



The Administration's Tax Proposals Would Disadvantage U.S. Multinationals

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The Obama Administration unveiled on February 1, 2010, a 10-year, \$3.8 trillion budget proposal for the federal government's 2011 fiscal year, which begins October 1, 2010. The budget includes tax initiatives that would impact corporate taxpayers, particularly those that have international operations. It carries over some, but not all, of the international tax proposals that were included in the 2010 budget proposal. The Administration detailed these initiatives in May 2009, and then incorporated them into the work of a White House task force, the President's Economic Recovery Advisory Board (PERAB), headed by Paul Volcker.¹

The tax proposals incorporated in the budget generally reflect the tax priorities President Obama articulated during his campaign and the first year of his presidency—reducing the burdens on small business and lower income taxpayers, and increasing taxes on higher income individuals and corporations, particularly those that operate globally. Importantly, the FY 2011 budget does not include a change in the “check-the-box” entity classification rules. A proposal in last year's budget would have made certain foreign entities ineligible to be treated as “disregarded.” Another important change limits to interest expense last year's proposal to defer deductions associated with foreign-source income.

Administration's International Tax Initiatives Comparison of FY 2011 and FY 2010 Budget Proposals

	FY 2011 Budget 2011-2020	FY 2010 Budget 2011-2019
	Revenue Impact (Billions)	
Reform U.S. international tax system		
Override 1996 "check-the-box" rules		86.5
Defer interest expense deductions related to deferred income	25.6	60.1
Determine the foreign tax credit on a “pooling” basis	32	24.5
Match creditable foreign taxes and associated foreign income	27.4	15.5
Limit shifting of income through intangible property transfers	1.2	2.9
Disallow deductions for excess nontaxed reinsurance premiums paid to affiliates	0.5	
Limit earnings stripping by expatriated entities	3.5	
Repeal “80/20 company” rules	11.5	
Prevent avoidance of dividend withholding taxes	1.2	
Modify tax rules for dual capacity taxpayers	8.6	
Combat under-reporting of income of accounts and entities in offshore jurisdictions	5.4	4.2
Offshore compliance and miscellaneous provisions		16.2
Total revenue impact of international tax proposals	122.2	209.9

The Administration's budget proposes significant changes to the foreign tax credit system. Under a proposal carried over from last year, a U.S. corporation would determine “deemed paid” foreign tax credits on a **con-**

solidated or “pooled” basis taking into account the aggregate foreign taxes and earnings and profits of all of the foreign subsidiaries. The proposal includes broad regulatory authority to implement anti-abuse rules. In 2007, House Ways and Means Committee Chair Charles B. Rangel, (D-NY) included a similar proposal in H.R. 3970, the Tax Reduction and Reform Act of 2007.

Another proposal would defer deductions for **interest** expense that relates to a taxpayer's foreign source income that is not currently subject to U.S. tax. In subsequent years, the deduction for interest expense that has deferred previously would be allowed to the extent the previously deferred foreign-source income becomes subject to U.S. tax. The Administration anticipates that legislative and regulatory changes will be needed to prevent abuse. This proposal is scaled back from last year's version which would have applied to all expenses that related to foreign income not subject to U.S. tax.

Other Significant Proposals

The tax proposals in the Administration budget plan for FY 2011 budget include two other proposals of interest to the business taxpayer. This budget renews a proposal to repeal the last-in-first-out (LIFO) inventory method for tax years beginning after December 31, 2011. Taxpayers would take the resulting increase in gross income into account ratably over 10 tax years (starting with the first tax year beginning after 2011).

The Administration's budget does include a helpful provision that would exclude cell phones and similar telecommunications devices from being considered “listed property,” effective for tax years ending after the date of enactment. This would relieve taxpayers from strict rules for substantiating the business use of cell phones.

The Administration's budget also calls for the extension to December 31, 2011 of various tax provisions that have expired or would otherwise expire before that date. Finally, it would raise taxes on the oil and gas sector by \$39 billion over 10 years.

Conclusion

The U.S. system for taxing the international operations of U.S. multinationals is out of sync with international norms, and the international tax “reforms” included in the Administration's budget for the 2011 fiscal year would make the United States even less competitive as a home for multinational business. Most trading partner countries do not assert worldwide tax jurisdiction—so foreign-based enterprises with which United States companies compete overseas generally do not pay “home country” taxes on “foreign” operating earnings. Twenty-five of the 30 countries represented in the Organization for Economic Cooperation and Development (OECD) have territorial tax systems and significantly lower corporate tax rates. At a time when the U.S. government should provide a tax and business environment that will foster U.S. competitiveness globally, the Administration is taking the opposite course by proposing international tax provisions that focus on perceived abuses. The international tax initiatives included in the budget plan for the 2011 fiscal year would disadvantage American companies relative to their foreign competitors for years to come.

¹ The “Green Book,” which describes the Administration's tax plan can be accessed at <http://www.treasury.gov/offices/tax-policy/library/greenbk10.pdf>