



Legislative Outlook 2010
PwC Accounting Symposium and Tax
Colloquium

Brian Meighan & Ed McClellan
Washington National Tax Services

San Francisco, CA
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Agenda

Economic factors affecting 2010 tax legislation

Health care

Job creation proposals

Expiring tax provisions

Administration FY 2011 budget

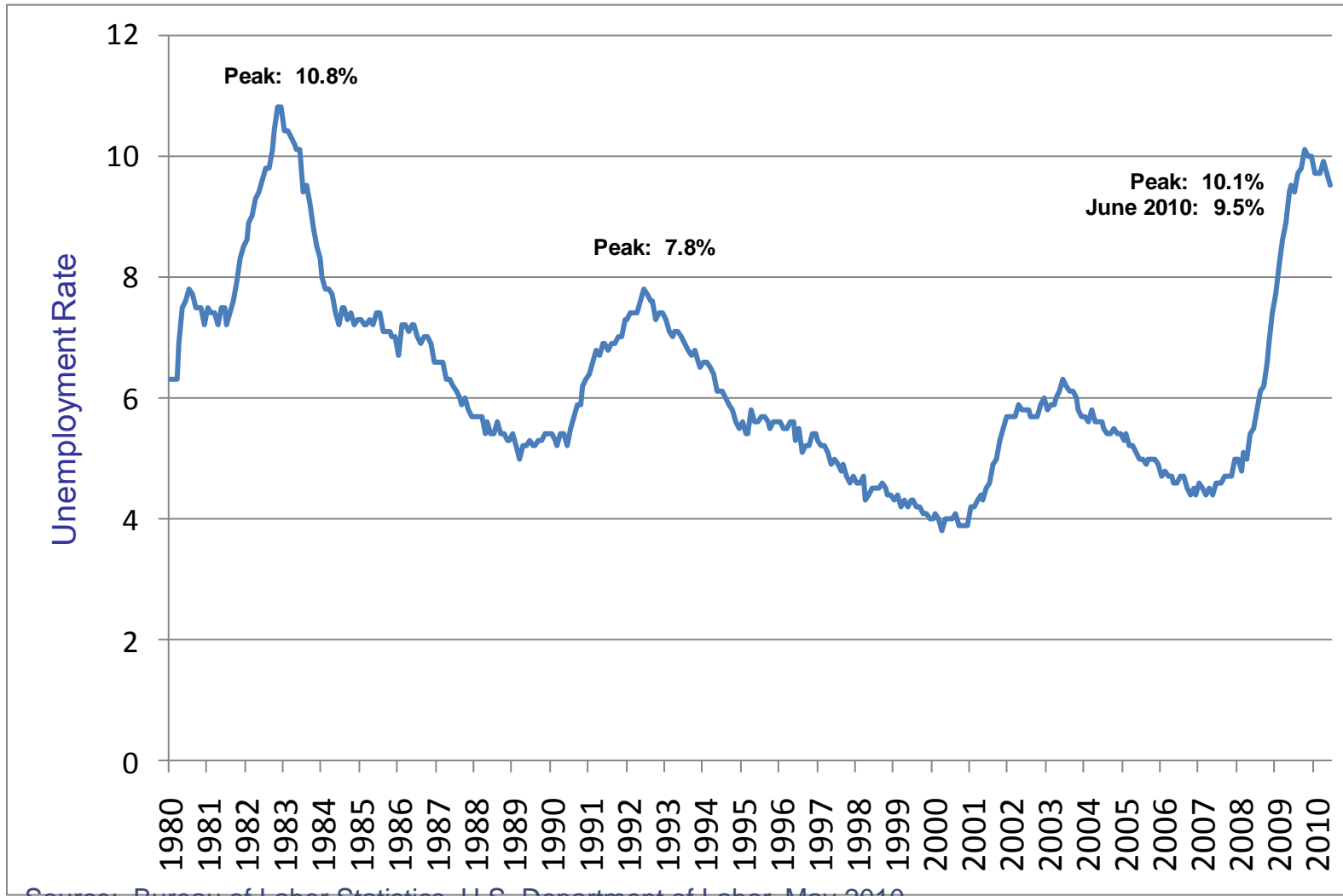
International tax proposals

Additional potential 2010 tax issues

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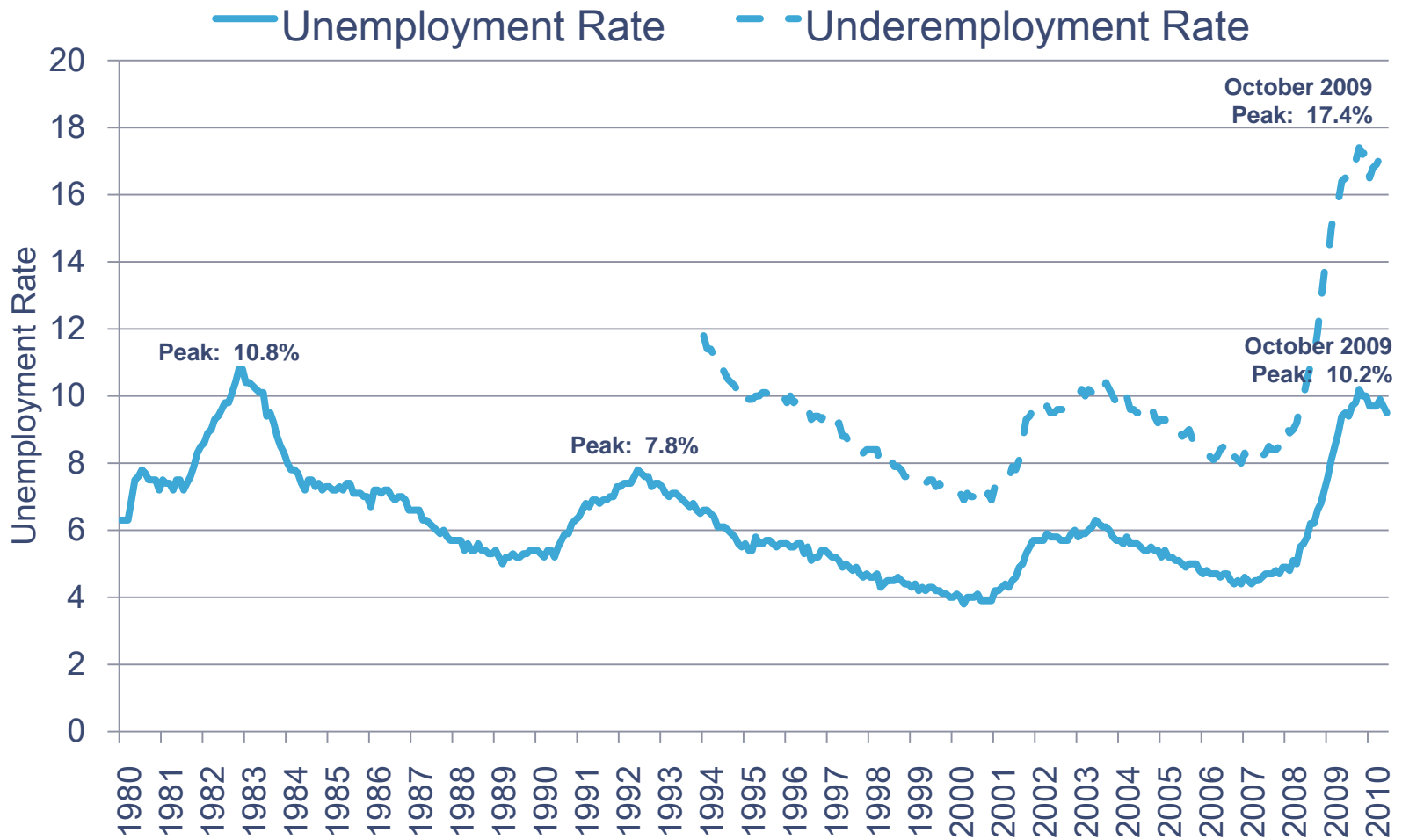
Continuing Concern Over High Unemployment



Source: Bureau of Labor Statistics, U.S. Department of Labor, May 2010.



