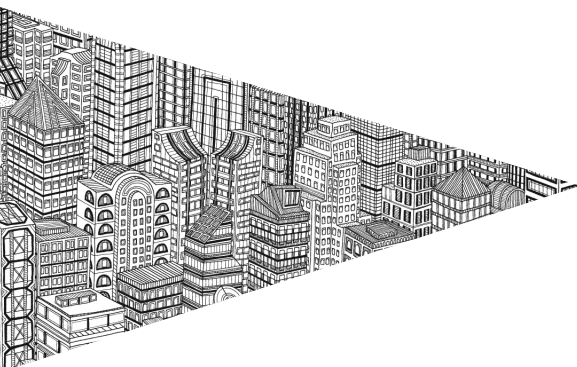


International Tax Alert



Administration's deficit reduction plan includes re-proposal of international tax changes

Executive summary

On 19 September 2011, President Obama unveiled his plan to reduce the Federal deficit in a document titled, *Living Within Our Means and Investing in the Future: The President's Plan for Economic Growth and Deficit Reduction* (the Deficit Plan). The Administration announced that the plan will reduce the deficit by approximately \$3.1 trillion over the next decade, primarily through tax and health policy changes. The Deficit Plan was released less than two weeks after the President introduced a jobs bill, which is intended to stimulate job creation and fund infrastructure investments. The Deficit Plan's tax policy changes are intended to raise revenue and advance the President's vision for comprehensive tax reform, which includes enacting several of the same revenue offsets included in the proposed jobs bill. Additionally, the Deficit Plan contains many proposals included in the Administration's FY 2012 Budget proposals (see International Tax Alert, *Administration's FY2012 Budget international proposals*, dated 17 February 2011), including almost all of the international tax revenue proposals.

Get the world to go!

You can access corporate income tax rates of over 60 countries for multiple years using your mobile device:

- ▶ Type into your web browser: www.ey.mobi/ITS/rates

Detailed discussion

As part of the Deficit Plan, President Obama calls on Congress to undertake comprehensive tax reform that:

- ▶ Lowers tax rates
- ▶ Cuts inefficient and unfair tax breaks
- ▶ Cuts the deficit
- ▶ Increases job creation and growth in the United States
- ▶ Observes a new "Buffett Rule" (described below).

In addition, the Deficit Plan describes “measures that could contribute to comprehensive tax reform or, absent such reform, act as a backstop.” These measures would impact individual and corporate taxpayers, and generally are proposed to become effective on 1 January 2013.

Measures in the Deficit Plan affecting individual taxpayers include allowing the “Bush-era tax cuts” to expire, reducing the value of itemized deductions and other tax preferences to 28 percent for families with incomes over \$250,000, and taxing at ordinary income rates a partner’s distributable share of partnership income with respect to certain partnership interests received in exchange for services (commonly referred to as carried interests). The so-called “Buffett rule” would require that taxpayers earning more than \$1 million a year not pay a smaller share of their income in taxes than middle-class families. Apart from the Buffett rule, each of these individual provisions (or a substantially similar provision) was included in the Administration’s FY 2012 Budget. The proposals to limit itemized deductions and tax carried interests as ordinary income also were included as revenue offsets in the proposed jobs bill.

Measures in the Deficit Plan affecting corporate taxpayers include eliminating special depreciation rules for purchases of corporate aircraft, repealing certain oil & gas tax preferences, repealing the

last in, first out and lower-of-cost-or-market methods of accounting for inventory, eliminating certain preferences for the coal industry, and modifying the tax treatment of insurance companies and products. The proposed jobs bill included the proposals on repealing the special depreciation rules concerning corporate aircraft purchases and oil & gas tax preferences. The other corporate tax proposals were included in the Administration’s FY 2012 Budget.

