - Large corporate tax reduction
  - Primarily effected though accelerated depreciation provisions
- 1986 Act
  - Base broadening changes raised corporate taxes (but not rates) in part to pay for individual tax cuts

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## Top corporate statutory rate has decreased since 1975

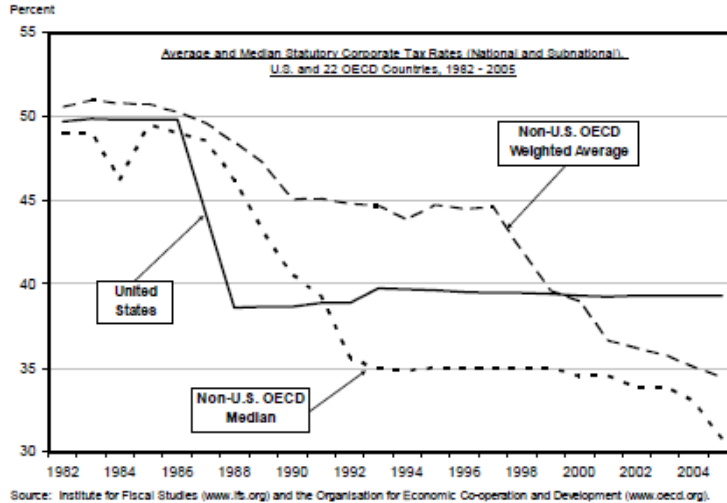
1975-1978	48%	(for income over \$50,000)
1979-1983	46%	(for income over \$100,000)
1984-1987	46%	(for income over \$1,405,000)
1988-1992	34%	(for income over \$335,000)
1993-2011	35%	(for income over \$18,333,333)

Note: chart excludes rates higher than the top bracket rate that reflect phaseouts from the lower bracket rates.

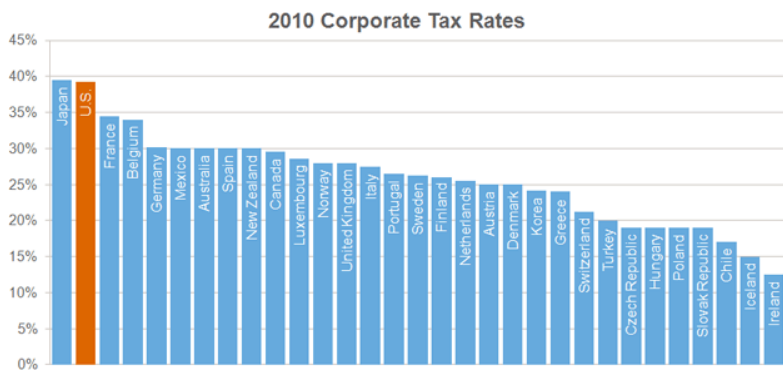
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On average, rate reductions have been greater in other developed countries

Chart 1.1: The U.S. Corporate Tax Rate Currently Exceeds the Average OECD Corporate Tax Rate



## OECD countries



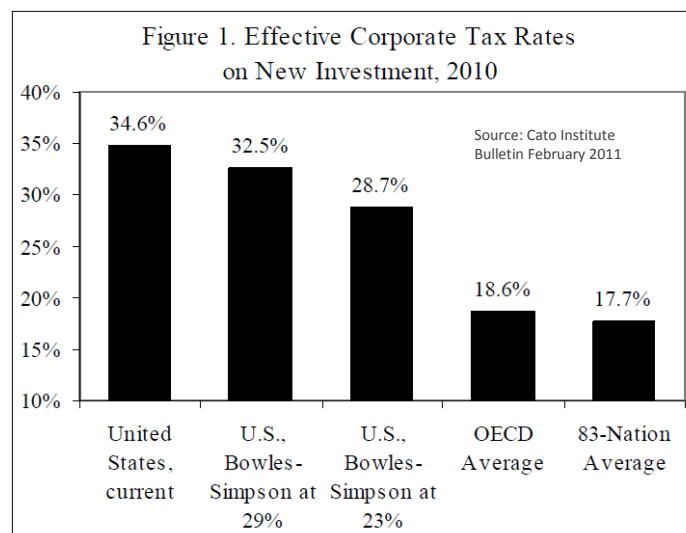
OECD member countries shown. Source: Organization for Economic Cooperation and Development (OECD).