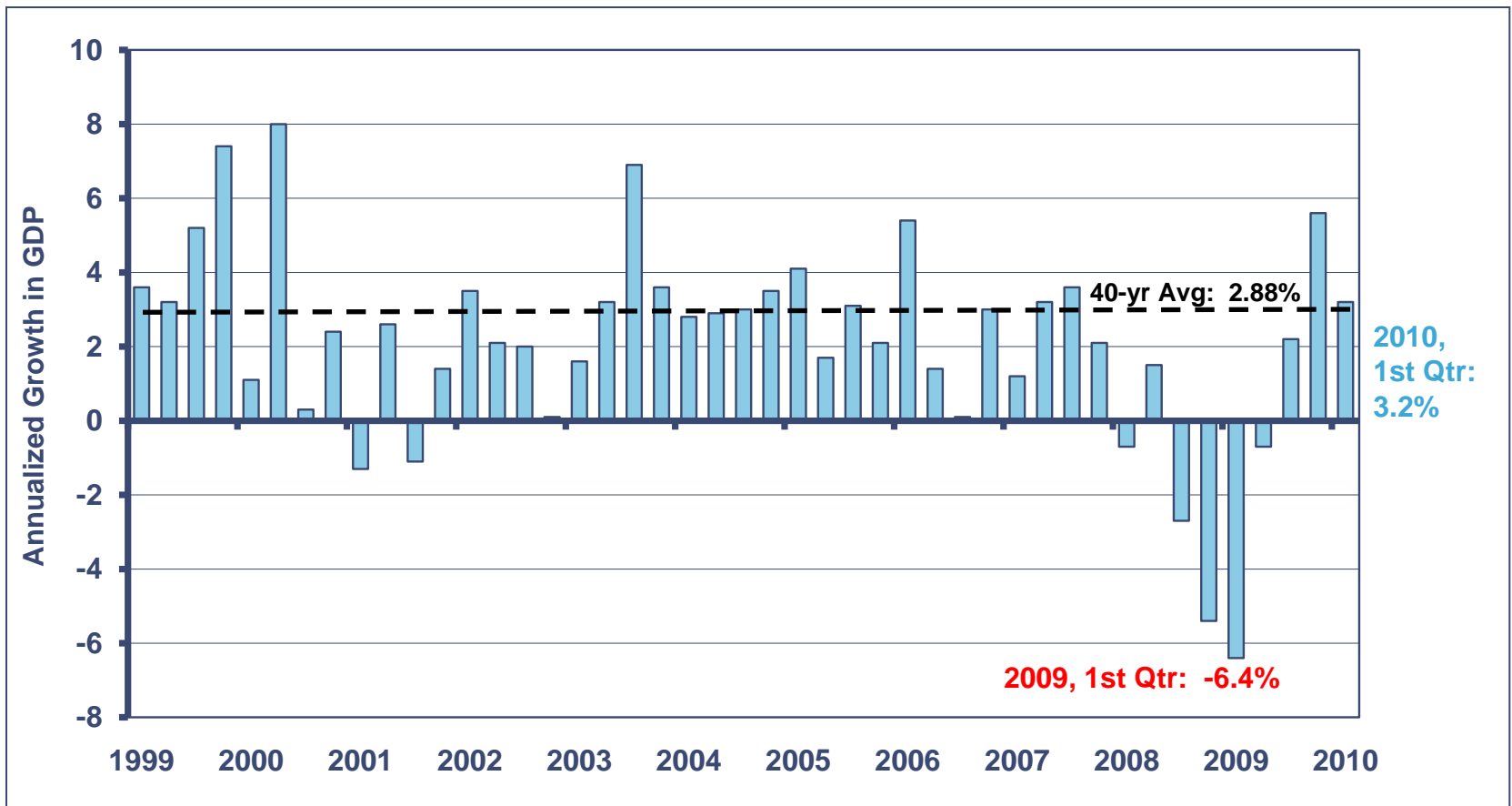
Continuing Concern Over High Unemployment and Underemployment



Source: Bureau of Labor Statistics, U.S. Department of Labor, July 2010.



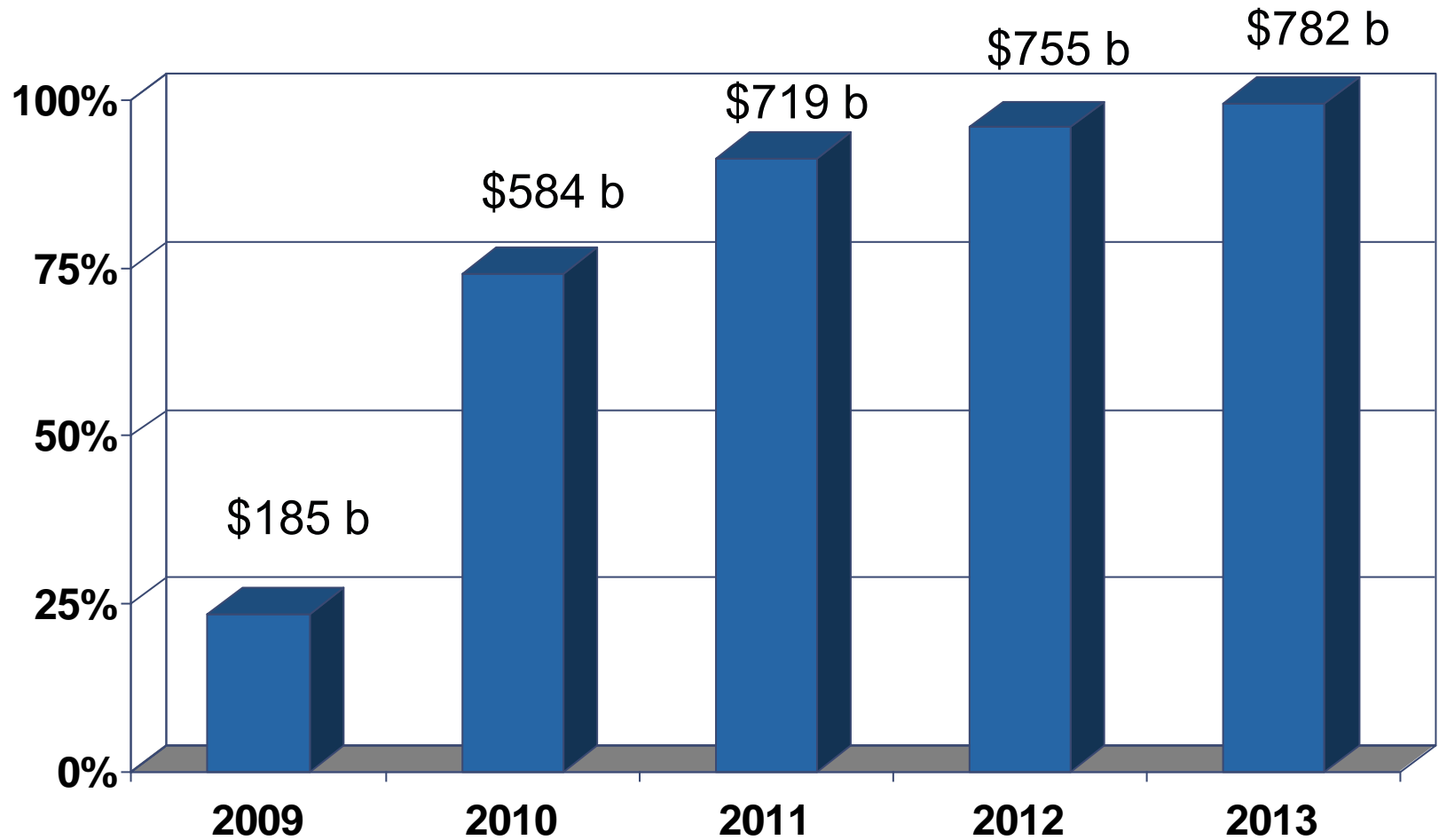
Growth Rate in Real GDP



Source: Bureau of Economic Analysis, April 2010.



