



Martin B. Tittle International Tax Attorney

U.S. INTERNATIONAL TAX OUTLOOKSM

25 October 2007

Vol. 1, No. 9

H.R.3970 – The Rangel Tax Reduction and Reform Act of 2007

Table of Contents

H.R.3970 – The Rangel
Tax Reduction and Reform
Act of 2007 1

PLI Tax Strategies Confer-
ences 3

U.S.-UK Competent
Authority Agreement 4

The Offshore Deferred
Compensation Reform
Act 4

For more information on
these and other interna-
tional tax topics, please
visit my web site at
www.martintittle.com.

You may contact me by
phone at (202) 344-7592
or by email at
mbt@martintittle.com.
Please be very cautious
about the information you
reveal in an initial contact
or inquiry. I have no duty
to keep confidential any
information that is com-
municated to me before
you sign an engagement
agreement.

If you would like to receive
future copies of U.S.
International Tax OutlookSM
by email, please send your
contact information, includ-
ing email address, to
subscribe@martintittle.com.

Ways and Means Chair Charlie Rangel in-
troduced his much-anticipated tax reform
package earlier today. [H.R.3970](#) contains
five proposals of particular interest to inter-
national practitioners. Four of them are in
Title III (Corporate Tax Reform) Subtitle
C – Provisions Related to Foreign Source
Income. The fifth is in Title III, Subtitle H
– Other Provisions.

Following are annotated versions of the de-
scriptions of those proposals that appear in
[the Chairman’s summary of the bill](#). I’m not
including the text of the provisions because
it is not likely that the bill will be enacted
in its present form. If you want to look at
the language in the bill, click on the link for
“H.R.3970” above, and then click on the
links at the top of the first page to jump to
beginning of each of the five sections listed
below.

The revenue impact figures that the Chair-
man’s summary includes at the end of each
description are from a [Joint Committee on
Taxation \(JCT\) estimated revenue impact
table](#) that is labeled “very preliminary.”

Subtitle C, Sec. 3201. Allocation of expenses and taxes on basis of repatriation of foreign income.

“Current law allows United States cor-
porations to defer active business income
that is earned through controlled foreign
corporations. However, these corpora-
tions are allowed to take the deductions
associated with this income into account
on a current basis. This inconsistency
encourages United States corporations to
shift jobs overseas and to finance these

overseas activities at the expense of tax-
payers. The bill would require United
States corporations that defer income
through controlled foreign corpora-
tions to also defer the deductions that
are associated with this income. These
corporations will be able to recognize
these deductions when they repatriate
the deferred income back to the United
States, which is when the deferred in-
come is taxed. The revenue raised from
modifying this aspect of current law will
be invested into reducing the corporate
marginal tax rate, which will encourage
corporations to create jobs here in the
United States. This proposal is estimated
to raise \$106.39 billion over 10 years.”

This provision “splits the difference” with
territorial taxation and could help pave the
way for its adoption. With territoriality, ex-
penses properly allocable to exempt foreign-
source income can never be deducted.

Subtitle C, Sec. 3202. Foreign currency conversion for determination of foreign taxes and foreign corporation’s earnings and profits.

The Chairman’s summary does not even
mention this provision, probably because its
revenue impact is almost nil (an additional
\$2 million over 10 years). Sec. 3202 makes
minor changes to IRC Secs. 986(b)(2) and
(c)(1). Those sections address translation of
functional currency foreign corporation E&P
into U.S. dollars and taxation of foreign cur-
rency gains and losses that occur due to the
differences between deemed and actual dis-
tribution dates.



The current Sec. 986(b)(2) requires translation “at the appropriate exchange rate” on a “when distributed, deemed distributed, or otherwise taken into account under this subtitle” basis. Sec. 3202 changes the phrase “appropriate exchange rate” to “the average exchange rate for the taxable year in which earned” to negate the benefit of any exchange rate planning a foreign corporation or its shareholders might engage in.

The change in Sec. 986(c)(1) conforms the calculations required by that paragraph to the exchange rate standard in the new Sec. 986(b)(2).

Subtitle C, Sec. 3203. Repeal of worldwide allocation of interest.

“The bill would repeal the current-law provision that allowed United States corporations to elect special interest allocation rules that reduce the amount of interest expense allocated to foreign assets. This provision was enacted in 2004 but it has yet to take effect. This proposal is estimated to raise \$26.20 billion over 10 years.”

Worldwide interest expense allocation was a feature of former W&M Chair Bill Thomas’s baby, the [American Jobs Creation Act of 2004](#). (See AJCA Sec. 401, which created a new IRC Sec. 864(f)). If not repealed, it would be effective for tax years beginning after Dec. 31, 2008. [Some legislative materials associated with the AJCA](#) are available on the home page of my web site.

