Domestic Tax Reform Proposals

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Domestic tax reform themes

1. Lower tax rates with revenue neutrality
   - Lower the corporate tax rate; perhaps also individual rate
   - Cut back or eliminate *tax expenditures* (tax preferences)
   - Tax distribution / equity
2. Entity structure and differences
3. Appropriate tax incentives for economy
4. Administrative reforms

What do these themes mean?

1. Lower tax rates with revenue neutrality

- Review all tax preferences (tax expenditures)
- Separate between corporate and individual
- Issues:
  - What is a tax expenditure?
    - Cash method of accounting?
    - Imputed value of owner-occupied housing?
  - Is it for individuals or corporations?
    - EX – exclusion for employer provided meals and lodging
  - How important is it – how to analyze?

Possibilities on how to broaden the base

Approach to reduce tax expenditures	Example
Outright repeal	TRA'86 and personal interest expense
Dollar cap	Mortgage interest deduction ($1 million acquisition debt limit + $100K equity limit)
Percent limit based on income	Medical expenses limited to amount over 10% of AGI Miscellaneous itemized deductions limited to excess over 2% of AGI
Alternative calculation with fewer tax preferences	AMT (Alternative Minimum Tax)
Phase-out as income rises	Itemized deductions, personal exemptions, others
Cap the tax benefit	Pres. Obama's proposals to cap itemized deductions and some deductions and exclusions of high income individuals at 28%
Surtax	President Obama's "Buffet rule" (not really a cut back on preferences though)

2. Entity structure and differences

Considerations:

- Double taxation
  - Corporate integration?
- Large passthroughs taxed differently than large C corps
- Differences between S and partnerships
  - EX – no SE tax on share of S corp income
- Over 50% of businesses are taxed at individual level
  - Inequity of only lowering the C corp tax rate

3. Appropriate tax incentives for economy

Possibilities:

- Startups
- Small businesses
- Hiring certain categories of workers
- Innovation
- R&D
- International competitiveness
- Alternative energy
- Higher education
- Savings including retirement
- Community renewal

4. Administrative reforms

- Simplify compliance
  - Have IRS prepare some individual forms
  - Change due dates
  - Repeal AMT and some phase-outs
  - Standardize some definitions
- Reduce the tax gap
  - Increase information reporting
  - Deny privileges to non-filers or delinquents
- Reduce identity theft
- Regulate return preparers
- Remove “deadwood” provisions
- Update taxpayer bill of rights

Tax reforms not seriously on the table at this time

- Switch to a consumption tax
  - Flat tax
  - VAT
- Add-on tax
  - Carbon tax
  - Financial transactions tax
  - VAT
  - Perhaps later for deficit reduction

Sources of Proposals

- Congressman Camp
- Senator Baucus
- Senator Wyden
- Others in Congress
  - Legislative proposals and ideas
  - Suggestions, including SFC “blank slate project”
- President Obama
- IRS National Taxpayer Advocate
- Various interest groups, including trade associations and tax professionals

Congressman Camp

and the House Ways and Means Committee

Hearings of 113rd Congress

COMMITTEE ON WAYS AND MEANS

- 6/13/13 - Tax Reform: Tax Havens, Base Erosion and Profit-Shifting
- 6/5/13 - How Social Security Protects the Benefits of Those Who Cannot Protect Themselves
- 5/15/13 - Small Business and Pass-Through Entity Tax Reform Discussion Draft
- 4/26/13 - Challenges Facing the Next Commissioner of Social Security
- 4/25/13 - Tax Reform and Residential Real Estate
- 3/20/13 - Ways and Means Financial Products Tax Reform Discussion Draft
- 3/19/13 - Tax Reform and Tax Provisions Affecting State and Local Governments
- 2/14/13 - Tax Reform and Charitable Contributions

Hearings of 112nd Congress

COMMITTEE ON WAYS AND MEANS

- 9/20/12 - Tax Reform and the Tax Treatment of Capital Gains (w/ SFC)
- 7/19/12 - Tax Reform and the U.S. Manufacturing Sector
- 6/27/12 - How Welfare and Tax Benefits Can Discourage Work
- 6/8/12 - Framework for Evaluating Certain Expiring Tax Provisions
- 3/7/12 - Treatment of Closely-Held Businesses in the Context of Tax Reform
- 2/8/12 - Interaction of Tax and Financial Accounting on Tax Reform
- 12/6/11 - Tax Reform and the Tax Treatment of Financial Product (w/ SFC)
- 11/17/11 - International Tax Reform Discussion Draft
- 9/21/11 - Economic Models Available to the Joint Committee on Taxation for Analyzing Tax Reform Proposals
- 7/26/11 - Tax Reform and Consumption-Based Tax Systems
- 7/13/11 - Tax Reform and the Tax Treatment of Debt and Equity (w/ SFC)

