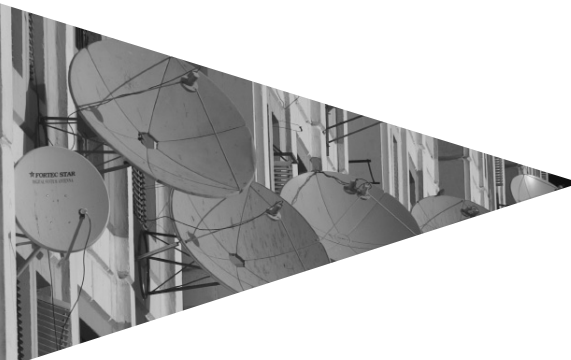


Washington Dispatch



In this issue...

Legislation

- 1 Ways and Means Committee Chairman unveils territorial tax proposal
- 2 President's jobs stimulus package fails in Senate
- 3 "Supercommittee" coming upon first major deadline
- 4 Senate subcommittee issues long-awaited report on 2004 tax repatriation "holiday"
- 5 New FIRPTA proposals would affect REITs

Transfer Pricing/Customs

- 6 US Customs seeks comments on new policy on effect of post-importation transfer pricing adjustments on transaction value

OECD

- 7 OECD proposes changes to commentary to model tax convention regarding permanent establishments

Legislation

Ways and Means Committee chairman unveils territorial tax proposal

Ways and Means Committee Chairman Dave Camp, R-MI, on 26 October released an international tax reform proposal, *The Tax Reform Act of 2011*, as a discussion draft for comment. The proposal, which includes draft statutory language and a detailed technical explanation, would reduce the maximum corporate tax rate to 25% and would move the United States to a largely territorial tax regime. The announcement indicated the proposal would be combined into a comprehensive tax reform package with other individual and corporate tax changes.

Highlights of the territorial tax regime in the proposal include:

- ▶ A 95% deduction for the foreign-source portion of dividends received by domestic corporations from controlled foreign corporations (CFCs) (foreign branches would be treated as a CFCs for this purpose);
- ▶ A 95% exemption for capital gains derived on the sale of qualified foreign corporation stock;
- ▶ An election for comparable treatment of dividends and gains with respect to so-called "10/50 companies";
- ▶ A general retention of the subpart F rules;
- ▶ A "thin capitalization" rule that would deny a deduction for a portion of a domestic corporation's interest expense;
- ▶ A transition rule that would tax a CFC's accumulated deferred foreign earnings at a 5.25% effective tax rate with the tax payable in up to 8 equal annual installments; and
- ▶ Three alternative options to address the potential for erosion of the US tax base.

The proposal builds upon a series of hearings in the Ways and Means Committee on issues regarding the competitiveness of the US international tax system and the need for international tax reform. Those hearings reflected an increasing focus on the potential for a move toward a territorial tax system in the United States.

As the Ways and Means Committee explored in a hearing in May 2010 that focused on the international tax approaches of major US trading partners, the use of a territorial tax approach, typically in the form of a dividend or participation exemption system, has become the prevailing approach among developed countries, including recent moves toward territorial taxation by Japan and the United Kingdom. Moreover, the President's National Commission on Fiscal Responsibility and Reform in its report released 1 December 2010 also included a territorial tax approach in its corporate tax reform plan.

The release of full draft statutory language and a detailed technical explanation will serve to focus the debate because, as with any tax reform of this magnitude, the devil is in the details. The specifics provided in the discussion draft will allow stakeholders to consider carefully the full range of policy and technical issues.

With the detail that has been provided, companies will be able to use modeling tools and engage in

other in-depth analysis in order to understand what the proposal would mean for their businesses, both currently and as anticipated for the future. Full information about the implications of the proposal will be invaluable in informing companies' engagement with policymakers in the debate over international tax reform. It will be critically important for companies to provide informed comments and reactions as this proposal, and others that may be developed, are considered and evolve through the legislative process.

