

# Pharma and life sciences tax news: Vol. 8, No. 1

## April 14, 2009

### Deferral of tax on foreign earnings for US multinationals in jeopardy

In the face of record deficits, the Obama administration's February 26, 2009, budget proposes to "implement international enforcement, reform deferral, and other tax reform policies" to raise \$210 billion for the US Treasury over the next 10 years.<sup>1</sup> Details have not yet been provided, but much speculation on Capitol Hill points to proposed changes that would severely restrict or indirectly limit the tax provision that allows US-based multinationals to defer US income tax on foreign earnings until repatriated.

When foreign profits are repatriated, usually as dividends, the multinational receives a credit for taxes already paid to foreign territories on those earnings and subtracts that amount from the US tax due. US multinationals see the ability to defer US taxation until foreign profits are repatriated as essential for the United States to remain competitive and oppose any weakening of the current provision.

#### Background

Obama stated in his budget proposal that it "begins to restore a basic sense of fairness to the tax code, eliminating incentives for companies that ship jobs overseas and giving a generous package of tax cuts to 95 percent of working families."<sup>2</sup>

Following a commitment made by President Obama to CEOs during a March 12 Business Roundtable meeting to obtain input from the business community on proposed changes to deferral,<sup>3</sup> Treasury Secretary Timothy Geithner, National Economic Council Director Lawrence Summers, and White House Senior Advisor Valerie Jarrett held a conference call with CEOs. The National Journal Group's *Congress Daily* reported that the officials "granted at least one minor concession: they would not kill deferral outright but rather deny deductions firms can take for active overseas business income until the money is brought home." Although characterized as a concession, companies have criticized this alternative as being just as onerous as outright repeal of deferral.<sup>4</sup>

#### Latest Developments

A group of 200 companies and trade associations wrote to Congress March 24 to express their opposition to the budget proposal that would increase taxes on "US companies that are

---

<sup>1</sup> Office of Management and Budget, "A New Era of Responsibility: Renewing America's Promise," Washington, D.C.: US Government Printing Office, Feb. 26, 2009, 122.

<sup>2</sup> *Ibid.*, 3.

<sup>3</sup> "Obama's Remarks to the Business Roundtable," *The Wall Street Journal*, March 12, 2009, <http://blogs.wsj.com/washwire/2009/03/12/obamas-remarks-to-the-business-roundtable/> (accessed March 8, 2009), 9.

<sup>4</sup> Peter Cohn, "Neal Says He Plans to Keep Targeting Offshore Loopholes," *Congress Daily/A.M.*, National Journal Group, Inc., March 26, 2009, accessed through Dow Jones Factiva, March 30, 2009.

competing for business in international markets.” The letter warned that repeal of deferral would “result in a loss of jobs for Americans and serious negative impacts on the US economy.”<sup>5</sup>

Pharmaceutical, life sciences, and medical device companies signing the letter included Abbott, Allergan Inc., Baxter Healthcare Corporation, Bayer Corporation, Boston Scientific Corporation, Bristol-Myers Squibb, Celgene Corporation, Edwards Life Sciences Corporation, Eli Lilly and Company, Imclone Systems Corporation, Johnson & Johnson, Merck & Co. Inc., Pfizer Inc., Schering-Plough Corporation, and Wyeth.<sup>6</sup>

Details related to the administration’s budget proposal may be forthcoming. A Treasury “Blue Book” is expected in the next several weeks. If Congressional action is delayed, the issue potentially might be considered as part of a tax code review undertaken by a task force of the president’s Economic Recovery Advisory Board, led by former Federal Reserve Board Chairman Paul Volcker, which is charged with providing its recommendations before the end of the year.<sup>7</sup>

### **Other Proposals**

In Congress, current proposals to limit deferral include S. 260, introduced by Senator Byron Dorgan (D-ND) with 13 cosponsors, which would repeal deferral relating to income on property exported to the United States.

In 2007, Representative Charles Rangel (D-NY), chairman of the House Ways and Means Committee, introduced a comprehensive tax reform measure that would have indirectly limited deferral. The deferral limitations were estimated to raise taxes by more than \$100 billion over 10 years, which in combination with other base broadening provisions would have permitted a reduction in the US corporate income tax rate to 30.5 percent in a revenue-neutral manner.<sup>8</sup> Deferral would be indirectly limited in two ways under Chairman Rangel's 2007 bill. First, the proposal would defer the deduction of U.S. expenses allocable to foreign-source income to the extent foreign-source income of a taxpayer’s controlled foreign corporations (CFCs) is not paid to the United States. Second, the proposal would limit foreign tax credits to an average of the tax rates paid by all of a taxpayer’s CFCs. This approach would blend high tax rates with lower ones, potentially raising the overall effective tax rate. Chairman Rangel has said a new draft of his tax reform bill would permit a reduction in the corporate tax rate to 28 percent. It is not clear when Chairman Rangel may reintroduce his revised tax reform measure.

### **What Can Taxpayers Do?**

- Give the budget proposal top-level attention. Assess how changes to deferral would affect your company’s bottom line and ability to compete in foreign markets.
- Evaluate your company’s best course of action if the proposal were to become law. How would the company adapt?

---

<sup>5</sup> Bureau of National Affairs, “200 Groups, Companies’ Letter to Congressional Leadership Opposing Proposed Increases in Taxes on U.S. Companies Doing Business Outside U.S.,” *BNA Daily Tax Report*, March 24, 2009.

<sup>6</sup> Ibid.

<sup>7</sup> Martin Vaughn, “White House Reaches Out to CEOs on Foreign-Profits Tax Plan,” Dow Jones Newswires, March 25, 2009.

<sup>8</sup> Peter Cohn, “Neal Says He Plans to Keep Targeting Offshore Loopholes,” *Congress Daily/A.M.*, National Journal Group, Inc., March 26, 2009, accessed through Dow Jones Factiva March 30, 2009.

- Review past approaches to limiting deferral. Would some proposed approaches be less adverse to your company than others?
- Be prepared to engage in the debate and help Congress understand the consequences of this proposal for your company and employees.

### **For Further Information**

PricewaterhouseCoopers, "10Minutes on International Tax Increases," April 2009,  
<http://www.pwc.com/10minutes>

### **Michael F. Swanick**

Partner, Global Pharmaceutical and Life Sciences Tax Leader  
PricewaterhouseCoopers (US)  
[michael.f.swanick@us.pwc.com](mailto:michael.f.swanick@us.pwc.com)  
[1] 267-330-6060

[pwc.com/pharma](http://pwc.com/pharma)

The information contained in this is provided "as is", for general guidance on matters of interest only. PricewaterhouseCoopers is not herein engaged in rendering legal, accounting, tax, or other professional advice and services. Before making any decision or taking any action, you should consult a competent professional adviser.

© 2009 PricewaterhouseCoopers. All rights reserved. "PricewaterhouseCoopers" refers to PricewaterhouseCoopers LLP or, as the context requires, the PricewaterhouseCoopers global network or other member firms of the network, each of which is a separate and independent legal entity. \*connectedthinking is a trademark of PricewaterhouseCoopers LLP (US).