Hearings of 112nd Congress

COMMITTEE ON WAYS AND MEANS

- 6/23/11 - Tax Reform and Foreign Investment in the United States
- 6/2/11 - How Business Tax Reform Can Encourage Job Creation
- 5/24/11 - How Other Countries Have Used Tax Reform to Help Their Companies Compete in the Global Market and Create Jobs
- 5/12/11 - Need for Comprehensive Tax Reform to Help American Companies Compete in the Global Market and Create Jobs for American Workers
- 4/13/11 - Tax Code's Burdens on Individuals and Families Demonstrate the Need for Comprehensive Tax Reform
- 3/3/11 - Small Business and Tax Reform
- 1/20/11 - First in a Series of Hearings on Fundamental Tax Reform

Camp Discussion Drafts

- Territorial System (2011)
- Financial Products Reform (2013)
- Small Business Reform (2013)

- Legislative language
- For discussion

http://waysandmeans.house.gov/taxreform/

Tax Reform Working Groups

- 11 groups formed in February 2013
- JCT issued 569 page report in May 2013 (JCS-3-13)

Charitable/Exempt Organizations
Debt, Equity and Capital
Education and Family Benefits
Energy
Financial Services
Income and Tax Distribution
International
Manufacturing
Pensions/Retirement
Real Estate
Small Business/Pass Throughs

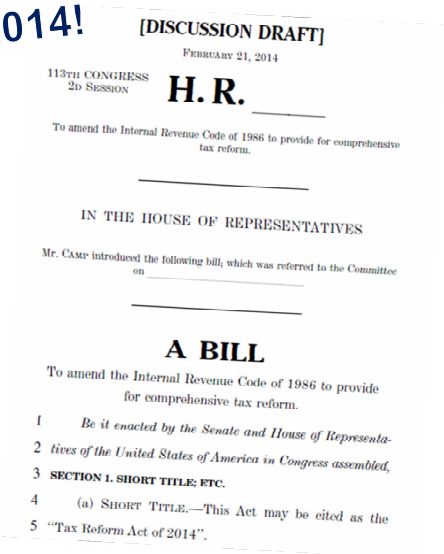
www.cob.sjsu.edu/nellen_a/txrefupd.html

http://tax.house.gov/

The Tax Reform Act of 2014!

This will …

- Make the system simpler and fairer!
- Create 1.8 million private sector jobs!
- Grow the economy!
- Put money in your pockets!
- Increase take-home pay!
- Close loopholes!
- Make the tax law more accountable!
- Lower double taxation!



[DISCUSSION DRAFT]

FEBRUARY 21, 2014

113TH CONGRESS
2D SESSION

H. R. _____

To amend the Internal Revenue Code of 1986 to provide for comprehensive tax reform.

IN THE HOUSE OF REPRESENTATIVES

MR. CAMP introduced the following bill, which was referred to the Committee on _____

A BILL

To amend the Internal Revenue Code of 1986 to provide for comprehensive tax reform.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; ETC.

(a) SHORT TITLE.—This Act may be cited as the "Tax Reform Act of 2014".

Camp Releases Tax Reform Plan to Strengthen the Economy and Make the Tax Code Simpler, Fairer and Flatter

Plan Closes Loopholes to Lower Tax Rates for Families and Job Creators

Washington, Feb 26 | 0 comments

Washington, DC - Today, Ways and Means Committee Chairman Dave Camp (R-MI) released draft legislation to fix America's broken tax code by lowering tax rates while making the code simpler and fairer for families and job creators. Camp's latest draft, the **"Tax Reform Act of 2014,"** spurs stronger economic growth, greater job creation and puts more money in the pockets of hardworking taxpayers.

Based on analysis by the independent, non-partisan Joint Committee on Taxation (JCT), without increasing the budget deficit, the Tax Reform Act of 2014:

- Creates up to **1.8 million new private sector jobs.**
- Allows roughly **95 percent of filers to get the lowest possible tax rate by simply claiming the standard deduction** (no more need to itemize and track receipts).
- Strengthens the economy and **increases Gross Domestic Product (GDP) by up to $3.4 trillion** (the equivalent of 20 percent of today's economy).

Based on calculations using data provided by JCT, **the average middle-class family of four could have an extra $1,300 per year in its pocket** from the combination of lower tax rates in the plan and higher wages due to a stronger economy.