Companies should focus on the transition rule included in the discussion draft, which would provide for an immediate deemed inclusion of all accumulated foreign earnings of their CFCs and 10/50 companies at a reduced tax rate as a transition into the new territorial tax regime being proposed. This deemed inclusion mechanism, which would generate federal revenues, is a key to Chairman Camp's goal of an international tax reform package that is revenue neutral in the context of broader comprehensive tax reform. Companies should begin to identify any steps that would need to be taken in order to be prepared for such a transition.

Chairman Camp's release of the Ways and Means Committee discussion draft is a significant development. It is an important step in the larger fundamental tax reform debate that will play out over the coming

months. Ernst & Young will continue to provide updates regarding developments in this area as we work with companies and engage with policymakers.

President's jobs stimulus package fails in Senate

President Obama's \$447 billion jobs bill, the *American Jobs Act of 2011*, the details of which he originally unveiled in mid-September, failed in the Senate on 11 October when it did not get the necessary 60 votes needed to advance. With recriminations on all sides, Senate Majority Leader Harry Reid, D-NV, announced he would bring up the defeated jobs bill "piece by piece."

The Administration's proposed jobs stimulus package is a study in current Washington politics. In its first iteration, it included proposed revenue offsets of \$467 billion, many of which were floated in the President's FY 2012 budget proposal. Among the revenue raisers, President Obama had expanded his annual budget proposal to restrict the value of itemized deductions for high-income taxpayers to 28% to also include certain above-the-line deductions and exclusions from income. The President's proposal would have limited above-the-line deductions for self-employed health insurance and the domestic production deduction, among others, as well as the exclusion of employer-provided health insurance costs and municipal bond interest income.

Republicans in Congress generally found the revenue offsets in the President's jobs bill unpalatable. To address that reality, Senate Democrats proposed a five-percent surtax on individuals earning at least \$1 million per year which proponents claimed would raise \$445 billion. The plan was for the millionaire offset to replace the politically unpopular offsets originally proposed by President Obama.

Senate Majority Leader Reid formally introduced the *American Jobs Act of 2011* (S. 1660) -- with the millionaire surtax -- on 6 October. President Obama soon announced he would support the millionaire offset. But as noted, the bill ultimately failed in the Senate on a procedural vote.

Senate Republicans then unveiled their own jobs bill on 13 October, the *Jobs Through Growth Act*, which features top individual and corporate tax rates of 25% and both temporary and permanent foreign earnings repatriation incentives, among other reform measures. Senate Republican sponsors said their proposed jobs plan was an opening gambit for discussions with the White House.

Senate Majority Leader Reid then made good on his pledge to bring up the defeated jobs bill piece-by-piece. That tactic has so far proved unsuccessful; the Senate rejected a pared down version of President Obama's jobs legislation in a test vote, this time a \$35 billion bill that would have provided funding for teachers and first-responders.

New repatriation tax proposal released

Sens. Kay R. Hagan, D-NC and John McCain, R-AZ, proposed a new tax repatriation holiday on 6 October 2011, the *Foreign Earnings Reinvestment Act*, which the sponsors originally had hoped to add as an amendment to President Obama's jobs bill. This repatriation holiday proposal would reduce the US corporate rate to an effective 8.75% rate on foreign earnings brought back to the United States, achieved through a 75% dividend received deduction. In addition, it would provide for a 5.25% effective tax rate on repatriated earnings if the taxpayer expands its "qualified payroll" in the US by 10% during 2012. The proposal would impose a penalty, however, on companies that reduce their payroll at a rate of \$75,000 per full-time employee that is eliminated.

This proposal follows the introduction of several repatriation proposals in both the House and Senate over the past several months. These proposals have taken various approaches to the repatriation idea, including how such a provision would interact with the issue of job creation. There continues to be significant discussion of a possible repatriation holiday in the business community, where some have expressed enthusiasm for a repatriation holiday while others have indicated a preference to focus on fundamental tax reform.

"Supercommittee" coming upon first major deadline

The bipartisan Joint Select Committee on Deficit Reduction, tasked by the *Budget Act* with developing a deficit reduction package in order to avoid mandatory across-the-board budget cuts under a sequestration process is coming upon its first major deadline. Under the *Budget Control Act*, the so-called "supercommittee" is required to vote by 23 November 2011 on:

- ▶ A report that includes a detailed statement of findings, conclusions and recommendations of

the committee, including the Congressional Budget Office's estimate of the recommendations; and

- ▶ Legislative language to carry out the committee's recommendations.