Subtitle C, Sec. 3204. Limitation on treaty benefit for certain deductible payments.

“The bill would prevent foreign multinational corporations incorporated in tax haven countries from avoiding tax on income earned in the United States by routing their income through structures in which a United States subsidiary of

the foreign multinational corporation makes a deductible payment to a country with which the United States has a tax treaty before ultimately repatriating these earnings in the tax haven country. This provision has been modified from a previous version approved by the House of Representatives as part of H.R. 2419, *The Farm, Nutrition and Bioenergy Act*, by a vote of 231 to 191 (with 19 Republicans joining 212 Democrats in support) to ensure that foreign multinational corporations incorporated in treaty partner countries will not be affected by this provision. This proposal is estimated to raise approximately \$6.40 billion over 10 years.”

The substantive difference between Sec. 3204 and [H.R. 2419](#), Title XII, Sec. 12001 lies in the new IRC Sec. 894(d)(1) created by paragraph (a) of both bills.

In H.R. 2419, new Sec. 894(d)(1) requires that the flat 30 percent tax imposed on U.S.-source fixed or determinable, annual or periodical (FDAP) income of non-resident alien individuals and foreign corporations and collected via IRC Chapter 3 withholding “shall not be less than the amount which would be imposed if the payment were made directly to the foreign parent corporation (taking into account any income tax treaty between the United States and the country in which the foreign parent corporation is resident).”

In Sec. 3204, the language quoted in the last paragraph is replaced with “may not be reduced under any treaty of the United States unless such withholding tax would be reduced under a treaty of the United States if such payment were made directly to the foreign parent corporation.” That is substantively different from the H.R. 2419 language. Under H.R. 2419, the U.S. withholding agent would compare the withholding required for a payment and the withholding required if that payment were made to the recipient’s foreign parent, and withhold the greater



of the two amounts. Under Sec. 3204, the withholding agent looks only to whether a reduction in withholding tax is authorized under a treaty with the country where the parent is located. If so, then the reduction in withholding tax authorized by the treaty with the country where the subsidiary is located will be given effect, *regardless of whether that reduction is more or less than the reduction that would be made if the payment were made directly to the parent.*

The effect of the new language in Sec. 3204, as noted in the Chairman's description, is to give effect to favorable withholding reductions as long as the country where the parent is located is a U.S. treaty partner. For parents in countries like Brazil that have no treaty with the U.S., the treaty rate of the subsidiary's country will be overridden, and the full 30 percent FDAP withholding will be applied.

Both Senate Finance Chair Max Baucus, D-Montana, and Ranking SFC Member Chuck Grassley, R-Iowa, had denounced Sec. 12001. Sen. Grassley almost made his opposition a mantra during the August recess, mentioning it in at least three press conferences. Sen. Baucus stated on Aug. 2 that Sec. 12001 would not be in the SFC version of the Farm Bill. The concerns of both

were that Sec. 12001 would abrogate treaties and perhaps provoke retaliation. Sec. 3204 retains a greatly curtailed version of that abrogation and turns it into a "stick" that parents in non-treaty countries can use to "motivate" their governments' trade negotiators. Whether that will be enough to satisfy Sec. 12001's opponents remains to be seen.

Subtitle H, Sec. 3207. Termination of special rules for domestic international sales corporation [DISC] provisions.

"The bill would terminate the domestic international sales corporation provisions and would make a technical correction clarifying that dividends received on or after September 29, 2006 from domestic international sales corporations do not qualify as qualified dividend income. This proposal is estimated to raise \$881 million over 10 years."

The September 29, 2006 date looks like an oversight. According to Sec. 3207, IRC Sec. 992(b) elections that are in effect for a corporation's last taxable year beginning in 2007 will be terminated effective the beginning of the next tax year. Further, no new Sec. 992(b) elections will be permitted for taxable years beginning after Dec. 31, 2007.

PLI Tax Strategies Conferences

The Practicing Law Institute is sponsoring a three-stop, traveling Tax Strategies conference that debuted in Chicago two weeks ago, is currently in progress in New York, and will appear in Los Angeles in mid-November. Two colleagues and I co-authored a contribution for the conference handbook on "Planning for Outbound Transfers Under the Section 367(a) and 367(b) Regulations, Including Expatriations."