Speed of Spend-Out of Stimulus Legislation \$787.2 billion over 11 years

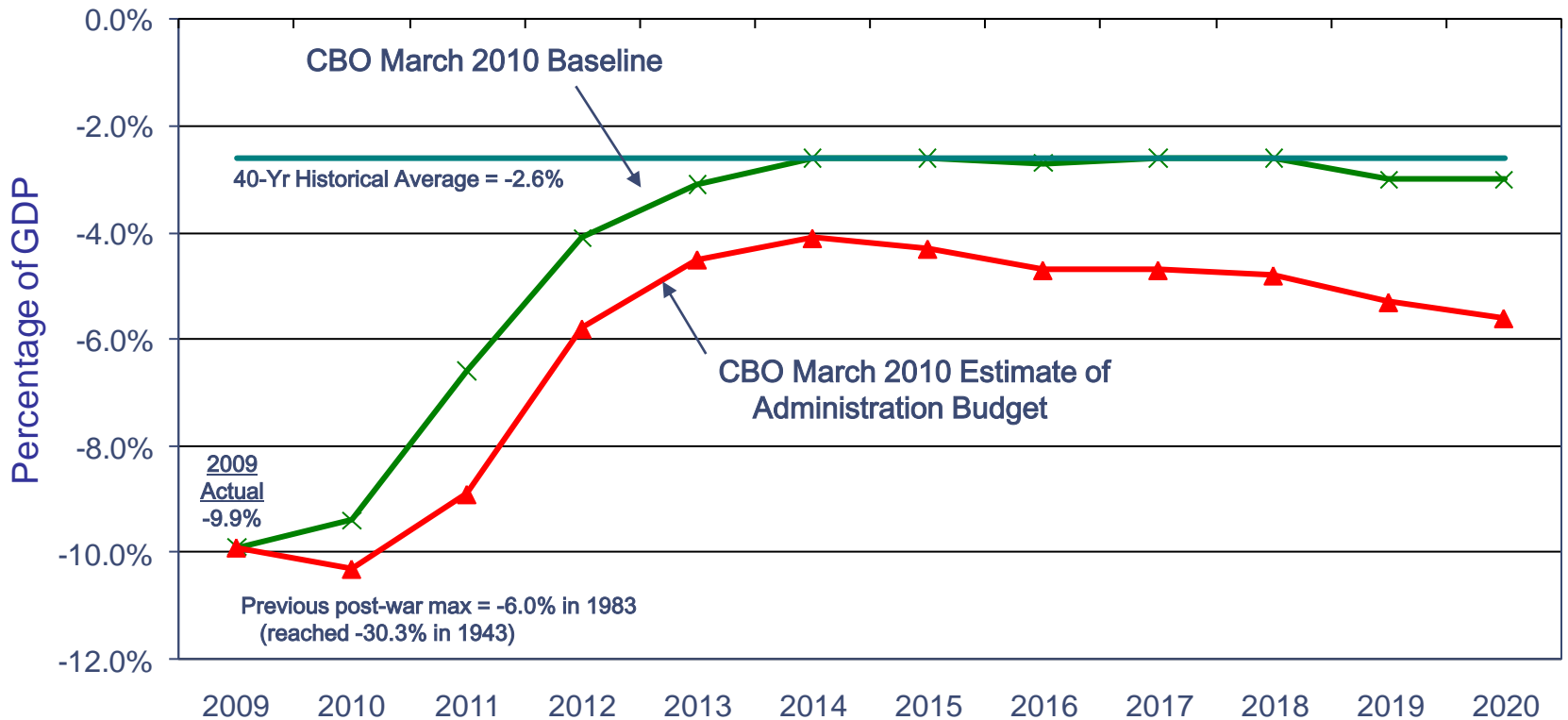


Source: CBO



Federal Budget Outlook

Federal budget deficit as a percentage of GDP: 2009-2020



Source: Congressional Budget Office (March 2010).

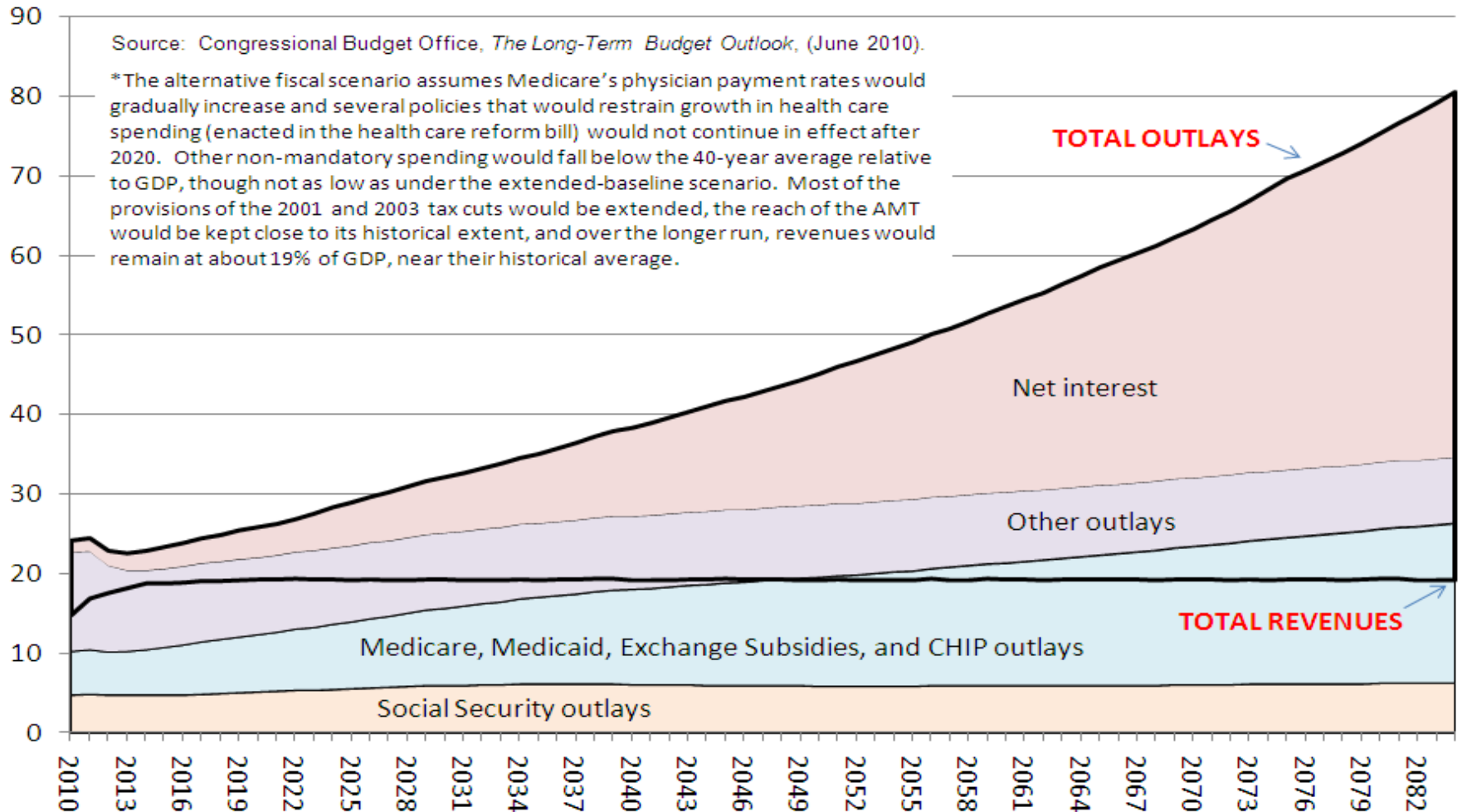


Long-Term Federal Budget Outlook

Federal Revenues, Spending Under CBO's Alternative Fiscal Scenario*
[Percent of GDP]

Source: Congressional Budget Office, *The Long-Term Budget Outlook*, (June 2010).