Discussing the need to fix America's broken tax code, Camp said, "It is no secret that Americans are struggling. Far too many families haven't seen a pay raise in years. Many have lost hope and stopped looking for a job. And too many kids coming out of college are buried under a mountain of debt and have few prospects for a good-paying career. We've already lost a decade, and before we lose a generation

http://waysandmeans.house.gov/news/documentsingle.aspx?DocumentID=370987

Who pays? JCT distributional analysis for 2015

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Average Tax Rate (4)	
							Present Law	Proposal
	Millions	Percent	Billions	Percent	Billions	Percent	Percent	Percent
Less than $10,000	$102	1.5%	$6.8	0.2%	$6.9	0.2%	8.2%	8.3%
$10,000 to $20,000	$62	1.3%	$4.8	0.2%	$4.9	0.2%	1.5%	1.5%
$20,000 to $30,000	-$1,602	-5.1%	$31.6	1.1%	$30.0	1.1%	5.7%	5.4%
$30,000 to $40,000	-$2,519	-4.6%	$54.9	1.9%	$52.4	1.9%	9.3%	8.9%
$40,000 to $50,000	-$7,842	-8.8%	$88.8	3.1%	$80.9	2.9%	12.7%	11.6%
$50,000 to $75,000	-$7,950	-3.2%	$247.8	8.7%	$239.8	8.5%	15.2%	14.7%
$75,000 to $100,000	-$15,991	-5.6%	$283.1	10.0%	$267.1	9.5%	17.8%	16.8%
$100,000 to $200,000	-$2,504	-0.3%	$820.8	28.9%	$818.3	29.2%	22.1%	22.0%
$200,000 to $500,000	$1,149	0.2%	$553.8	19.5%	$555.0	19.8%	27.1%	27.2%
$500,000 to $1,000,000	$2,505	1.3%	$194.4	6.9%	$196.9	7.0%	30.9%	31.1%
$1,000,000 and over	$3,462	0.6%	$550.2	19.4%	$553.6	19.7%	33.0%	32.9%
Total, All Taxpayers	**-$31,126**	**-1.1%**	**$2,836.9**	**100.0%**	**$2,805.8**	**100.0%**	**21.0%**	**20.7%**

(3) Federal taxes are equal to individual income tax (including the outlay portion of refundable credits), employment tax (attributed to employees), excise taxes (attributed to consumers), and corporate income taxes. The estimates of Federal taxes are preliminary and subject to change.
Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
Does not include indirect effects.

TRA 2014 broad categories (# changes)

I. Tax reform for individuals (78)
II. AMT repeal (2)
III. Business tax reform (169)
IV. Participation exemption system for the taxation of foreign income (16)
V. Tax exempt entities (20)
VI. Tax administration and compliance (25)
VII. Excise taxes (5)
VIII. Deadwood and technical provisions (85)

Selected individual provisions

- 10% and 25% rate + 10% surtax if taxable income > $450,000 (MFJ)
  - Surtax n/a to qualified domestic manufacturing income (25% max rate); phased in over 3 years.
  - Some tax preferences limited to 25% benefit.
- Same rate for capital gains and dividends
  - 40% exclusion
- Repeal head-of-household filing status

Selected individual provisions - more

- Increase standard deduction
  - Today – 33% of filers itemize
  - Estimated under TRA 2014 – 5% would itemize
- Repeal personal exemption – instead:
  - Larger standard deduction
  - Expanded child and dependent tax credit
- Expand child and dependent tax credit
  - Child credit $1,500, under age 18
  - $500 for non-child dependents
  - Index for inflation
  - High phase-out range
  - Partially refundable
- Repeal dependent care credit

More - individual

- Consolidate education provisions
  - Keep a reformed American Opportunity Tax Credit
  - Repeal employer-provided educational assistance exclusion
- Repeal most credits
- EITC – modify to refund employment taxes
  - HWM analysis – *"Exempting a portion of wages from payroll tax would represent a tax cut, whereas the current EITC constitutes government spending."*
- Charitable contributions
  - Deduct if pay by April 15 of next year
  - Only deduct amount > 2% AGI
  - Donation = to adj basis (not FMV), with exceptions

And more - individual

- Only deduct state and local taxes for carrying on a trade or business or producing income
- No deduction for
  - Personal casualty or theft losses
  - Medical expenses
  - Moving expenses
  - Miscellaneous itemized deductions
  - Alimony (and not taxable to recipient)

Individuals - homes

- Mortgage interest deduction
  - Gradually reduce to AI of $500,000
  - Phase out home equity rule
  - But not for existing debt
  - No deduction for new equity loans
- Gain exclusion on sale of principal residence
  - Own and use 5 of 8 years
  - Use once every 5 years
  - Phase out exclusion if MAGI > $500,000 (MFJ)

Corporate and Individual AMT repealed

Use MTC over 3 years

Selected business reforms

- Top corporate rate dropped to flat 25%
  - Phased in
- Repeal MACRS
  - Use system like ADS
- §179 expensing
  - $250,000 / $800,000 phase-out start
  - Includes software and certain real property
- NOL deduction limited to 90% TI
- SE tax applies to income of p/s, LLC, S corp
  - Generally, 70% taxed

R&D and acquired intangibles

- Write off R&D over 5 years
  - Includes software development costs
  - Phased in
- Research credit modified and made permanent
  - Simplified credit at 15%
  - No supplies
  - No computer software development
- Amortization of intangibles – increased to 20 years

