Legislative Proposal:

House Ways and Means Committee Discussion Draft and International Tax Planning in the Post Election Environment.

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Agenda

- Discussion Draft: Recent Developments
- Ways and Means Territorial Discussion Draft
- Discussion Draft Model
- Takeaways
- Questions

Discussion Draft: Camp Proposal and Obama Options

November Election Results

	Old Congress:	New Congress:
Republican	240	233
Democrat	190	190
Vacant/Undecided	5	10

	Old Senate:	New Senate:
Republican	47	45
Democrat	53	52
Vacant/Undecided		3

Outlook for Lame Duck Session

High Probability

Tax Extenders

AMT Fix

Sequestering Delay

Bush Middle Class Tax Cuts

All Bush Tax Cuts

Debt Ceiling

Tax Reform

Payroll Tax Extension

Low Probability

Setting the Stage for Tax Reform

- Tax reform as the way to solve the Rubik's Cube problem of higher revenues without higher rates
- Instructions / expedited process as part of year-end 2012 bill?
- Key pieces are out there for action before the 2014 election season heats up (e.g., Camp territorial draft)
- Consensus emerging on key elements
- Q: Will we see drafts / white papers from other key players, such as the Senate Finance Committee or the White House?

Elements of the Fiscal Cliff

- Expired and Expiring Business and Individual Tax Provisions:
    - Tax rates on individual income, marriage penalty, and expanded child credit;
    - Estate and gift tax parameters;
    - Top tax rates on dividends and long-term capital gains;
    - Payroll tax relief;
    - AMT patch; and
    - Temporary business and individual provisions, including R&D credit, Subpart F and CFC look-through

- **Tax Increases Effective in 2013: On earned and unearned income, enacted as part of health reform**
- **The sequester (on both defense and non-defense spending), enacted in 2011**
- **Expanded Unemployment Benefits**
- **Medicare "doc fix"**
- **Farm Bill and Postal Service**
- **Another Debt Limit Increase?**

Discussion Draft: Camp Proposal

On October 26, 2011, Chairman Dave Camp (R-Mich.) of the Ways and Means Committee (the "Committee") released a discussion draft of the Tax Reform Act of 2011, a bill that would reduce the top corporate tax rate to 25% and dramatically rewrite the rules for taxing the foreign income of U.S. multinationals (the "discussion draft").

The discussion draft was accompanied by a technical explanation of its provisions.

The discussion draft reserves space for additional tax reform proposals related to individuals and to corporate tax generally, including presumably provisions that expand the business tax base.

No revenue estimate was released along with the discussion draft.

Ways and Means Territorial Discussion Draft

Discussion Draft Overview

Proposal	Description
95% DRD	• Generally provides U.S. corporate shareholders a 95% DRD for foreign source dividends received from CFCs • Foreign branches and electing 10/50 companies deemed CFCs • Generally, 1.25% U.S. rate on qualifying dividends • (Stock gain also 95% exempt in certain instances)
FTC	• §§902 and 909 repealed • §960 retained in modified form (single 904 basket; modified deductions)
Subpart F	• Retains and expands existing rules. *See* next slide • §§956, 959, and 961 repealed • Repatriated subpart F income generally subject to 26.25% U.S. rate
Interest Deductions	• Corporate U.S. shareholders of a WW affiliated group must reduce interest deductions by the lesser of haircuts imposed by either: (i) relative leverage test or (ii) percentage-of-adjusted-taxable-income test. *See* next slides
Transition	• Accumulated deferred income treated as subpart F income of CFCs & 10/50s last TY of CFCs & 10/50s ending before 2013 • 85% DRD, but remaining 15% can be sheltered by NOLs/excess FTCs

Discussion Draft: Subpart F

Proposal	Description
Option A	• Obama Administration's proposal to create new category of foreign base company income called "foreign base company excess intangible income" that would tax currently "excess returns" associated with transfers of intangibles offshore
Option B	• Creates a new category of subpart F income called "low-taxed cross-border income," which would be *any income* of a CFC unless it is derived in the CFC's home country, or is subject to a foreign effective tax rate exceeding 10%
Option C	• <u>Bitter</u>: Creates a new category of foreign base company income called "foreign base company intangible income" (FBCII), which is income "properly attributable" to IP unless subject to a 13.5% or lower ETR. • <u>Sweet</u>: Creates new deduction equal to sum of 40% of the "foreign intangible income" of the U.S. shareholder, and 40% of the lesser of (a) FBCII inclusion from its CFCs or (b) FBCII based only on CFCs' foreign intangible income

Discussion Draft: Interest Deductions

Proposal	Description
Interest Deductions	• General: Corporate U.S. shareholders of a WW affiliated group must reduce interest deductions by the lesser of reduction under (i) relative leverage test or (ii) percentage-of-adjusted-taxable-income test • Relative leverage test: Disallows interest expense attributable to the differential between the U.S. affiliated group's debt-to-equity versus the worldwide affiliated group's debt-to-equity ratio • Percentage-of adjusted-taxable-income test: Disallows domestic corporation's interest expense in excess of [?] percentage of its adjusted taxable income • Unspecified percentage – however, §163(j) is 50%; Obama Administration proposal would reduce to 25% • Coordination with §163(j): No double disallowance under both provisions • Carryfoward of deductions: Indefinite carryforward of disallowed deductions (possible book impact)