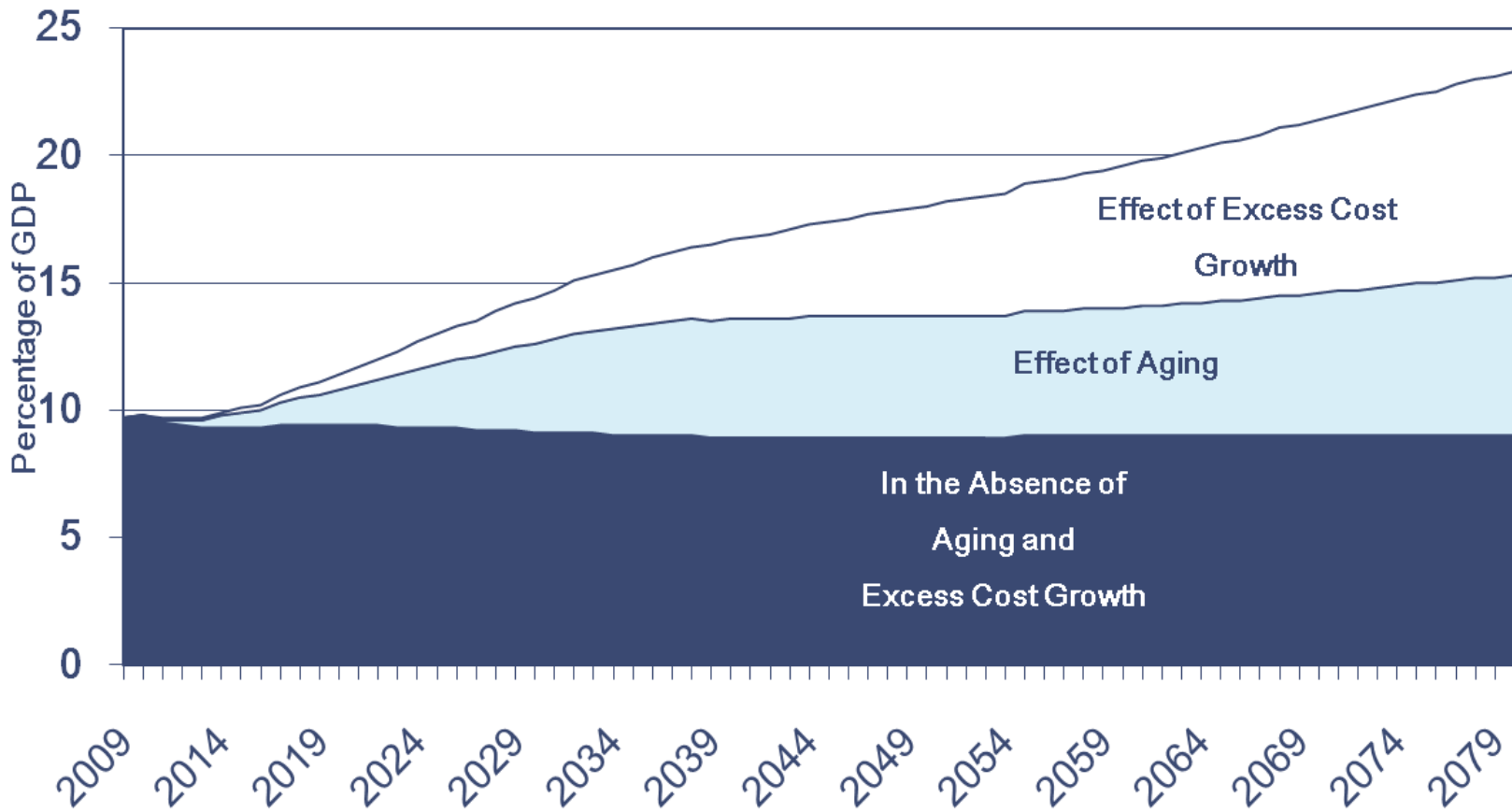
*The alternative fiscal scenario assumes Medicare's physician payment rates would gradually increase and several policies that would restrain growth in health care spending (enacted in the health care reform bill) would not continue in effect after 2020. Other non-mandatory spending would fall below the 40-year average relative to GDP, though not as low as under the extended-baseline scenario. Most of the provisions of the 2001 and 2003 tax cuts would be extended, the reach of the AMT would be kept close to its historical extent, and over the longer run, revenues would remain at about 19% of GDP, near their historical average.





Long-Term Growth in Entitlement Programs

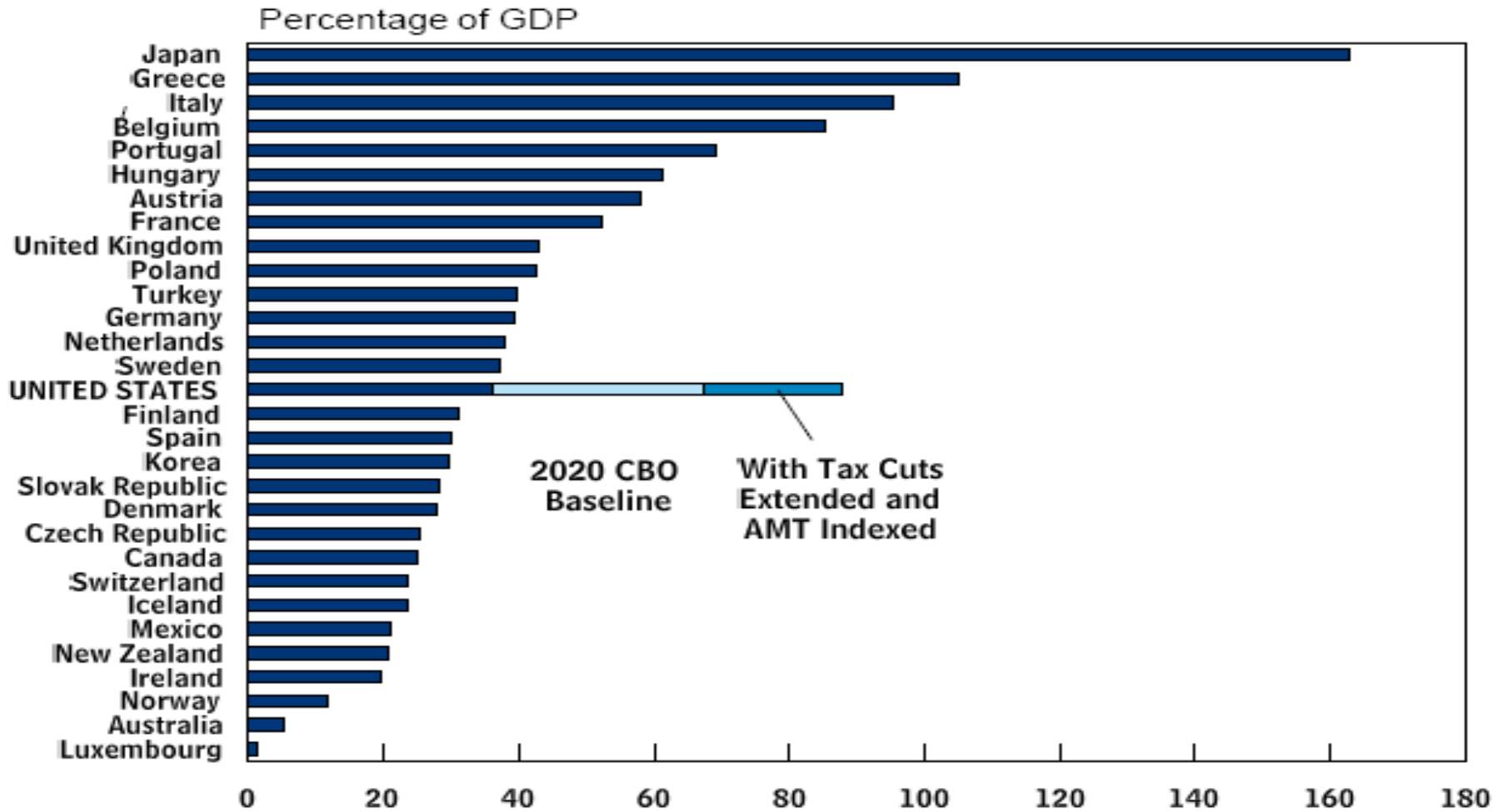
Factors underlying Growth in Medicare, Medicaid, and Social Security