More business reforms

- Advertising – deduct 50%, amortize balance over 10 years; phased in
- Several special deductions repealed
- §199 deduction phased out
- Repeal like-kind exchange deferral (§1031)
- Repeal §1202 QSBS exclusion
- Repeal §1235 on sale of patents
- Most credits repealed
- Tax portion of carried interest as ordinary income

TRA 2014 - Accounting methods

- Cash only if GR ≤ $10 million or farming or sole proprietor
- Expand LT contract use of % completion
- Repeal LIFO
- Repeal LCM

TRA 2014 - misc

- Repeal medical device excise tax
- Quarterly excise tax of 0.035% of *systemically important financial institution*'s total consolidated assets in excess of $500 billion
- IRS prohibitions
  - No conferences until TIGTA reviews
  - No personal email for official business
  - Review exam selection procedures
  - Pre-populated returns prohibited

TRA 2014 – return due dates

Return	Current due dates	Proposed due date	Proposed extended due date
1065	April 15/Sept 15	March 15	Sept 15
1120S	March 15/Sept 15	March 15	Sept 30
1120	March 15/Sept 15	April 15	October 15
FBAR	June 30	April 15	October 15

Senator Baucus

and the Senate Finance Committee

The United States Senate
COMMITTEE on FINANCE

Hearings of the 113rd Congress

The United States Senate COMMITTEE on FINANCE

- 2/26/14 - Retirement Savings for Low-Income Workers
- 12/18/13 - The Role of Social Security, Defined Benefits, and Private Retirement Accounts in the Face of the Retirement Crisis
- 7/31/13 - Powering Our Future: Principles for Energy Tax Reform
- 4/16/13 - Tax Fraud and Tax ID Theft: Moving Forward with Solutions

Hearings of the 112nd Congress

The United States Senate COMMITTEE on FINANCE

- 12/12/12 - Tax Reform and Federal Energy Policy: Incentives to Promote Energy Efficiency
- 9/20/12 - Tax Reform and the Tax Treatment of Capital Gains (w/ HWM)
- 8/1/12 - Tax Reform: Examining the Taxation of Business Entities
- 7/25/12 - Education Tax Incentives and Tax Reform
- 7/10/12 - Boosting Opportunities and Growth Through Tax Reform: Helping More Young People Achieve The American Dream
- 6/12/12 - Tax Reform: Impact on U.S. Energy Policy
- 5/15/12 - Tax Reform: What It Could Mean for Tribes and Territories
- 4/26/12 - Tax Filing Season: Improving the Taxpayer Experience
- 4/25/12 - Tax Reform: What It Means for State and Local Tax and Fiscal Policy
- 3/27/12 - Renewable Energy Tax Incentives: How have the recent and pending expirations of key incentives affected the renewable energy industry in the United States?
- 3/6/12 - Tax Reform Options: Incentives for Capital Investment and Manufacturing
- 1/31/12 - Extenders and Tax Reform: Seeking Long-Term Solutions

Hearings of the 112nd Congress

The United States Senate COMMITTEE on FINANCE

- 12/14/11 - Alternative Energy Tax Incentives: The Effect of Short-Term Extensions on Alternative Technology Investment, Domestic Manufacturing, and Jobs
- 12/6/11 - Tax Reform and the Tax Treatment of Financial Products (w/ HWM)
- 11/17/11 - International Tax Reform Discussion Draft
- 10/18/11 - Tax Reform Options: Incentives for Charitable Giving
- 10/6/11 - Tax Reform Options: Incentives for Homeownership
- 9/20/11 - Tax Reform Options: Incentives for Innovation
- 9/14/11 - Tax Reform Options: Marginal Rates on High-Income Taxpayers, Capital Gains and Dividends
- 9/13/11 - Examining Whether There is a Role for Tax Reform in Comprehensive Deficit Reduction and U.S. Fiscal Policy
- 9/8/11 - Tax Reform Options: International Issues
- 7/27/11 - CEO Perspectives on How the Tax Code Affects Hiring, Businesses and Economic Growth

Hearings of the 112nd Congress

The United States Senate COMMITTEE on FINANCE

- 7/26/11 - Perspectives on Deficit Reduction: A Review of Key Issues
- 7/13/11 - Tax Reform and the Tax Treatment of Debt and Equity (w/ HWM)
- 6/28/11 - Complexity and the Tax Gap: Making Tax Compliance Easier and Collecting What's Due
- 5/12/11 - Oil and Gas Tax Incentives and Rising Energy Prices
- 5/3/11 - Is the Distribution of Tax Burdens and Tax Benefits Equitable?
- 4/12/11 - Best Practices In Tax Administration: A Look Across the Globe
- 3/30/11 - How Do Complexity, Uncertainty and Other Factors Impact Responses to Tax Incentives?
- 3/8/11 - Does the Tax System Support Economic Efficiency, Job Creation and Broad-Based Economic Growth?
- 3/1/11 - How Did We Get Here? Changes in the Law and Tax Environment Since the Tax Reform Act of 1986

