Senators introduce international tax bills with new and significant provisions

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In brief

President Obama and Congressional leaders continue to call for tax reform, including reform of the US international tax regime. In addition, fiscal policy is expected to dominate legislative discussion in 2013. Senators Carl Levin (D-MI) and Bernard Sanders (I-VT) have added to the tax reform and budget debates with separate bills addressing perceived international tax 'loopholes.'

Senator Levin on February 11 reintroduced the Cutting Unjustified Tax (CUT) Loopholes Act, an extensive and wide-ranging anti-abuse bill. In the international area, this bill (S. 268) includes new provisions eliminating controlled foreign corporation (CFC) look-through treatment and entity status electivity for certain foreign entities. In addition, it treats CFC loans to US shareholders as dividends to the extent of aggregate CFC earnings. The 2013 Levin bill also includes provisions apparently drawn from previous bills on deferral of foreign expenses, pooling of foreign tax credits (FTCs), limits on outbound transfers of intangible property (IP) (both under subpart F and Sections 367(d) and 482), and limits on earnings-stripping by inverted companies.

Senator Sanders on February 7 introduced a separate bill (S. 250, the Corporate Tax Fairness Act) that would eliminate deferral for active income of CFCs, reinstate per-country FTC rules, limit FTCs for oil companies that are dual-capacity taxpayers, and treat foreign companies managed and controlled in the United States as US companies. Representative Janice Schakowsky (D-IL) introduced a companion bill (H.R. 694) in the House on February 13.

Although the Levin and Sanders bills are unlikely to be enacted as introduced, the specific provisions are now on the table as possible revenue raisers for the 2013 legislative session and could become part of the corporate tax reform debate. Companies that might be affected by these proposals should consider participating in the legislative process.

In detail

Senator Levin chairs the Senate Permanent Subcommittee on Investigations (PSI). Senator Sanders is a member of the Senate Budget Committee. Neither Senator is a member of the Finance Committee, which is responsible for tax legislation. However, Senator Levin has used PSI's broad investigative powers to focus attention on perceived tax abuses, and both Senators have the ability to offer their bills as floor amendments on pending legislation.

Senator Levin's new provision to eliminate both CFC look-through treatment and the ability to check-the-box on most foreign subsidiaries would have a very significant impact. Furthermore, the newly-proposed limitations on CFC loans to US shareholders would affect many US multinationals. Note, however, that Republican members of Congress have the ability to block legislation they oppose through their majority control of the House of Representatives and their ability to filibuster most legislation in the Democratic-led Senate.

The Levin bill

The 2013 Levin bill is a broad anti-abuse bill that includes 35 total provisions, most of which do not target corporate international tax issues. This bill is a revised version of a bill previously introduced in early 2012, and contains some additional provisions.

Corporate international tax provisions

The new additions include a provision to eliminate CFC look-through (Section 954(c)(6)) altogether, a proposal not previously seen from any source. This proposal would have a significant — and immediate — effect on many current global structures. Although CFC look-through has not been enacted on a permanent basis, it has now become one of the tax extenders that Congress has repeatedly re-authorized. The Obama Administration has supported its continued application. However, Senator Levin released a September 20, 2012 PSI investigative report on offshore profit shifting that identified CFC look-through treatment as an international tax 'loophole' and recommended its elimination.

In addition, the 2013 Levin bill would eliminate the ability of US taxpayers to elect noncorporate status for foreign business entities that have a single owner without limited liability or one or more members, all of which have limited liability. This provision goes beyond previous legislative proposals limiting the use of the check-the-box rules for foreign subsidiaries of US multinationals. Enactment of this provision would significantly impact current global structures, requiring many companies to change their arrangements.

The third new provision in the 2013 Levin Bill would create a new Section 966 to require an income inclusion equal to the lesser of the aggregate untaxed earnings of all of a US shareholder's CFCs or their aggregate loans to the US shareholder. Moreover, this income inclusion would be treated as US source income. In addition, the provision would deny interest deductions with respect to CFC loans to US shareholders. This provision would not have the same broad impact as the elimination of CFC look-through or the check-the-box rules for foreign entities, but it would still affect many US multinationals adversely.