Source: Congressional Budget Office, June 2009



Comparing Debt Burdens Across Countries in 2007

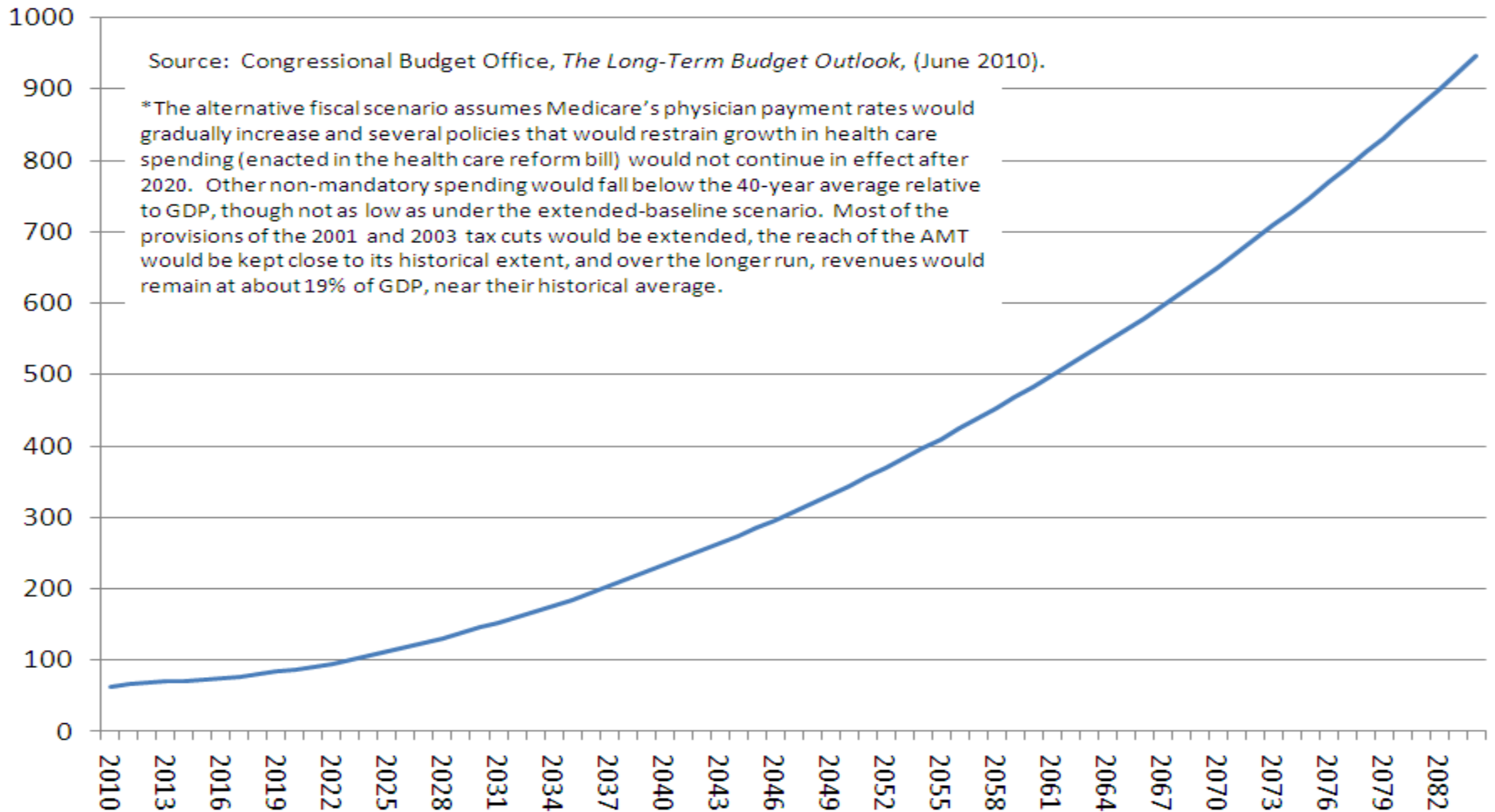


Source: CBO and OECD.



Federal Debt Outlook

Debt Held by the Public under CBO's Alternative Fiscal Scenario [Percent of GDP]





Statutory PAYGO

New permanent statutory pay-go measure approved by Congress as part of legislation (H.J.Res. 45) increasing the national debt limit by \$1.9 trillion to \$14.3 trillion

Mandatory spending sequestration enforcement mechanism

Limited exceptions

- “Emergency” legislation
- Permanent extension of middle-class portions of the 2001/2003 tax cuts.
- AMT relief for only 2010 and 2011 similar to the 2009 “patch.”
- Extension through 2011 of the estate tax provisions at 2009 levels (45% rate, \$3.5 million exemption), indexed for inflation.
- Extension through 2014 of the Medicare doctor payment fix.