## Statutory tax rates are only part of the story

- U.S. effective marginal and average tax rates are at or below average
  - No commonly agreed to metric
  - Effective marginal tax rate (EMTR) differs by type of investment
    - U.S. EMTR for equity is above the OECD average but right in line with the G7 average
    - EMTR for debt is well below G7 average and OECD average (2007 Treasury study)
  - U.S. average tax rates (ratio of corporate taxes to corporate capital income) are below average
    - U.S. average rate (13.4%) is below OECD average (16.1%) (2007 Treasury Study)

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## No agreement on effective tax rates



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## **BUSINESS INCOME: THE BIGGER PICTURE**

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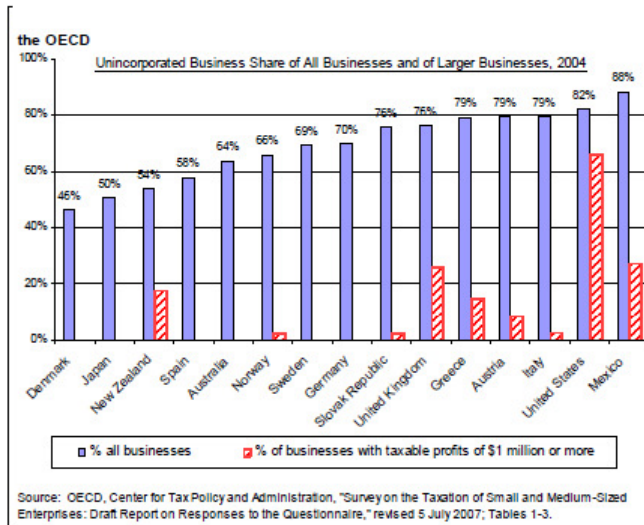


### **Business income has moved out of corporations**

- Pass-through entities such as LLCs and LLPs provide limited liability and a better tax result
- Tax rules treat most publicly traded partnerships as C corporations
- Double tax can be thought of as price paid for access to public equity markets

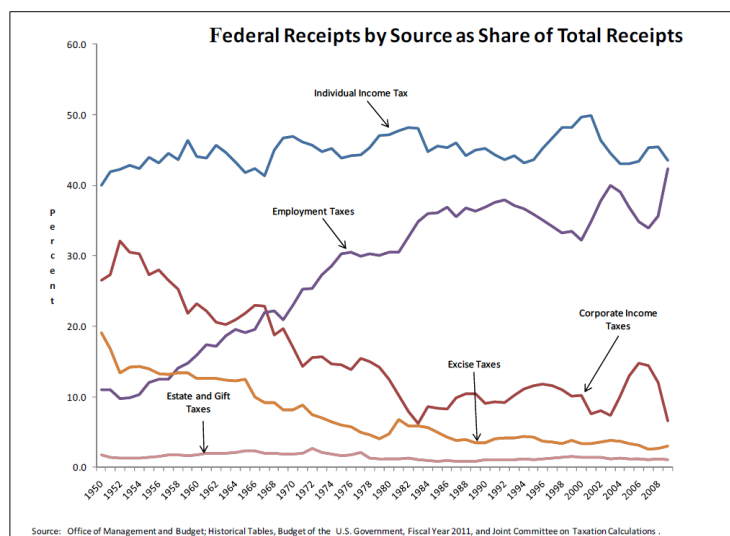
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## U.S. has among the largest unincorporated business sectors within the OECD



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## Corporate receipts are a declining percentage of total receipts



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# CORPORATE TAX EXPENDITURE REFORM: WHAT DOES IT BUY?