In the opening conference in Chicago, Assistant Treasury Secretary for Tax Policy Eric

Solomon reassured attendees that his office had not forgotten about territorial taxation as one possible way to improve the global competitiveness of U.S. business. The subject is in the discussion phase, he said, with two of the big issues being the benefit of "penalty-free" repatriation (no residual U.S. tax when offshore funds are brought back into the U.S.) and the countervailing drawback of currently deductible expenses that would become nondeductible if properly allocated to exempt, offshore income.



My alternative to territorial taxation, [foreign tax credit for value added taxes](#), is still off the radar screen, possibly because it would increase the complexity of the Internal Revenue Code and possibly because its effect on particular industries is still in dispute.

Also in Chicago, IRS Associate Chief Counsel (International) Steve Musher mentioned several international projects that are in progress, including regulations under IRC Secs. 367(a)(5) and (d), finalization of guidance under Sec. 7874 regarding corporate inversions, and formalization in regulations of the two Killer B notices. (Information and links regarding the Killer B notices and the underlying issue they address is on the home page of my web site in the [June 7](#) and

[March 9](#) commentary entries.) The 367(d) project was already on the table when Acting Treasury International Tax Counsel John Harrington spoke to the ABA Tax Section meeting last May.

At the New York conference, which was still in progress when this text was written, Deputy Assistant Secretary for Tax Policy Karen Sowell said the government is trying to decide whether to issue regulations addressing an international issue in Treas. Reg. Sec. 1.338-9. The issue involves stock purchases of a foreign target that are treated as asset transfers.

More to follow as the PLI road show continues.

[U.S.-UK Competent Authority Agreement](#)

The U.S. and UK competent authorities have decided that the phrase “first notification of the action resulting in taxation not in accordance with the Convention” in Art. 26(1) of the 2001 U.S.-UK tax treaty shall be interpreted as referring to

“the date when all domestic remedies have been exhausted. In the United Kingdom, this will be either the date of issue of a statutory notice required to conclude an assessment and/or any related appeal procedures for the period of assessment in question, or a letter of acceptance by an officer of the Board of

HM Revenue & Customs to settlement terms for the period in question. In the United States, this will be the date of the later of: (1) an assessment pursuant to a notice of proposed adjustment or a statutory notice of deficiency; (2) when a closing agreement is accepted by the Secretary of the Treasury or his delegate; or (3) if the taxpayer is a party in an action in a US court regarding a redetermination of tax liability or requesting a refund of tax, when such action is finally resolved, including any appeal.”

The Offshore Deferred Compensation Reform Act

On Oct. 18, Sen. John Kerry, D-Massachusetts, and Rep. Rahm Emanuel, D-Illinois, introduced S.2199 and [H.R.3923](#), The Offshore Deferred Compensation Reform Act. These bills would make “compensation which is deferred under a nonqualified deferred compensation plan (within the meaning of section 409A(d)) of a nonqualified foreign corporation [] includible in gross income for purposes of this chapter [Chapter

1 of the IRC] when there is no substantial risk of forfeiture of the rights to such amount.”

Here is rationale for the bills: Non-qualified deferred compensation (NQDC) is permitted now in unlimited amounts both in the U.S. and offshore. No deduction is available for U.S. NQDC until it is paid. Assuming that the employer has to make some provision



for future payment, the no-deduction rule discourages NQDC. However, if an offshore company is located in a jurisdiction that does not charge income tax, the “limitation on deductibility” issue effectively disappears. That benefit provides an incentive for companies to be formed offshore, and it provides a benefit to employees of those companies that the employees would likely not receive if the companies were located in the U.S. These bills, according to their sponsors, level the playing field for employees of U.S. companies by eliminating the advantage of

locating offshore.

The initial workaround for the limitation imposed by the new bills is obvious: create a substantial risk of forfeiture. Will that work? Probably not unless the risk is very real, in which case the employees would not accept it. I would imagine the next effort to get around the limitation would involve allowing the employees to become owners by buying stock that would have to be offered back to the company before it could be sold elsewhere.

This newsletter is published by Martin B. Tittle to provide a commentary on current developments for clients and friends. It is intended to be informational and does not constitute legal advice regarding any specific situation. Pursuant to Circular 230, you should note that any federal tax advice contained herein is not intended or written to be used, and cannot be used, for purposes of (i) avoiding penalties under the Internal Revenue Code, or (ii) promoting, marketing or recommending to another party any transaction or tax-related matter addressed herein. This newsletter may also be considered attorney advertising under the court rules of certain jurisdictions.

Permission is granted to reprint the newsletter as long as it is reprinted in its entirety, including my name, photo, and contact information. If you want to extract individual articles, contact me for permission first, even if you plan to provide attribution and a notice regarding my copyright claim.