No exception for maintaining 20% top individual rate on qualified dividends as proposed by President Obama



2010 Tax Legislation

- Enacted
 - Health Care
 - HIRE Act
- Pending
 - Tax Extenders
 - Small Business/Infrastructure
 - Energy/Climate Change
- Anticipated
 - Estate Tax
 - 2001/2003 Tax Cuts



Tax Provisions in Health Reform

Provision	Effective	10-year Revenue
Additional 0.9% surtax on earned income over \$200K/\$250K and 3.8% surtax on unearned income of taxpayers with AGI over \$200K/\$250K	2013	\$210.2 billion
Annual fee on health insurance providers	2014	\$60.1 billion
40% excise tax on health coverage in excess of \$10,200/\$27,500 (\$11,850/\$30,950 for retirees/high-risk professions)	2018	\$32 billion
Annual fee on manufacturers and importers of branded drugs	2011	\$27 billion
Exclusion of “black liquor” from cellulosic biofuel producer credit	2010	\$23.6 billion
2.3% excise tax on medical device manufacturers and importers	2013	\$20 billion
Require information reporting on payments to corporations	2012	\$17.1 billion
Raise 7.5% AGI floor on medical expenses deduction to 10%; AGI floor for 65 and over (and their spouses) remains at 7.5% thru 2016	2013	\$15.2 billion
Limit health FSA in cafeteria plans to \$2,500 (indexed)	2013	\$13 billion

[Source: Joint Committee on Taxation](#)



Tax Provisions in Health Reform (cont'd)

Provision	Effective	10-year Revenue
Conform medical expense definition (excludes OTC medicines)	2011	\$5 billion
Eliminate deduction for expenses allocable to Medicare Part D subsidy	2013	\$4.5 billion
Codify economic substance doctrine and impose underpayment penalty	3/30/10	\$4.5 billion
10% excise tax on indoor tanning services	7/1/10	\$2.7 billion
Impose fee on insured and self-insured health plans	9/30/12	\$2.6 billion
Increase tax on nonqualified distributions from HSA/MSA to 20%	2011	\$1.4 billion
\$500K executive comp deduction limit for health insurance providers	2013	\$0.6 billion
Modification of section 833 treatment of certain health organizations	2010	\$0.4 billion
Qualifying therapeutic discovery project credit (thru 2010)	2009	(\$0.9 billion)
Employer W-2 reporting of value of health benefits	2011	N/A
Total (includes additional, miscellaneous provisions)		\$438 billion

[Source: Joint Committee on Taxation](#)



Tax Provisions in Health Reform

Select Revenue Provisions	Effective	10-year Revenue
Additional 0.9% HI tax on wages >\$200,000/\$250,000 Plus 3.8% HI tax on non-wage income	2013	\$ 210.2 billion
Annual fee on health insurance providers	2014	\$ 60.1 billion
Annual fee on drug manufacturers	2011	\$ 27.0 billion
40% excise tax on coverage >\$10,200/\$27,500	2018	\$ 32.0 billion
Eliminate biofuel producer credit for “Black Liquor”	2010	\$ 23.6 billion
Excise tax on medical device manufacturers	2013	\$ 20.0 billion
Corporate information reporting	2012	\$ 17.1 billion
Limit health FSAs in cafeteria plans to \$2,500	2013	\$ 13.0 billion
Codify economic substance doctrine, with related penalties	3/31/10	\$ 4.5 billion
Eliminate expense deduction for Medicare Part D subsidy	2013	\$ 4.5 billion
10% excise tax on indoor tanning services	7/1/10	\$ 2.7 billion
Approximate Total (including other revenue provisions)		\$437.8 billion

Source: Joint Committee on Taxation revenue estimates



New Information Reporting Requirements

Enacted as part of health care legislation

Expanded 1099 reporting

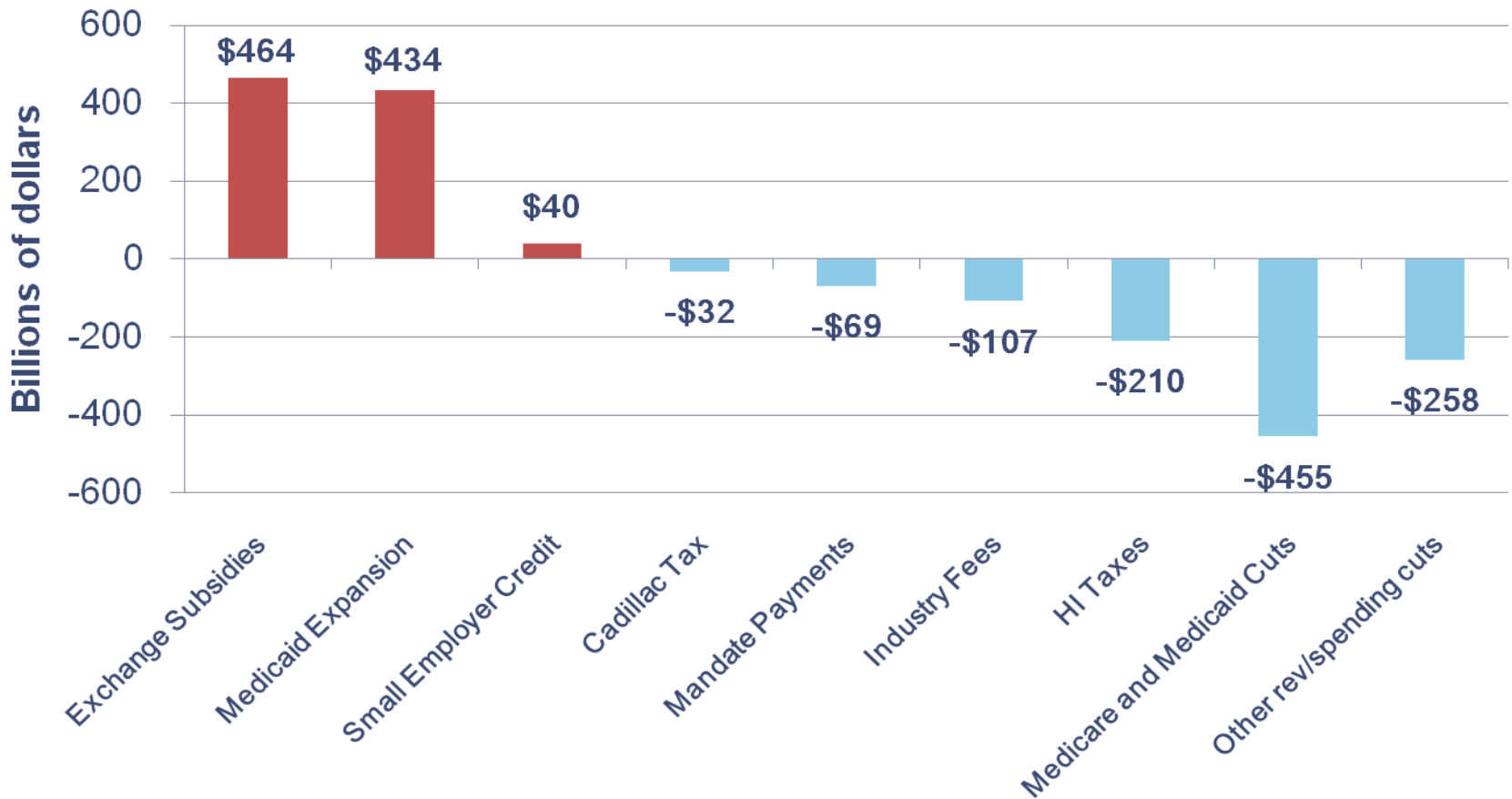
- Businesses must file 1099 information returns for all payments to a single business that total \$600 or more annually
- Covers amounts paid for both goods and services
- Limited exceptions for payments to tax-exempt organizations and certain securities and broker transactions
- Effective for payments made after December 31, 2011
- Estimated to raise \$17.1 billion over 10 years

W-2 reporting

- Employers must report on employee's annual W-2 the value of employer-provided health insurance coverage
- Effective for tax years beginning after December 31, 2010
- Estimated to have a negligible revenue effect.



Budgetary Impact of Selected Health Care Provisions (FY 2010-2019, billions of dollars)



Source: CBO, March 20, 2010. Combined budgetary impact of H.R. 3590 and H.R. 4872.