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## Tax Expenditures That Substantially Narrow the Corporate Tax Base

Tax Provision	FY 2011-2021 Revenue from Repeal of Provisions for Corporations and Pass-through Entities (in billions)
MACRS	\$724
Deduction for U.S. production activities (section 199)	\$164
Expensing of R&E	\$160
LIFO	\$ 70
Low-income housing tax credit	\$ 39
Section 1031 (deferral of gain on like-kind exchanges)	\$ 18
Completed contract rules method	\$ 14
Cash accounting	\$ 14
Percentage depletion for oil, gas, coal and hard mineral fossil fuels	\$ 12
Exclusion of interest on private activity bonds	\$ 9

Source: Joint Committee on Taxation, Revenue Estimates Memorandum, October 27, 2011.

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## What does base-broadening buy?

- Eliminating everything on the JCT table including accelerated depreciation would allow rates to go to 28%
- Eliminating everything but accelerated depreciation would allow rates to go to 31%
- Substantially less money would be raised if the research credit, LIHTC, the charitable deduction, and certain green energy benefits were retained
- These expenditures represent 23% of the total

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## Questions about corporate tax reform

- Should corporate reform be revenue neutral?
  - CBPP, CTJ, others argue that corporate reform should contribute to deficit reduction
  - Business is looking for a tax cut
- Should corporate reform be separated from individual tax reform?
  - Certain business tax expenditures, if repealed for corporations, should be repealed for all businesses
  - Where does the revenue savings go?
- Other goals that should be set?
  - Simplification
  - Changing tax treatment of debt-financed investment
  - Improving efficiency
  - Change incentives for investing overseas
- Who wins and who loses?

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## Tax reform winners and losers

Table 2A. Percentage Change in Tax Liability From a Revenue-Neutral Corporate Tax Reform

Industry	Slower Depreciation	Repeal Domestic Production Credit	Repeal Research Credit	Rate Reduction to 30%	Net Overall Tax Effect
1. Securities	1.8%	0.1%	0.1%	-14.3%	-12.3%
2. Insurance	1.9%	0.1%	0.4%	-14.3%	-11.9%
3. Credit intermediation	3.6%	0.2%	0.4%	-14.3%	-10.2%
4. Retail trade	3.5%	0.4%	0.2%	-14.3%	-10.1%
5. Bank holding companies	3.7%	0.2%	0.3%	-14.3%	-10.1%
6. Real estate	5.9%	0.3%	0.2%	-14.3%	-7.9%
7. Accommodations	5.8%	0.9%	0.8%	-14.3%	-6.9%
8. Other services	7.5%	0.5%	0.4%	-14.3%	-5.8%
9. Wholesale	6.1%	2.6%	1.5%	-14.3%	-4.1%
10. Mining	4.1%	9.1%	0.2%	-14.3%	-0.9%
11. Construction	7.6%	6.8%	0.2%	-14.3%	0.3%
12. Oil and coal products	4.1%	11.1%	0.3%	-14.3%	1.2%
13. Food manufacturing	6.1%	9.1%	1.5%	-14.3%	2.5%
14. Utilities	12.9%	6.4%	0.5%	-14.3%	5.5%
15. Other manufacturing	8.7%	8.9%	3.5%	-14.3%	6.8%
16. Publishing	3.4%	10.7%	7.0%	-14.3%	6.8%
17. Chemicals	5.4%	7.4%	8.8%	-14.3%	7.3%
18. Metal, minerals, and machinery manufacturing	7.9%	9.3%	4.5%	-14.3%	7.3%
19. Transportation	23.3%	0.1%	0.2%	-14.3%	9.3%
20. Internet	17.6%	4.1%	2.7%	-14.3%	10.2%
21. Agriculture	24.4%	6.0%	0.7%	-14.3%	16.8%
22. Technical services	9.9%	2.9%	19.0%	-14.3%	17.5%
23. Computers and electronics	11.4%	10.0%	25.9%	-14.3%	33.0%
24. Transport equipment	34.4%	10.5%	17.4%	-14.3%	48.1%
25. Electrical products	48.3%	18.3%	17.3%	-14.3%	69.7%