The rest of the 2013 Levin bill is similar to the 2012 Levin bill, which drew on previous legislation. It addresses foreign expense deferral and FTC pooling by reintroducing the 2007 legislative language from former Ways and Means Chairman Charles Rangel (D-NY) (even though the Obama Administration has offered a more recent proposal on foreign expense deferral and FTC pooling with different scope and mechanics). The 2013 Levin bill also adopts the Obama Administration's legislative language on provisions (i) creating a new category of subpart F income for "excess" income from transfers of intangibles to low-taxed affiliates, (ii) limiting earnings stripping by expatriated entities, and (iii) limiting income-shifting through intangible property transfers through clarified definitions of intangibles and valuation methods. In addition, Senator Levin includes his own previous proposal to treat foreign companies managed and controlled in the United States as US companies under Section 7701. Note, however, that Senator Levin has not reintroduced his 2012 provision to treat CFC earnings deposited in US banks as subject to deemed dividend treatment under Section 956.

Other provisions

The 2013 Levin Bill aims most of its 35 provisions at further strengthening tax enforcement and foreign financial disclosures, but it also includes efforts to end perceived abuses involving carried interest, treatment of derivatives, tar sands oil spills, and executive compensation involving stock options. Specifically, the non-international provisions are as follows:

Deterring the use of tax havens for tax evasion

Authorizing special measures against foreign jurisdictions, financial institutions, and others that significantly impede US tax enforcement; strengthening FATCA; reporting US beneficial owners of foreign-owned financial accounts; and addressing swap payments made from the United States to persons offshore.

Other measures to combat tax haven and tax shelter abuses

Country-by-country reporting; penalty for failing to disclose offshore holdings; deadline for anti-money laundering rule for investment advisers; anti-money laundering requirements for formation agents; strengthening John Doe summons proceedings; and improving enforcement of foreign financial account reporting.

Combating tax shelter promotion

Penalty for promoting abusive tax shelters; penalty for aiding and abetting the understatement of tax liability; prohibited fee arrangements;

preventing tax shelter activities by financial institutions; information-sharing for enforcement purposes; disclosure of information to Congress; and tax opinion standards for tax practitioners.

Additional provisions include:

- simplifying tax lien procedure for the national tax lien filing system
- ending excessive corporate tax deductions for stock options through consistent treatment of stock options by corporations; application of the executive pay deduction limit
- ending current treatment of carried interest through rules for partnership interests transferred in connection with the performance of services and special rules for partners providing investment management services to partnerships
- eliminating the derivatives blended rate through modifications to the treatment of section 1256 contracts and dealers in securities and commodities
- changing the current treatment of tar sands by amending the requirements for contributions to the Oil Spill Liability Trust Fund and extension of the Oil Spill Liability Trust Fund financing rate.

The Sanders bill

The Sanders bill is aimed exclusively at corporate taxpayers with cross-border activities. It only includes four provisions, but they would significantly impact most of those corporate taxpayers.

First, the Sanders bill includes a provision to eliminate deferral for the active income of CFCs by simply making all income earned by a CFC in a foreign country subpart F income under Section 952. The Sanders bill also amends Section 904 to reinstate the per-country FTC regime that was in place before the Tax Reform Act of 1986 established the Section 904 FTC basket system. These two broadly applicable provisions alone would significantly impact US multinationals.

Senator Sanders has apparently drawn his other two provisions from more narrowly-targeted provisions previously introduced by others. One, essentially the same as one of the 2013 Levin bill's provisions, would treat foreign companies managed and controlled in the United States as US companies under Section 7701. The other, apparently drawn from a prior-year provision proposed by the Obama Administration, would limit FTC claims under Section 901 for dual-capacity taxpayers that are "large integrated oil companies." The Sanders bill approach on this issue differs from the Obama provision in specifically limiting the impact of the provision to large integrated oil companies; the Obama provision would also potentially affect other companies, such as smaller oil companies and companies in the mining industry.

The takeaway

We expect the Obama Administration to release its FY 2014 Budget proposals soon. Meanwhile, Senators Levin and Sanders have introduced bills that are now part of the tax reform and budget debates. Their provisions are on the table as potential revenue-raisers, whether for tax reform, deficit reduction, or other budgetary needs. Companies headquartered in the United States or abroad should assess the potential impact of these bills on their current structures and consider whether to participate in the legislative process.

Let's talk

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