Senator Baucus Discussion Drafts

- International
- Administrative
- Cost Recovery and Accounting
- Energy Tax Reforms

- Released Nov/Dec 2013

http://www.finance.senate.gov/issue/?id=7D222262-D589-4D5E-A2AB-1504273E2E61

Administrative Discussion Draft

- Don't correct 1099 if error < $25
- Change due dates for 1120S and 1065
- Identity theft remedies
- Expand info reported on Form 1098
- Improve info for 1098-T by universities
- Revoke passport if owe > $50,000
- Modify 31 USC 330 to regulate all paid return preparers

Cost Recovery and Accounting Discussion Draft

- Replace MACRS with pooling system
  - 4 pools
  - Real property outside of pool; 43 year life
  - Repeal §1031
- Amortize intangibles over 20 years
- R&D write off over 5 years
- Advertising – expense 50%, balance over 5 years
- §179 - $1 million / $2 million threshold
  - Can bring in R&D, advertising, software
- Cash method
  - Only if GR ≤ $10 million
  - Also exempt from Unicap
- Repeal LIFO and LCM

Energy Tax Reforms Discussion Draft

- Repeal several current energy credits
- Replace with a new credit that is “technology-neutral and performance-based.”

SFC Option Papers – Broad Areas

- Simplifying the Tax System for Families and Businesses
- Business Investment and Innovation
- Family, Education and Opportunities
- Infrastructure, Energy, and Natural Resources
- International Competitiveness
- Economic and Community Development
- Economic Security
- Types of Income and Business Entities
- Tax-Exempt Organizations and Charitable Giving
- Non-Income Tax Issues and Related Reforms

"*represent a non-exhaustive list of prominent tax reform options suggested by witnesses at the Committee's 30 hearings on tax reform to date, bipartisan commissions, tax policy experts, and members of Congress. For the sake of brevity, the list does not include options that retain current law. The options listed are not necessarily endorsed by either the Chairman or Ranking Member.*"

Simplifying the Tax System for Families and Businesses

- Reduce tax fraud and identity theft
- Restructure and simplify penalties to improve voluntary compliance
- Improve the collection process
- Improve info reporting to get info to t/p more quickly and efficiently
- Repeal AMT and some phase-outs

Business Investment and Innovation

- Increase 179 expensing
- Simplify tax accounting for small business
- §1202 – increase to 100% exclusion and no AMT hit
- Income deduction for passthroughs
- Tie depreciation to economic lives better
- §199
  - Repeal
  - Better target
- Research tax credit
  - Repeal
  - Repeal traditional credit and increase ASC
- Adopt a patent box
- Repeal LIFO and LCM

Economic Security

- Limit or eliminate tax preferences for retirement saving
- Require inherited IRAs to be distributed within five years
- Replace deductions, exclusions and credits for retirement savings with a single refundable tax credit
- Increase retirement savings incentives
- Increase automatic retirement savings vehicles
- Consolidate existing plan options for employers
- Reduce “leakage” from retirement plans
- Establish “Lifetime Savings Account” for each child born in the U.S. starting with a federal government contribution of, for example, $500
- Reduce tax expenditures for employer-provided health benefits and/or other fringe benefits
- Modify the Affordable Care Act (ACA)

Economic Security - continued

- Expand the tax benefits for health
- Expand long-term care benefits
- Modify alcohol and/or tobacco excise taxes
- Revise the limits on the deductibility of executive compensation
- Revise the rules related to non-qualified deferred compensation
- Revise the rules related to equity-based compensation
- Revise the rules related to golden parachute payments to executives upon a change in control

Types of Income and Business Entities

- Tax all or most types of income the same
- Corporate integration
- Conform S and p/s rules
- Greater parity for corp debt and equity
- Reform taxation of carried interests
- Reform S corp income from personal services
- Reform derivatives, mark-to-market, hedging

Non-Income Tax Issues and Related Reforms

- Modify FICA and SE taxes
  - Remove wage cap
  - Increase Medicare tax rate
  - Make SS tax less regressive
- Estate and gift tax reforms
  - Repeal
  - Replace
- Excise taxes
  - Create securities transactions excise tax
  - Sin taxes – increase, repeal
- Enact a consumption tax

The United States Senate
COMMITTEE on FINANCE
Ron Wyden, Chairman Orrin G. Hatch, Ranking Member

Senator Wyden

As member and now chair of Senate Finance Committee

Bipartisan Tax Fairness and Simplification Act of 2011 (Wyden, S. 727, 112th Congress)