↑ WINNERS  
↓ LOSERS

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**KEEPING SCORE –  
DETERMINING WHETHER  
REFORM IS REVENUE  
NEUTRAL**

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## Revenue estimates: key concepts

- Estimates relative to a current law baseline
- The budget window
- Time value of money
- Taxpayer behavior
- Static vs. dynamic estimates:
  - The fixed GNP constraint
  - Tax expenditure estimates
  - Macro-dynamic scoring

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## Chairman's Mark for the American Recovery Act, Section 108(i)

### Description of Proposal

The proposal permits a taxpayer to elect to defer income from cancellation of indebtedness recognized by the taxpayer as a result of a repurchase by (1) the taxpayer or (2) a person who bears a relationship to the taxpayer described in section 267(b) or section 707(b), of a "debt instrument" that was issued by the taxpayer. The proposal applies only to repurchases of debt that (1) occur after December 31, 2008, and prior to January 1, 2011, and (2) are repurchases for cash. Thus, for example, the proposal does not apply to a debt-for-debt exchange or to any exchange of the taxpayer's equity for a debt instrument of the taxpayer. For purposes of the proposal, a "debt instrument" is broadly defined to include any bond, debenture, note, certificate or any other instrument or contractual arrangement constituting indebtedness.

A taxpayer electing to defer cancellation of debt from income under the proposal is required to include in income an amount equal to 25 percent of the deferred amount in each of the four taxable years beginning in the year following the year of the repurchase.

### Effective Date

The proposal is effective for repurchases after December 31, 2008.

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## Chairman's Modified Mark

### 6. Modification to proposal deferring certain income from discharge of indebtedness

The Chairman's modification provides that certain income from the cancellation of indebtedness recognized by the taxpayer as a result of a repurchase in 2009 or 2010 by (1) the taxpayer or (2) a related person of a "debt instrument" that was issued by the taxpayer is deferred and recognized in later years. Such cancellation of indebtedness income realized in 2009 is deferred and included ratably in income in each of the eight taxable years beginning two years after the year of realization, and such cancellation of indebtedness income realized in 2010 is deferred and included ratably in income in each of the eight taxable years beginning one year after the year of realization.