Health Care Reform Individual Tax Increase

Adopts 0.9% increase in Medicare HI tax on wages of upper-income individuals (\$200,000), MFJ (\$250,000)

- 2.35% HI tax for upper-income employee wages above the threshold
- Employer-share remains 1.45%

Adds new 3.8% Medicare HI tax on investment income for upper-income individuals

- Exception for income derived through ordinary course of business activity, such as S corporation active participation

	Wage income	Capital gain	Passive income
Top rate in 2011	41.05% *	20%	39.6%
Effective in 2013	0.9 % HI tax	3.8 % HI tax	3.8 % HI tax
Combined rate in 2013	41.95%	23.8%	43.4%

* Includes 1.45% current law employee share of Medicare HI tax



Job Creation Proposals

HIRE Act (H.R. 2847, P.L. 111-147)

- Temporary payroll tax holiday for hiring unemployed workers
 - Limited to workers unemployed for more than 60 days
 - Additional \$1,000 credit for employers retaining new employees for more than 52 weeks
- Highway funding, Build America Bonds, and Section 179 provisions

Revenue offsets

- Foreign Account Tax Compliance
- Delay worldwide interest allocation rules until 2021



Small Business Tax Relief

House approves \$17.8 billion bill (H.R. 4297)

- Temporary capital gains exclusion for qualified small business stock
- Limitation on penalties for failure to disclose reportable transactions
- Infrastructure provisions, including expanded Build America Bonds program

Revenue offsets include

- Limitation on tax treaties
- Minimum 10-year term for grantor retained annuity trusts
- Information reporting for rental property expense payments
- Repeal 80/20 rules
- Clarify treatment of gain recognized in certain spin-off transactions



Small Business Lending Tax Bill

House-approved bill (H.R. 5297)

- Temporary capital gains exclusion for qualified small business stock
- Limitation on penalties for failure to disclose reportable transactions

Offsets include:

- Minimum 10-year term for grantor retained annuity trusts
- Crude tall oil excluded from biofuel producer credit

Baucus substitute amendment

- Extend bonus depreciation
- Remove cell phones from “listed property”
- Extend and expand section 179 small business expensing
- Temporary capital gains exclusion for qualified small business stock
- Limitation on penalties for failure to disclose reportable transactions

Offsets include:

- Modify source rules on guarantee fees
- Allow rollovers to Roth 401(k) plans and Roth 457 plans
- Crude tall oil excluded from biofuel producer credit
- Information reporting for rental property expense payments
- Increased penalties for failure to file information returns



Expired Business and Individual Provisions

Expired business tax provisions include:

- Research credit
- Active financing exception
- CFC look-through treatment
- 15-year depreciation on leasehold, restaurant, and retail improvements

Primary revenue offsets include:

- Carried interest
- International tax proposals
- Self-employment tax imposed on certain S corporation and LLC income
- Oil spill liability trust fund tax increase



Carried Interest Legislation

Proposal approved on May 28 by House as part of tax extender bill (H.R. 4213)

- Tax carried interest (“services partnership interest”) as 75% ordinary income, 25% capital, beginning in 2013
- 50% ordinary / 50% capital transition period prior to 2013
- Also subject to self-employment tax
- Anti-abuse provisions for loans or other “disqualified interests”
- Deny PTP exception for publicly-traded investment partnerships
- Effective for taxable years ending after 12/31/2010
- Estimated to raise \$14.2 billion through 2020

Senate Finance Chairman Baucus – June 23 substitute amendment

- Tax carried interest (“services partnership interest”) as 75% ordinary income, 25% capital, beginning in 2011
- Provide 50% ordinary / 50% capital rate for assets held more than 5 years
- Preserves PTP exception for sale of interests in energy-related publicly traded partnerships
- “Clarifies” treatment of section 197 intangibles
- Estimated to raise \$13.6 billion through 2020



International Tax Revenue-Raising Proposals

Proposals in both the House-passed bill and the Baucus amendment

- Foreign tax credit "splitter" transactions - \$6.3 billion
- Denial of foreign tax credits with respect to foreign income not subject to U.S. tax by reason of covered asset acquisitions - \$4.0 billion
- Source rules on guarantees - \$2.0 billion
- Limitation on the use of section 956 for foreign tax credit planning (described as the "hopscotch" rule) - \$1.0 billion
- Modification of affiliation rules for purposes of rules allocating interest expense - \$400 million
- Special rule with respect to certain redemptions by foreign subsidiaries - \$255 million
- Separate application of foreign tax credit limitations to items resourced under tax treaties - \$253 million
- Repeal of 80/20 rules - \$153 million



Additional Obama Administration International Tax Proposals

FY11 Budget Proposals not currently part of active legislation

- Determine foreign tax credit on a pooling basis - \$49.2 billion
- Defer deduction of interest expenses related to deferred income - \$35.5 billion
- Tax “excess returns” from transfers of intangibles - \$10.2 billion
- Modify tax rules for dual capacity taxpayers - \$8.2 billion
- Disallow deduction for certain reinsurance premiums - \$2.3 billion
- Limit earnings stripping by expatriated entities - \$1.7 billion
- Limit shifting of income through intangible property transfers - \$0.5 billion



Additional Recent Anti-Deferral Proposals

Ways and Means Chairman Rangel Deferral Proposal

- Suspend U.S. deductions related to unrepatriated foreign earnings and limit use of foreign tax credits

Dorgan “Runaway Plant” Proposal

- Deny deferral benefits for income from property exported to the U.S. from a CFC jurisdiction

Dorgan “Tax Haven” Proposal

- Deny deferral benefits for U.S. CFCs located in 40 “tax haven” jurisdictions, including Bermuda

Other select proposals

- Repeal worldwide interest allocation rules
- Repeal sales source rule
- Treat all CFC income as Subpart F except for active home country income



Corporate Residency

Levin/Doggett Bills (S. 506, H.R. 1265) *March 16, 2009*

- Corporate residency “management and control” provision
- List of 34 “Offshore Secrecy Jurisdictions”
- Included foreign account compliance provisions enacted as part of Hiring Incentives to Restore Employment Act (P.L. 111-147)

Latest Doggett Bill (H.R. 5328) *May 18, 2010*

- Management & control for publicly traded companies or gross assets in excess of \$50 million
- If substantially all of the executive officers and senior management who exercise day-to-day responsibility for decisions involving strategic, financial, and operational policies, *plus* individuals who exercise such day-to-day responsibilities, are located primarily in the United States.



Doggett Treaty Override

- Denies reduced withholding rates under a U.S. tax treaty when the foreign parent is in a non-treaty jurisdiction and its subsidiary is in a treaty jurisdiction.
- Possibly targets inverted companies or companies based in tax havens.
- Impacts significant South American trading partners that do not have a tax treaty with the United States.
- Approved by House as part of H.R. 4849, Small Business and Infrastructure Jobs Tax Act



Heightened Scrutiny of Transfer Pricing Issues

November 2007 Treasury Study on Transfer Pricing

January 2008 JCT Chief of Staff Testimony on Transfer Pricing

March 2008 GAO Investigation of Uglund House

July 2008 SFC Tax Reform Hearing on U.S. Multinationals

July 2010 Ways and Means hearing on transfer pricing



Oversight: Permanent Subcommittee on Investigations (PSI)

Tax Haven Projects

- August 2006: Tax Haven Abuses: The Enablers, The Tools & Secrecy
- July 2008: Tax Haven Banks & U.S. Tax Compliance
- September 2008: Dividend Tax Abuse

Pending Investigations

- August 2007: Questionnaire on FIN 48 issues
- January 2009: Questionnaire on sec. 965 repatriation
- February 2009: Questionnaire on foreign subsidiaries operation in “tax havens”



“Financial Crisis Responsibility Fee”

Proposed tax would apply to covered firms with more than \$50 billion in assets

- Exception for Fannie Mae, Freddie Mac, and automakers

Tax set at 15 basis points on a firm’s qualifying liabilities, excluding deposits or reserves assessed by a federal regulator (e.g. FDIC)

- Ways and Means staff exploring option of basing tax on income and not assets

Expected to raise \$90 billion over first 10 years to cover projected TARP losses