The Deficit Plan’s proposals to change the US international tax rules include:

- ▶ Deferring the deduction of interest expense related to foreign-source income not currently subject to US federal income tax;
- ▶ Requiring corporate taxpayers to determine the deemed paid foreign tax credit under Section 902 on a “pooling basis”;
- ▶ Taxing currently “excess returns” earned by a CFC with respect to certain intangible property transferred to it by a related US person;
- ▶ Clarifying the definition of intangible property under Section 936(h)(3)(B) for purposes of Sections 482 and 367(d) and tightening the rules regarding outbound transfers of such property;
- ▶ Tightening the Section 163(j) “earnings-stripping” rules for certain expatriated entities; and

- ▶ Modifying the tax rules applicable to dual-capacity taxpayers.
- ▶ The proposed jobs bill included the proposal applicable to dual-capacity taxpayers.

The Deficit Plan includes most of the international tax proposals included in the Administration’s FY 2012 Budget, but not the proposal to disallow the deduction for “excess non-taxed reinsurance premiums” paid to foreign affiliates with respect to US risks, or the proposal to repeal the “boot-within-gain” rule of Section 356(a)(1) with respect to certain reorganizations.

Implications

While the President’s Deficit Plan does not include a detailed plan for tax reform, the plan sends a further signal regarding the President’s interest in long-term tax reform. If enacted, the Deficit Plan’s revenue proposals would impact high-income individual taxpayers, and corporate taxpayers in every industry. However, the Deficit Plan represents only the Administration’s recommendations to Congress, which under the *Budget Control Act* of 2011 is charged with developing legislation to deliver substantial deficit reduction this fall. The *Budget Control Act* gives the so-called “Supercommittee” a deadline of 23 November to advance its own deficit reduction plan and the recommendations included in the President’s Deficit Plan may be considered in that context.

For additional information with respect to this Alert, please contact the following:

Ernst & Young LLP, International Tax Services, Washington, DC

- ▶ Barbara Angus +1 202 327 5824 barbara.angus@ey.com
- ▶ Jose Murillo +1 202 327 6044 jose.murillo@ey.com
- ▶ Trey Olson +1 202 327 6033 trey.olson@ey.com

Ernst & Young

Assurance | Tax | Transactions | Advisory

About Ernst & Young

Ernst & Young is a global leader in assurance, tax, transaction and advisory services.

Worldwide, our 141,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve their potential.

Ernst & Young refers to the global organization of member firms of Ernst & Young Global Limited, each of which is a separate legal entity.

Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit www.ey.com. Ernst & Young LLP is a member firm of Ernst & Young Global Limited, serving clients in the US.

International Tax Services

About Ernst & Young's International Tax Services practice

Our dedicated international tax professionals assist our clients with their cross-border tax structuring, planning, reporting and risk management. We work with you to build proactive and truly integrated global tax strategies that address the tax risks of today's businesses and achieve sustainable growth. It's how Ernst & Young makes a difference.

www.ey.com

© 2011 EYGM Limited
All Rights Reserved.

SCORE no. CM2524

This publication contains information in summary form and is therefore intended for general guidance only. It is not intended to be a substitute for detailed research or the exercise of professional judgment. Neither EYGM Limited nor any other member of the global Ernst & Young organization can accept any responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication. On any specific matter, reference should be made to the appropriate advisor.

International Tax Services

- ▶ Global ITS, **Jim Tobin**, *New York*
- ▶ ITS Director, Americas, **Jeffrey Michalak**, *Detroit*
- ▶ ITS Director of National Washington, DC, **Margie Rollinson**, *Washington*

- ▶ Northeast
Craig Hillier, *Boston*
- ▶ East Central
Johnny Lindroos, *McLean, VA*
- ▶ FSO
Phil Green, *New York*
- ▶ Midwest
Simon Moore, *Chicago*
- ▶ Southeast
Scott Shell, *Charlotte, NC*
- ▶ Southwest
Paul Palmer, *Houston*

- ▶ West
Julie Wooldridge, *Irvine, CA*
- ▶ Canada
George Guedikian, *Toronto*
- ▶ Israel
Sharon Shulman, *Tel Aviv*
- ▶ Mexico and Central America
Koen Van 't Hek, *Mexico City*
- ▶ South America
Alberto Lopez, *New York*