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## The Revenue Table

Page 3

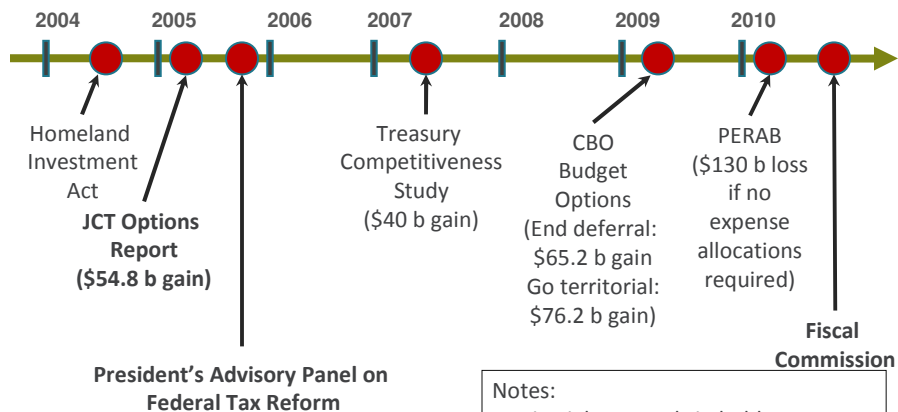
Provision	Effective	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2009-13	2009-14	2009-18	2009-19
10. 7-year carryback of general business credits and allow general business credits to offset 100% of Federal tax liability.....	[6]	-9,137	-292	-257	-231	-208	-187	-168	-152	-136	-123	-111	-10,115	-10,302	-10,882	-10,992
11. Modify carbon sequestration credit to require permanent geologic storage for CO2 used in a tertiary injectant.....	DOE															
12. Modification of credit for qualified plug-in electric drive motor vehicles.....	vps 12/31/2009		-19	-62	-31	6	4	3	2	1				-103	-100	-94
<b>Total of Renewable Energy Incentives.....</b>		<b>-9,446</b>	<b>-2,634</b>	<b>-2,891</b>	<b>-1,366</b>	<b>-1,784</b>	<b>-2,650</b>	<b>-2,119</b>	<b>-2,182</b>	<b>-2,164</b>	<b>-2,135</b>	<b>-2,136</b>		<b>-18,320</b>	<b>-18,372</b>	<b>-18,979</b>
<b>III. Tax Incentives for Business:</b>																
1. Special allowance for certain property acquired during 2009 [7].....	vps 12/31/08	-23,916	-14,893	8,347	6,445	5,646	4,614	3,098	1,985	1,275	961	938	-18,171	-13,557	-6,258	-5,320
2. Temporary increase in limitation on expensing of certain depreciable business assets.....	vps 2009	-642	-425	352	222	162	125	79	45	22	10	10	-331	-206	-50	-41
3. 7-year carryback of 2008 and 2009 30% work expense for R&D recipients.....	[8]	-32,494	-35,027	11,489	10,824	8,364	5,935	4,155	2,872	2,003	1,377	981	-36,844	-30,908	-20,502	-19,321
4. Modification of the work opportunity tax credit-incentive to base unemployed veteran and disconnected youth.....	vps 12/31/08	-28	-73	-64	-23	-10	-5	-1	[4]					-200	-206	-207
5. Extension of election to accelerate AMT and SALT credits in case of bonus depreciation [9].....	vps 12/31/08	-20	-984	49	47	33	21	15	10	8	8	8	8	475	454	405
6. Deferral of certain income from discharge of indebtedness (5-year spread).....	below 11/11	-6,076	-13,269	-2,701	3,462	3,454	3,443	3,436	3,427	3,418	3,409	3,362	-19,310	-13,863	-12,173	-813
7. Increase section 1205 exclusions to 75% (through 12/31/10).....	via DOE	2	6	2			-207	-160	-163	-50	-36	-22	9	-198	-607	-629
8. Equalize the one-time email and parking benefits set back at 2/29 for 2009 and then index equally in 2010.....	DOE	-57	-106	-29										-192	-192	-192
9. Temporarily reduce the 5 corporate health plan building period from 10 to 7 years.....	vps 12/31/08 and below 11/11	-31	-154	-73	-32	-28	-19	-20	-16	-14	-13	-15	-318	-337	-400	-415
10. Clarification of regulations related to limitations on certain health losses following an ownership change.....	vps 11/6/09	1,437	1,775	646	261	225	304	419	457	470	484	499	4,344	4,647	6,478	6,977
<b>Total of Tax Incentives for Business.....</b>		<b>-43,825</b>	<b>-45,259</b>	<b>17,938</b>	<b>11,084</b>	<b>17,846</b>	<b>14,213</b>	<b>18,820</b>	<b>8,617</b>	<b>7,112</b>	<b>6,200</b>	<b>3,763</b>	<b>-71,888</b>	<b>-57,676</b>	<b>-34,926</b>	<b>-21,167</b>

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# TERRITORIAL TAX PROPOSALS AND CHAIRMAN CAMP'S DISCUSSION DRAFT

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## Timeline on Territorial Proposals and Revenue Estimates