Discuss Draft Model

Discussion Draft Tax Return

Option A *Choose which Expansion of Subpart F Option to Apply (A, B or C)*

Estimated Post-effective Date Tax Return Computation[1]

Line		Discussion Draft Tax Return	Current Tax Return	Variance
	<u>Income</u>			
1	Gross income (from Form 1120)	85,000,000		
2	Less foreign dividends from CFCs & 10/50 corporations[2]	(5,000,000)		
3	Less qualifying stock gains[6]	(1,500,000)		
4	Less foreign branch income or loss[3]	(4,000,000)		
5	Plus foreign income from Sch A-Exempt Foreign Income	650,000		
6	*Optional*: incremental subpart F income from sunset provisions (including §78 gross up)[4]	2,000,000		
7	Additional subpart F income under discussion draft from Sch B-Expansion of Subpart F	9,422,449		
8	Total gross income	86,572,449	85,000,000	1,572,449
	<u>Deductions</u>			
9	Deductions other than interest expense (from Form 1120)[5]	(20,000,000)		
10	Interest expense allowable from Sch C-Interest Disallowance	(6,000,000)		
11	Option C Only: Foreign intangible income deduction from Sch B-Expansion of Subpart F	-		
12	Total deductions	(26,000,000)	(30,000,000)	4,000,000
13	Adjustments for other base broadening provisions[7]	-		
14	**Taxable income**	**60,572,449**	55,000,000	5,572,449
15	Corporate tax rate[8]	25%		
16	Tax before FTC and other tax credits	15,143,112	5,247,200	9,895,912
17	Other tax credits[5]	(10,000)		
18	FTC from Sch D-FTC	(5,545,796)		
19	*Optional*: §960 FTCs related to incremental subpart F income from sunset provisions[4]	(500,000)		
20	Discussion draft tax before transition tax	9,087,316		
21	Transition tax from Sch E-Transition Tax	527,500		
22	**US federal income tax**	**9,614,816**	3,100,000	6,514,816

Sch A-Exempt Foreign Income

Taxation of Offshore Income

Line		
1	Foreign dividends from CFCs & 10/50 corporations[1]	5,000,000
2	Foreign branch income[2]	4,000,000
3	Qualifying stock gains[5]	1,500,000
4	Distributions of "PTI"[3]	2,500,000
5	Foreign dividend income	13,000,000
6	DRD rate	95%
7	DRD[6]	12,350,000
8	Foreign income subject to US federal income tax[4]	650,000

Sch B-Expansion of Subpart F (Option A)

Option A - Excess Return on Covered Intangibles

Line	Foreign Base Company Excess Intangible Income (FBCEII)	
1	Non-same country income associated with covered intangibles[1]	60,000,000
2	Directly allocable expenses (not interest or taxes)[2]	(25,000,000)
3	Net income	35,000,000
4	Foreign income taxes attributable to the net income	4,500,000
5	ETR	12.86%
6	150% of directly allocable expenses (not interest or taxes)	(37,500,000)
7	FBCEII (before ETR exception)	22,500,000
8	Applicable percentage[3]	57.14%
9	FBCEII	9,642,857
10	Other §954(b)(5) deductions (excluding foreign income taxes)[4]	800,000
11	Prorated other §954(b)(5) deductions (excluding foreign income taxes)	(220,408)
12	Prorated foreign income taxes properly attributable	(1,239,796)
13	Net FBCEII	8,182,653
14	§960 FTCs & §78 gross up[5]	1,239,796
15	Increase in taxable income (Option A)	9,422,449

Sch B-Expansion of Subpart F (Option B)

Option B - Low-Taxed Cross-Border Income

	Low-Taxed Cross-Border Foreign Income (LTCBFI)	
16	Total non-home country income[6]	100,000,000
17	Allocable non-home country deductions (excluding foreign income taxes)[6]	(20,000,000)
18	Net income before foreign income taxes	80,000,000
19	Foreign income taxes attributable to the net income	(7,000,000)
20	Net income after foreign income taxes	73,000,000
21	ETR (except home-country)[7]	8.75%
22	LTCBFI (>10% ETR threshold)	73,000,000
23	§960 FTCs & §78 gross up[5]	7,000,000
24	Increase in taxable income (Option B)	80,000,000

Sch B-Expansion of Subpart F (Option C)

Option C - Foreign Base Company Intangible Income & Foreign Intangible Income Deduction