- Congressional Budget Office report cites incidence of tax burden being passed through to consumers



Estate Tax Debate

Estate tax repealed beginning January 1, 2010

- Modified carryover basis rules apply

If no action is taken, estate tax returns to pre-2001 levels in 2011

- 55% rate and \$1 million per-person exemption
- Step-up basis rules apply

House-passed bill (H.R. 4154) in 2009

- Same approach as proposed in the President's budget
- Permanently extends estate tax at 2009 levels (45% rate and \$3.5 million per-person exemption)

Senate took no action before end of 2009

- Senate narrowly approved non-binding Lincoln-Kyl budget amendment calling for 35% top rate and \$5 million per-person exemption



Outlook for 2011

Impact of 2010 Mid-Term Election

- Democrats expected to lose House and Senate seats
- Possible GOP control of the House
- Lead-up to 2012 presidential election

Focus on deficit reduction

- Federal FY10 annual deficit on track to exceed 10% of GDP (\$1.37 trillion)
- Unsustainable long-term growth in federal entitlement programs (Social Security, Medicare and Medicaid) without reform
- Federal government debt service projected to approach \$1 trillion by 2020
- President's bipartisan National Commission on Fiscal Responsibility and Reform considering options for entitlement reforms, spending reductions, and tax reform
- Increased Congressional interest in deficit reduction instead of revenue-neutral tax reform



Codification of “Economic Substance” Doctrine

Must change in meaningful way pre-tax economic position and must be undertaken for nontax business purpose

- 40-percent penalty for underpayments attributable to undisclosed transactions lacking economic substance
- 20-percent penalty for disclosed transactions
- Effective for transactions entered into after March 30, 2010 (date of enactment)

Treasury guidance important in light of strict liability penalty for transactions lacking economic substance



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IRS Announcement 2010-9

Exploring IRS Announcement 2010-9

Brian A. Meighan – Washington National Tax Services



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Agenda

- Overview of IRS Announcement 2010-9
- Policy and Operational Issues
- Taxpayer Considerations
- Q&A

Overview of IRS Announcement 2010-9

IRS Transparency Initiative

- IRS Announcement 2010-9 - latest action in IRS' overall transparency initiative

Why is the IRS seeking UTP reporting?

- Stated objectives:

- Certainty,
- Consistency, and
- Efficiency in the administration of tax.

- Other issues:

- Currently, the Service indicates that it spends 25% of its audit time searching for issues rather than auditing issues.
- Current sustention rate for corporate tax adjustments is low.
- Goal is to reduce time spent searching for issues and better focus on completing examinations.

IRS Transparency Initiative

IRS Announcement 2010-9

Recent examples of increased transparency

- **Compliance Audit Program**
 - Memorandum of Understanding
- **Schedule M-3**
 - Revised to make it easier for the IRS to reconcile book-tax differences
- **International Disclosures**
 - Increased focus on Forms 5471, 5472, and international information reporting
- **Reportable Transaction Disclosure**
 - Provides early information regarding potentially abusive transactions
- **Commissioner Shulman's discussion with Corporate Board members on managing tax risk**
- **IRS Announcement 2010-9**

IRS Announcement 2010-9

Overview

- IRS Announcement 2010-9 released on January 26, 2010
- Would require taxpayers with over \$10 million in assets to disclose uncertain tax positions as part of a new schedule filed with their tax return
- IRS Announcement 2010-17, released on March 5, 2010, provided additional information and extended the comment period to June 1, 2010
- Draft “Schedule UTP” and instructions released on April 19, 2010

Schedule UTP and Instructions

- Who must file
 - Treatment of affiliated groups
 - Treatment of pass-through entities, REITs, RICs and tax-exempts
- Reporting uncertain tax positions - 60-day rule
- Transition rules
 - Uncertain tax positions pre-2010
 - Uncertain tax positions post-2010

Contents of Proposed Disclosure

- Disclosure on Schedule UTP required if two criteria met:
 - Taxpayer has taken a federal income tax position on a return, and
 - Taxpayer currently records a reserve in audited financial statement
- Two additional definitions of uncertain tax positions (beyond FIN 48) included in the reporting regime
 - Tax positions expected to be litigated
 - “Widely understood” administrative practices

Contents of Proposed Disclosure

- Computation of a maximum tax adjustment (MTA)
 - The MTA for a tax position taken in a tax return is an estimate of the maximum amount of potential United States federal income tax liability associated with the tax year for which the tax position was taken
 - Determination generally made in isolation
 - Valuation and transfer pricing positions

Contents of Proposed Disclosure

- Concise description of the tax position, including information that reasonably can be expected to apprise the IRS of the identity of the tax position and the nature of the uncertainty.
 - The description must include:
 - A statement that the position involves an item of income, gain, loss, deduction, or credit against tax;
 - A statement whether the position involves a determination of the value of any property or right or a computation of basis; and
 - The rationale for the position and the reasons for determining the position is uncertain.

Policy and Operational Issues

Discussion of Policy Considerations

- Is it appropriate to link tax return disclosures to financial accounting concepts?
- Will this type of disclosure impact how a taxpayer evaluates whether to record tax reserves for financial accounting purposes? If so, could this raise public policy concerns?
- Could the proposal impact the relationship between taxpayers and independent accountants?
- Does the proposal diminish the long standing IRS “policy of restraint?”
- Does the proposal move the IRS and taxpayers toward a culture of mutual transparency and enhance a trust based relationship?

PwC Comments on IRS Announcement 2010-9

Summary of Comments

- We support the Service's stated objectives in issuing the UTP proposal

However, we are concerned the UTP proposal raises important policy considerations, as it:

- Diminishes the long-standing "policy of restraint" of the IRS
- Does not promote mutual transparency
- Could negatively impact financial reporting and the relationship between taxpayers and independent auditors
- Raises privilege and work product doctrine issues

To better balance these policy considerations, we recommend the IRS, prior to implementing the UTP proposal, focus on alternative actions which would:

- Enhance taxpayer ability to obtain tax certainty earlier
- Develop a more trust-based and mutually transparent relationship with taxpayers
- Reduce the existing compliance burden on taxpayers

Operational Issues

Common Themes from Comment Letters Regarding Operational Issues

- Disclosure of litigation exceptions
- Disclosure of administrative practice exceptions
- Calculation of Maximum Tax Benefit/Adjustment
- 60 day rule
- Concise description

Additional Questions Raised by the UTP Proposal

- How would the IRS utilize the Schedule UTP?
- What procedural controls can the IRS enact to ensure information reported is not misused?
- What about CAP and CIC taxpayers?
- How would penalty provisions apply?
- Would US states and/or other countries ⁵⁰ follow this initiative?

Taxpayer Considerations

Taxpayer Considerations

In General

- What will the impact be on roles and responsibilities of tax and audit in the company?
- What will the impact be for board members, corporate executives, and corporate tax directors?
- What will the impact be with auditors?
- What additional responsibilities, tasks, documentation, etc. may be required?

Taxpayer Considerations

IRS Announcement 2010-9

Action Items

- Evaluate a taxpayers need to expedite the closing of open examinations and appeals cases for all or any issues
- Assess if expedited certainty should be a priority
- Analyze if currency is critical to a taxpayer
 - If so, consider taking actions to close open/ongoing examinations and appeals cycles. Consider if concession of open audit issues makes sense to get the tax year(s) closed before the new schedule applies.

Taxpayer Considerations

IRS Announcement 2010-9

Financial Accounting Items to Consider Before the UTP Proposal is Implemented

- Revisit financial statement materiality
- Revisit “unit of account”
- Evaluate binary positions
- Create process to manage concise description and associated work product concerns
- Address recurring tax positions

Q&A

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