If the Joint Select Committee passes (by a simple majority vote) any recommendations, those recommendations will be sent directly to the Senate and House for a vote. Amendments to the legislation are not permitted, and a filibuster in the Senate also is prohibited. The Senate and House

are required to vote on the committee's recommendations by 23 December 2011.

If the Joint Select Committee actions do not result in a bill being enacted by 15 January 2012, or if legislation produced by the Joint Select Committee process is enacted that reduces the deficit by less than \$1.2 trillion over 10 years, across-the-board sequestration, split between domestic spending (with certain limitations) and defense spending for FY 2013 and later, would take effect beginning 2 January 2013.

Senate subcommittee issues long-awaited report on 2004 tax repatriation "holiday"

On 11 October 2011, the Permanent Subcommittee on Investigations (PSI), part of the Senate Committee on Homeland Security and Governmental Affairs, chaired by Senator Carl Levin, D-MI, issued a majority staff report, *Repatriating Offshore Funds: 2004 Tax Windfall for Select Multinationals*, on the effects of the dividends received deduction of Section 965 (the 2004

repatriation provision) enacted by the *American Jobs Creation Act of 2004*.

The report explains the findings of research conducted by the PSI involving 20 US-based multinational corporations that used the 2004 repatriation provision, including the 15 corporations that reported the highest amounts of repatriation. The top 15 corporations together brought back a total of \$150 billion in offshore earnings, representing close to half of the \$312 billion total funds repatriated as qualifying dividends. The study focused on how the repatriated funds had been used by the corporations in four key areas: job creation, R&D, executive compensation, and stock repurchases.

The report concludes that there were no job increases or acceleration of R&D spending as a result of the repatriation and that there was an increase in stock repurchases and executive pay. The report also states that the repatriation benefitted a narrow portion of the US economy,

primarily pharmaceutical and technology corporations, and that funds were repatriated primarily from low tax or tax haven jurisdictions. Additionally, the report states that since the repatriation companies have accumulated funds at a greater rate than before 2004.

The report concludes that the 2004 repatriation cost Treasury an estimated net revenue of \$3.3 billion over ten years, produced no appreciable increase in US jobs or research investments, and led to US corporations directing more funds offshore. On this basis, the report recommends against enactment of any similar repatriation initiative.

Senator Carl Levin has been investigating offshore activities of US individuals and US corporations for several years and has introduced legislation aimed at stopping what he considers abusive practices that avoid US taxes by increasing foreign activities. The Senator has been a vocal critic of repatriation proposals in the past. It is not surprising that this report has been released while

EY launches Americas Tax Center

Ernst & Young in October 2011 launched the Americas Tax Center (ATC). Led by EY's National Tax Department co-directors Eric Solomon and Michael Mundaca (both formerly Treasury Assistant Secretaries for Tax Policy), the ATC is a platform that links the tax practices in 33 Ernst & Young member firms including 10,000 EY tax professionals who comprise the Americas region. The ATC will provide seamless cross-border technical capability and an enhanced level of service to our clients with operations throughout the Americas and the world. [Link to ATC slipsheet](#) for more information.

there are multiple bills that have been introduced in the House and in the Senate that include some sort of repatriation “holiday.”

The findings of the PSI may make it more difficult for advocates of another repatriation provision to gain support given the current economic and financial environment and the focus on job creation and US growth stimulation. The current proposals do attempt to more closely tie repatriation to job creation. For example, the provision proposed by Sens. Kay R. Hagan, D-NC, and John McCain, R-AZ, would provide for an additional benefit beyond the 75 percent dividends received deduction with respect to repatriated earnings if the taxpayer expands its “qualified payroll” in the US by 10% during 2012. Moreover the proposal would impose a penalty on companies that reduce their payroll at a rate of \$75,000 per full-time employee that is eliminated. However, it remains to be seen whether discussion of a new repatriation holiday will gain traction in the current environment. (See p.3 for more details.)