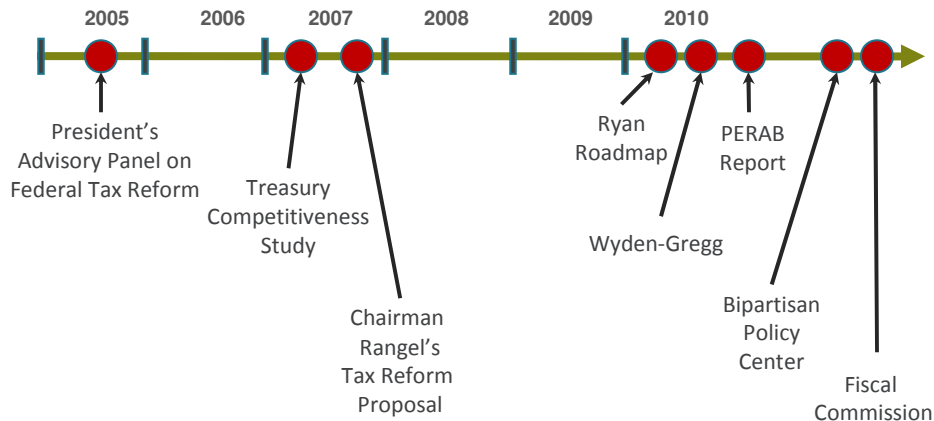


Source: Dr. Rosanne Altshuler

Notes:  
Territorial proposals in bold  
Revenue costs in billions over ten years

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## Timeline on Reform Proposals



Source: Dr. Rosanne Altshuler

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## Chairman Camp's Discussion Draft

- Corporate rate reduced to 25 percent (offsets to be provided at a later date)
  - Congressman Levin's JCT request: elimination of tax expenditures for corporations reduces the corporate rate to 28 percent
  - Can reduce corporate rate to 25 percent if use revenue from repeal of tax expenditures for pass-throughs

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## Chairman Camp's Discussion Draft

- Camp's Dividend Exemption Plan:
  - Exempts 95 percent of foreign-source income, including dividends and capital gains
  - Retains Subpart F: subject to possible refinement?
  - Foreign tax credits available for passive income, not exempted income
  - Previously untaxed earnings are taxed twice --
    - Once as a deemed repatriation (85% DRD)
    - Again when actually repatriated (95% DRD)
  - Three options to address base erosion, including the excess returns proposal from the FY2012 Budget
  - Debt limitation (anti-stuffing) rule

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## Options for Preventing Base Erosion

- Tax excess IP returns as subpart F income -- Obama Administration proposal
- Tax low tax cross-border income as subpart F income
- U.S. patent box coupled with subpart F treatment of intangibles income

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## Taxing Excess IP Returns

- If ...
  - US person transfers a covered intangible to a related CFC
  - The CFC is subject to a low foreign effective tax rate
  - The CFC earns excessive intangibles income
- Then ...
  - The excessive return is treated as subpart F income
  - In a separate FTC limitation basket

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## Excess Return/Low Tax

- Excess return -- excess over allocable "costs" + % mark-up -- 50%
- Low tax -- to be based on sliding scale of foreign tax rates -- 10-15%
  - Effective tax rate calculated under U.S. E&P principles?

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## Taxing Low Tax Cross-Border Income

- New category of subpart F income for CFC income subject to effective foreign tax rate of less than 10%
- Same country exception if meet all of:
  - Active trade or business in same country
  - Office or fixed place of business in same country
  - Income derived from services performed or products used or consumed in same country
  - Would essentially undo existing deferral structures

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## U.S. Patent Box

- 15% rate on foreign intangibles income of U.S. corporation
- New category of subpart F income for intangibles income of CFC
- Proposal would essentially eliminate benefit of earning income from exploitation of intangibles offshore
  - Provision would apply to current structures
- Proposal may violate WTO rules as export subsidy

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## Anti-Stuffing/Thin Capitalization Rule

- The proposal limits the deductibility of interest of a U.S. corporation with foreign subs unless two tests are met:
  - Relative leverage test: DER of U.S. corporations in the group cannot exceed DER of affiliated foreign corporations
  - Adjusted taxable income test: interest expense may not exceed a prescribed percentage of adjusted taxable income
- Limits the ability of U.S. corporations to reduce their U.S. tax liability with interest deductions where the interest is incurred for the purpose of funding the activities of subsidiaries