Changes include …

- Individuals:
  - 3 rates: 15, 25 and 35%
  - No AMT
  - Standard deduction about 3x larger
  - No phase-out for itemized deductions and personal exemptions
  - Repeal miscellaneous itemized deduction and some exclusions
  - Consolidate education provisions
  - Greater opportunities for tax-free savings – a new Retirement Savings Account and American Dream Account
  - 35% exclusion for dividends and LT capital gains +gains from assets held over 6 months (for first $500,000 of short term gains)
  - Nonrefundable 25% credit for state/local bond interest
  - Create system where IRS can prepare returns of many individuals
- Corporations:
  - 24% flat rate
  - Small business expense all equipment and inventory purchases ($1 million or less of gross receipts)
  - Reduces foreign deferral
  - Allow dividends received deduction for dividends from controlled foreign corps for 2011 (if reinvested in US)
  - Repeal lower-of-cost-or-market, §199 deduction and a few other items
  - No deduction for punitive damages

March 3, 2011

3/3/11 – House Ways and Means Committee hearing on Small Business and Tax Reform

Released that day:

- "Tax reform needs to be on the table because it is a proven tool for generating jobs and economic growth. But let's not leave any business behind. Small business is the engine driving our economy. Helping them grow and reach new markets isn't just an opportunity for bipartisan common ground -- it's the single best way this Congress can create new jobs."
  - http://www.wyden.senate.gov/news/press-releases/small-business-needs-tax-reform-too

Interview of Senator Wyden by Al Hunt (2/13/14)

- HUNT: "One final tax question.
  Do you think when you do, do tax reform, should it be a revenue raiser that contributes to deficit reduction?"

http://www.bloomberg.com/news/2014-02-14/wyden-says-tax-break-extension-goal-of-senate-panel-transcript-.html

WYDEN: obviously, there are going to be a lot of pieces to this debate, but I can tell you, Al, **this tax code is a rotten, dysfunctional mess**, and my sense is that when we get through the extenders and we look at them as a bridge to comprehensive reform, Democrats and Republicans can come together.

Feb 2014 tax conference comments

Issues identified by Senator Wyden

- Smaller gap between investment and ordinary income
- Increase standard deduction
- Simplify and enhance EITC and child credit
- Create new savings vehicle to start at birth
- Enhance job training
- Restore Build America Bonds

Reported by Tax Policy Center

http://taxvox.taxpolicycenter.org/2014/02/10/incoming-senate-finance-chair-wyden-outlines-his-tax-agenda/

Universal Savings Accounts

- Start at birth
  - $500 account
- Help reduce poverty

http://www.bloomberg.com/news/2014-02-07/wyden-backs-universal-savings-accounts-for-u-s-newborns.html

Others in Congress

Legislative proposals

SFC “Blank Slate” Project of 2013

H.R. 1 reserved for tax reform

http://waysandmeans.house.gov/news/documentsingle.aspx?DocumentID=321343

Sample – cut back on mortgage interest deductions

- H.R. 1213, *Common Sense Housing Investment Act* – 15% credit on QRI (AI and HEI capped at $500K combined; HEI capped at $100K); for PR and 2nd home; use savings to increase LIHC and fund rental assistance programs
- H.R. 2563, *Ending Taxpayer Subsidies for Yachts Act* – disallow mtg interest deduction for boat used as second residence

"Blank Slate" project

Generally,

- Lower rates
  - Some – tax capital gains at higher rate
- Reduce or eliminate loopholes and special interest rules
- Simplification
- Fairer
- End oil and gas preferences
- Perhaps some new incentives

http://crfb.org/blogs/opening-tax-reform-vault
http://21stcenturytaxation.blogspot.com/2014/02/sfc-blank-slate-project-2013-senator.html

President Obama

Budget proposals and related statements and documents

Frameworks

Commissions and boards

President Obama's Tax Reform Activities

- Tax panel within PERAB – report released August 2010
- Deficit Commission – report released December 2010
  - Better known as Simpson-Bowles report.
- State of the Union address (1/25/11):
  - Reduce tax breaks for oil companies.
  - Permanent American Opportunity Tax Credit
  - "I'm asking Democrats and Republicans to simplify the system. Get rid of the loopholes. Level the playing field. And use the savings to lower the corporate tax rate for the first time in 25 years —- without adding to our deficit. It can be done."
  - http://www.whitehouse.gov/the-press-office/2011/01/25/remarks-president-state-union-address
  - Repeated in 2014 State of the union address.