	<u>Foreign Base Company Intangible Income (FBCII)</u>			
25	Intangible income[8]			80,000,000
26	§954(b)(5) deductions (excluding foreign income taxes)			(10,000,000)
27	Net income before foreign income taxes			70,000,000
28	Foreign income taxes attributable to net income			(8,000,000)
29	FBCII			62,000,000
30	ETR			11.43%
31	FBCII after high-tax exception (13.5% ETR threshold)			62,000,000
32	§960 FTCs & §78 gross up[5]			8,000,000
33	Increase in taxable income (Option C)			70,000,000
	<u>Foreign intangible income deduction</u>			
34	Domestic corporation's foreign intangible income[9]			5,000,000
	Plus the lesser of the §951 inclusion from the CFC's:			
35	FBCII after high-tax exception		62,000,000	
	Modified FBCII (using only foreign intangible income)[10]			
36	Foreign intangible income[9]	70,000,000		
37	§954(b)(5) deductions (excluding foreign income taxes)[11]	(8,750,000)		
38	Net income before foreign income taxes	61,250,000		
39	Foreign income taxes attributable to net income[11]	(7,000,000)		
40	Modified FBCII	54,250,000		
41	ETR	11.43%		
42	Modified FBCII after high-tax exception (13.5% ETR threshold)		54,250,000	54,250,000
43	Sum for foreign intangible income deduction			59,250,000
44	Foreign intangible income deduction rate (40%)			40%
45	Foreign intangible income deduction			23,700,000

Sch C-Interest Disallowance

Interest Disallowance

Line		
	Relative Leverage Test	
1	US net interest expense[1]	10,000,000
2	Worldwide indebtedness[2]	20,000,000
3	Worldwide equity[3]	400,000,000
4	Worldwide debt-to-equity ratio	5.00%
5	Domestic indebtedness[4]	100,000,000
6	Domestic equity[4]	200,000,000
7	Excess domestic indebtedness	90,000,000
8	Debt-to-equity differential percentage	90%
9	Net interest disallowed under relative leverage test	9,000,000
	50% *Choose an Estimated Percentage of Adjusted Taxable Income to Apply (50% or 25%)*	
	Percentage of Adjusted Taxable Income Test	
10	US net interest expense[1]	10,000,000
11	Adjusted taxable income[5]	12,000,000
12	[X]% of adjusted taxable income[6]	6,000,000
13	Net interest disallowed under percentage of adjusted taxable income test	4,000,000
14	Interest disallowed (lesser of two tests)[7]	4,000,000
15	Interest expense allowed	6,000,000

Sch D-FTCs

Foreign Tax Credits

Line		Discussion Draft Tax Return	Actual Tax Return	Variance
	Foreign source income[1]			
1	Subpart F income (excluding expansion of subpart F income under discussion draft)	3,000,000		
2	Expansion subpart F income under discussion draft (Option A, B or C)	9,422,449		
3	Interest	4,000,000		
4	Rents	100,000		
5	Royalties	15,000,000		
6	Portfolio dividends	500,000		
7	§863(b) foreign source income	8,000,000		
8	Other foreign source income	-		
9	§904 gross foreign source income	40,022,449		
10	Directly allocable expenses[2]	(7,500,000)		
11	Net foreign source income	32,522,449	40,000,000	(7,477,551)
12	Corporate tax rate	25%	35%	-10%
13	FTC limit	8,130,612	14,000,000	(5,869,388)
	Foreign tax credits[3]			
14	Current year foreign income taxes attributable to subpart F income (excluding expansion)	900,000		
15	Expansion subpart F income FTCs under discussion draft (Option A, B or C)	1,239,796		
16	Withholding tax on interest	400,000		
17	Withholding tax on rents	5,000		
18	Withholding tax on royalties	3,000,000		
19	Withholding tax on portfolio dividends	1,000		
20	Other foreign tax credits	-		
21	Foreign tax credit carryforwards (if any)[4]	-		
22	Total FTCs	5,545,796	18,000,000	(12,454,204)
23	**Allowable FTCs**	**5,545,796**	14,000,000	(8,454,204)

Sch E-Transition Tax

Pre-Effective Date Earnings

Line		
1	Accumulated deferred foreign income[1]	1,000,000,000
2	Deduction rate (85%)	85%
3	Transition income	150,000,000
4	§902 taxes with respect to accumulated deferred foreign income	250,000,000
5	Withholding taxes on distributions	50,000,000
6	Applicable FTCs & §78 gross up	45,000,000
7	Grossed-up transition income (before NOLs)	195,000,000
8	NOLs[2]	(20,000,000)
9	Net grossed-up transition income (after NOLs)	175,000,000
10	Corporate tax rate	35%
11	US federal income tax	61,250,000
12	Less applicable FTCs[3]	(45,000,000)
13	Less other tax credits[2]	(30,000)
14	Less excess FTCs carryforwards[2]	(12,000,000)
15	Estimated US federal income tax for transtition[4]	4,220,000
16	1/8 transition tax liability[5]	527,500

Takeaways

Key Takeaways

- Discussion draft is still a work in process
- *Changes are likely*
- Identify key policy components of your tax position
- Measure the impact of specific proposals: cash vs. book, comparative analysis
- Establish a communications program
- Keep abreast of new developments
- You should be modeling the impact on your ETR and current tax structure—look to create flexibility.

Questions?

Deloitte.