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## Chairman Camp's Discussion Draft: Unaddressed Issues

- The Committee recognizes that the discussion draft omits numerous technical and policy issues that might need to be resolved in a final product and invites comment on how to address certain provisions, such as those related to:
  - Overall domestic and foreign loss accounts;
  - Tax redeterminations – refunds and or additional taxes paid;
  - Subpart F changes, including with respect to recapture accounts;
  - Dual consolidated losses;
  - Tax treaty implications; and
  - Cross-border reorganizations

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## Chairman Camp's Discussion Draft: Request for Comments

- Chairman Camp requested input on all aspects of the discussion draft and specifically requested constructive feedback on the following issues:
  - Which of the three base erosion options would best protect the U.S. tax base with minimum impact on the competitiveness of American businesses? What modifications could be made to make one or more of the options more workable? If these three options are undesirable, what other effective options exist to deal with base erosion, especially with respect to intangibles?
  - How can thin capitalization rules be designed to effectively protect the U.S. tax base with minimum impact on the competitiveness of American businesses?
  - What are the pros and cons of treating foreign branches as CFCs? Should foreign branches continue to be treated as disregarded entities instead?
  - How should foreign partnerships with U.S. corporate partners owning interests of at least 10% be treated? What special rules might be necessary to incorporate them into the new regime?
  - Is the 95% exemption for certain capital gains appropriate? Are any additional anti-abuse rules needed in this area?

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## Additional Sources of Revenue

- Tax "large" partnerships as corporations (see WSJ, page A1, 1/10/2012)
- Reduce the deduction for interest
- Tighten the territorial tax system to raise revenue (e.g., expense allocation for overhead, R&D)

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## Tax Reform in 2012?

- Tax reform hearings in Senate Finance and Ways and Means Committees
- Increased focus on transfer pricing and base erosion
- The Department of the Treasury's Tax Reform Proposal?



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## FY 2013 Green Book (Coming Soon)

- Likely to see unused revenue provisions when the FY 2013 Green Book is released on 2/13/2012
- Old chestnuts include:
  - Excess returns associated with transfers of intangibles offshore
  - Limit shifting of income through intangible property transfers
  - Carried interest
- Buffet Rule?

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## President's Insourcing Proposals

- President's "insourcing" proposals to reward companies that choose to invest or bring back jobs to the United States, and to eliminate tax advantages for companies moving jobs overseas
  - No deduction for outsourcing jobs
  - Multinational corporations should pay a minimum level of tax (as part of corporate tax reform)
  - Increase section 199 from 9 percent to 18 percent for certain domestic manufacturing

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## Repatriation

- Section 965, version 2, would cost \$78.7 billion over ten years
- Cost is due to:
  - Acceleration of baseline repatriations in the budget window into the holiday period; and
  - Further base erosion in anticipation of another holiday
- Politics in the House: Boehner/Camp v. Cantor/McCarthy
- Politics in the Senate: PSI's addendum to the October 11, 2011 report



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## February 2012: Unfinished Business

- Payroll tax holiday conference
- Extension of 59 tax provisions that expired at the end of 2011 (extenders)



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## Extenders

- R&E Credit: \$7.65 billion for 1 year
- Section 954(c)(6): \$776 million for 1 year
- Active financing exception to subpart F: \$5.2 billion for 1 year
- Cost to extend all provisions that expired in 2011 (excluding AMT patch, 100% bonus depreciation, and payroll tax holiday): \$38.06 billion for 1 year

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## Other Legislation You Should Care About

- S.45, Offshoring Prevention Act
- H.R. 64, Anti-treaty shopping proposal
- S. 727, Bipartisan Tax Fairness and Simplification Act of 2011
- S. 1346; H.R. 2669, Stop Tax Haven Abuse Act (managed and controlled)

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Thank you

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