New FIRPTA proposals would affect REITs

On 22 September 2011, the *Real Estate Investment and Jobs Act of 2011* (S. 1616) was introduced in the Senate. A similar bill (H.R. 2989, the *Real Estate Jobs and Investment Act of 2011*) was introduced in the House on 21 September 2011. If enacted, the bill would stimulate investment in US real estate. It would

amend FIRPTA (Foreign Investment in Real Property Tax Act) in three significant ways.

The bill would increase from 5% to 10% the current “portfolio investor” exception for sales of stock and capital gains dividends to foreign shareholders of publicly traded REITs. In addition, the bill would extend the “portfolio investor” exception to publicly traded REIT stock held by a “qualified shareholder.” Qualified shareholder is generally defined as a publicly traded foreign entity eligible for a reduced rate of withholding under any US income tax treaty on ordinary REIT dividends, to the extent that a foreign investor in the

qualified shareholder holds (directly or indirectly through the qualified shareholder) 10% or less of the stock of the REIT.

The bill would also reverse the result in IRS Notice 2007-55, under which a liquidating distribution by a REIT is treated as a distribution attributable to the sale of a US real property interest by the REIT, generally subject to FIRPTA, rather than as a sale of REIT stock that may be exempt from FIRPTA.

In determining whether a REIT is domestically controlled, the bill would allow stock held by another REIT to be treated as held by a foreign person, unless such other REIT is itself domestically controlled.

Get the world – to go
Now getting tax rates is easier than ordering take out

You can now access corporate income tax rates of over 60 countries whenever and wherever using your mobile device. Rates are updated quarterly.

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



For this purpose, special rules would apply to less than 5% shareholders of publicly traded REITs.

The legislative prospects for this bill are uncertain. While the bill has been introduced in the House and Senate, it is uncertain if, or when, the bill may be considered in the full House and Senate.

Transfer Pricing/Customs

US Customs seeks comments on new policy on effect of post-importation transfer pricing adjustments on transaction value

In a significant development in customs valuation and transfer pricing, the US Customs and Border Protection (CBP) is considering a change regarding the effect of post-importation price adjustments on transaction value. CBP recently posted a notice regarding this matter on its website, and requested comments.

Many importations into the United States involve related-party transactions requiring the transfer price to meet the arm's length standard for income tax purposes. These transactions often involve formal intercompany agreements that call for adjustments to be made to the transfer price after importation. These agreements have raised the issue of whether transaction value is the proper basis for customs valuation when a post-importation adjustment has been made.

In contrast to its prior position, CBP is proposing that even though the parties are related and certain costs may be within the control of the parties, if the transfer pricing policy is set before importation, the transfer pricing policy may be considered an objective formula, allowing the use of transaction value. Moreover, when prices are adjusted downwards pursuant to the transfer pricing policy, CBP is considering that these adjustments may allow importers to obtain a refund of previously overpaid customs duties. Previously, CBP has often considered a decrease in the transfer price to be a post-importation rebate or decrease that is disregarded for customs purposes.

CBP in the past has allowed some adjustments, but not under the transaction value method. CBP had determined that transaction value did not apply because the price was not considered to be fixed or determinable pursuant

to an objective formula prior to importation because at least one of the elements for determining the price was within the control of the buyer and/or the seller. Adjustments made pursuant to other methods of customs valuation have proven difficult to manage and apply.

CBP notes that, as with any other transaction, companies must be prepared to demonstrate that the transaction value is arm's length based on customs regulations. Also under the proposed new policy, for companies to claim post-importations adjustments under transaction value, CBP is contemplating that importers must use the US Customs Reconciliation Program to properly apply adjustments (under this program, adjustments can be filed up to 21 months from the customs entry summary date).

If this policy is adopted, importers will have specific guidance on how to report post-importation transfer

Taxpayer Alert: FBAR scam

Ernst & Young has become aware of a "phishing" scam, related to the filing of Report of Foreign Bank and Financial Accounts (FBAR). Under the scam, taxpayers receive an email notice, purportedly from the IRS Chief of Criminal Investigations, indicating there are issues with their filings and requesting disclosure of all their "domestic and international financial accounts." The notice instructs the recipient to fax this information to 888-265-4730 (not an IRS number).