President Obama – and …

- OMB, *Living Within Our Means and Investing in the Future - The President's Plan for Economic Growth and Deficit Reduction*, Sept. 2011
- *The President's Framework for Business Tax Reform*, Feb 2012
- Annual budget "Greenbooks" with numerous tax proposals, including:
  - Revenue raisers for high income individuals
  - Encourage insourcing / discourage outsourcing
  - Cut back fossil fuel preferences

President Obama

PRINCIPLES FOR TAX REFORM

1. **Lower tax rates.** The tax system should be simplified and work for all Americans with lower individual and corporate tax rates and fewer brackets.
2. **Cut Inefficient and Unfair Tax Breaks.** Cut tax breaks that are inefficient, unfair, or both so that the American people and businesses spend less time and less money each year filing taxes and cannot avoid their responsibility by gaming the system.
3. **Cut the deficit.** Cut the deficit by $1.5 trillion over the next decade through tax reform, including the expiration of tax cuts for single taxpayers making over $200,000 and married couples making over $250,000.
4. **Increase job creation and growth in the United States.** Make America stronger at home and more competitive globally by increasing the incentive to work and invest in the United States.
5. **Observe the Buffett Rule.** No household making over $1 million annually should pay a smaller share of its income in taxes than middle-class families pay. As Warren Buffett has pointed out, his effective tax rate is lower than his secretary's. No household making over $1 million annually should pay a smaller share of its income in taxes than middle-class families pay. This rule will be achieved as part of an overall reform that increases the progressivity of the tax code.

http://www.whitehouse.gov/sites/default/files/omb/budget/fy2012/assets/jointcommitteereport.pdf

Sept. 2011

President Obama's Elements of Business Tax Reform

I. **Eliminate dozens of tax loopholes and subsidies, broaden the base and cut the corporate tax rate to spur growth in America:** The Framework would eliminate dozens of different tax expenditures and fundamentally reform the business tax base to reduce distortions that hurt productivity and growth. It would reinvest these savings to lower the corporate tax rate to 28 percent, putting the United States in line with major competitor countries and encouraging greater investment in America.

II. **Strengthen American manufacturing and innovation:** The Framework would refocus the manufacturing deduction and use the savings to reduce the effective rate on manufacturing to no more than 25 percent, while encouraging greater research and development and the production of clean energy.

III. **Strengthen the international tax system, including establishing a new minimum tax on foreign earnings, to encourage domestic investment:** Our tax system should not give companies an incentive to locate production overseas or engage in accounting games to shift profits abroad, eroding the U.S. tax base. Introducing a minimum tax on foreign earnings would help address these problems and discourage a global race to the bottom in tax rates.

IV. **Simplify and cut taxes for America's small businesses:** Tax reform should make tax filing simpler for small businesses and entrepreneurs so that they can focus on growing their businesses rather than filling out tax returns.

V. **Restore fiscal responsibility and not add a dime to the deficit:** Business tax reform should be fully paid for and lead to greater fiscal responsibility than our current business tax system by either eliminating or making permanent and fully paying for temporary tax provisions now in the tax code.

http://www.treasury.gov/resource-center/tax-policy/Documents/The-Presidents-Framework-for-Business-Tax-Reform-02-22-2012.pdf

Greenbooks

- Waiting for FY2015 (expected in March)
- General view:
  - Tax cuts for individuals and families
  - Tax increases for higher income individuals
    - Cap value of some deductions and exclusions at 28%
    - Buffett rule – 30% of income at minimum for income and employment taxes
  - Restore estate and gift tax to 2009
  - Tax relief for small business
  - Incentives for regional growth
  - Incentives for manufacturing, research, clean energy, insourcing, job creation
  - Eliminate oil and gas preferences
  - International tax reform

Principle	Reports: / Proposal:	Green book	Jobs Act and Deficit Reduction	Business Tax Reform	PERAB	Deficit Commission	Revenue estimate over 10 years (if available) (millions)
1	Repeal the individual AMT				X	X	
	INCENTIVES FOR EXPANDING MANUFACTURING AND INSOURCING JOBS IN AMERICA						
4	Provide tax incentives for locating jobs and business activity in the United States and remove tax deductions for shipping jobs overseas	X		X			-$90
	Provide New Manufacturing Communities Tax Credit	X					-$4,426
4	Target the Domestic Production Deduction to domestic manufacturing activities and double the deduction for Advanced Manufacturing Activities	X		X			Negligible
4	Enhance and make permanent the Research and Experimentation (R&E) tax credit	X		X			-$108,535
	Provide a tax credit for the production of Advanced Technology Vehicles	X					-$1,995
	Provide a tax credit for Medium- and Heavy-Duty Alternative-Fuel Commercial Vehicles	X					-$1,697
	Extend and modify certain energy incentives	X					-$3,870
	Make the renewable electricity production credit permanent			X			
	TAX RELIEF FOR SMALL BUSINESS						
4	Eliminate capital gains taxation on investments in Small Business Stock	X					-$7,991
4	Double the amount of expensed start-up expenditures	X		X			-$3,073
	Expand and simplify the tax	X		X			-$14,161