Taxpayers who receive such a notice should not reply. The IRS has asked that all unsolicited email claiming to be from the IRS be reported to phishing@irs.gov. Additional information can be located at the IRS website.

pricing adjustments. Importers following the new procedure should be able to use the US Customs Reconciliation Program to report both upward and downward transfer pricing adjustments, make necessary additional duty payments, and request refunds of previously overpaid duties.

OECD

OECD proposes changes to commentary to model tax convention regarding permanent establishments

On 12 October 2011, the OECD's Centre for Tax Policy and Administration released a public discussion draft on proposed

changes to the Commentary on Article 5 (Permanent Establishment) of the OECD Model Tax Convention (OECD Model).

The highlights of the Discussion Draft include:

- ▶ Confirmation that the permanent establishment (PE) analysis should be unaffected by any prior business restructurings;
- ▶ Clarification of exceptions to the PE definition which may be particularly relevant in the context of limited risk distribution and contract manufacturing models; and

- ▶ Clarifications concerning the application of the PE concept in the context of joint ventures and partnerships.

The proposed additions and changes to the Commentary on Article 5 of the OECD Model will be considered for inclusion in the next update to the OECD Model and Commentary, which is currently planned for 2014. The OECD invites comments on the Discussion Draft before 10 February 2012.

International Tax Services, Washington, DC

▶ Margie Rollinson	+1 202 327 5757
Sal Vaudo	+1 617 375 8333
▶ Robert Ackerman	+1 202 327 5944
▶ Barbara Angus	+1 202 327 5824
▶ Stephen Bates	+1 415 894 8190
▶ David Canale	+1 202 327 7653
▶ Doug Chestnut	+1 202 327 5780
▶ Ken Christman	+1 2-2 327 8766
▶ David Golden	+1 202 327 6526
▶ Liz Hale	+1 202 327 8070
▶ Lilo Hester	+1 202 327 5764
▶ Stephen Jackson	+1 212 773 8555
▶ Karen Kirwan	+1 202 327 8731
▶ Kyle Klein	+1 202 327 8843
▶ Richard Larkins	+1 202 327 7808
▶ David Levere	+1 212 773 4610
▶ Dick McAlonan	+1 202 327 6025
▶ Stephen Meadows	+1 202 327 6020
▶ Alan Munro	+1 202 327 7773
▶ Jose Murillo	+1 202 327 6044
▶ Peg O'Connor	+1 202 327 6229
▶ Chris Ocasal	+1 202 327 6868
▶ Al Paul	+1 202 327 7476
▶ John Turro	+1 202 327 8019
▶ Tim Wichman	+1 312 879 2282
▶ Steven Wrappe	+1 202 327 5956
▶ Denen Boyce	+1 202 327 5602
▶ Tom Coony	+1 202 327 5658
▶ Norman Hannawa	+1 202 327 6250
▶ Julio Jimenez	+1 212 773 5297
▶ Petya Kirilova	+1 202 327 6075
▶ Tammy LeGrys	+1 202 327 7757
▶ Katherine Loda	+1 212 773 6634
▶ John Morris	+1 202 327 8026
▶ Jasper Nzedu	+1 202 327 6203
▶ Ben Orenstein	+1 212 773 4485
▶ Karen Petrosino	+1 212 773 0375
▶ Julia Tonkovich	+1 202 327 8801
▶ fax number	+1 202 327 6721

International Tax Services

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

Ernst & Young

Assurance | Tax | Transactions | Advisory

About Ernst & Young

Ernst & Young is a global leader in assurance, tax, transaction and advisory services. Worldwide, our 152,000 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.

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.

The Washington Dispatch is a monthly communication prepared by Ernst & Young's Washington International Tax Services summarizing recent developments and "inside-the-beltway" news pertinent to multinational companies. For additional information, please contact your local international Tax professional.

ITS Washington, DC
Margie Rollinson

www.ey.com

© 2011 Ernst & Young LLP.
All Rights Reserved.

SCORE no. CM2547

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.