www.cob.sjsu.edu/nellen_a/ObamaTaxReform.html

TAXPAYER ADVOCATE SERVICE
YOUR VOICE AT THE IRS

IRS National Taxpayer Advocate

Annual reports to Congress

MSP #1

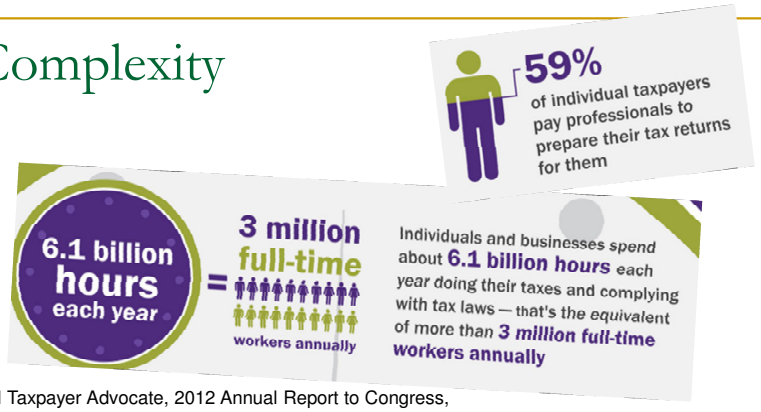
The Complexity of the Tax Code

Definition of Problem

The most serious problem facing taxpayers is the complexity of the Internal Revenue Code.

2008 Annual report - http://www.irs.gov/pub/irs-utl/08_tas_arc_msp_1.pdf

Complexity



National Taxpayer Advocate, 2012 Annual Report to Congress,
http://www.taxpayeradvocate.irs.gov/2012-Annual-Report/tax-code-complexity/

If tax compliance were an industry, it would be one of the largest in the United States. To consume 6.1 billion hours, the "tax industry" requires the equivalent of more than three million full-time workers.[2]

2010 report, The Time for Tax Reform is Now
http://www.taxpayeradvocate.irs.gov/files/MSP1_Tax%20Reform.pdf

Tax reform quotes

- "Tax complexity doesn't occur just because of "big money" special interests. It occurs because of the tax provisions that benefit each one of us. We are the special interests."
- "The road to true tax reform requires each and every one to be willing to stop protecting our own tax breaks long enough to begin a dialogue about what we want our system to look like, so we remain a vibrant nation with a tax system that is transparent to its taxpayers – one that is simpler to understand and to comply with."
- "The tax laws should be simple enough so that most taxpayers can prepare their own returns without professional help, simple enough so that taxpayers can compute their tax liabilities on a single form, and simple enough so that IRS telephone assistors can fully and accurately answer taxpayers' questions."

http://www.taxpayeradvocate.irs.gov/Media-Resources/National-Taxpayer-Advocate-Quotes

Call for public dialogue

- "When proposals to reduce tax expenditures are made, affected groups and industries often mobilize quickly to try to generate public opposition. To build broad support for tax reform, it is therefore **essential to engage the public in a substantive dialogue** about the required tradeoffs between tax rates and tax breaks. An uninformed taxpayer who hears he may lose a tax break will instinctively want to keep it to prevent his tax bill from rising. An informed taxpayer who understands that tax rates will be substantially lowered in exchange for losing tax breaks often will have a very different reaction."

Annual report to Congress, Jan. 2013, page 3 (emphasis added)
http://www.taxpayeradvocate.irs.gov/userfiles/file/2012-Annual-Report-to-Congress-Executive-Summary.pdf

Others

Interest groups
Trade associations
Tax professionals

AICPA Tax Section

- Decades – Advocate for simplification and following principles of tax policy
  - http://www.aicpa.org/taxreform
- Numerous proposals over the years including repeal AMT
- 2/19/14 letter - 32 proposals "focused on improving tax administration, making the tax code fairer, and effectively promoting important policy objectives."
- Includes:
  - Clarify and simplify reporting of cancellation of debt income
  - Harmonize and simplify education-related tax provisions
  - Allow a reasonable cause exception to the section 6707A and 6662A penalties

http://www.aicpa.org/Advocacy/Tax/TaxLegislationPolicy/DownloadableDocuments/AICPA_Compendium_of_Legislative_Proposals-Feb2014.pdf

More from AICPA (2/19/14 letter)

- Allow S corporations to have nonresident aliens as shareholders and potential current beneficiaries of electing small business trusts
- Allow transfer of partnership suspended losses to one another when spousal transfers under section 1041(a) take place
- Provide small business relief by creating a de minimis threshold for applying the section 382 loss limitation rules
- Repeal the anti-churning rules of section 197(f)(9)
- Modify the definition of W-2 wages for purposes of section 199

ABA Tax Section

Various comment letters, such as on:

- Camp's financial products discussion draft
- Inbound int'l transactions
- S corps
- Real property

Think tank ideas - example

Tax Policy Center

New Perspectives on Homeownership Tax Incentives (1/6/14)

- Replace mtg int ded with:
  - First-time homebuyer credit
  - Refundable credit for property taxes
  - Annual flat credit for homeowners

"Although far from perfect, these reforms would provide a more efficient and equitable allocation of housing subsidies. Our simulations show that relative to existing incentives, each policy would raise home prices and make the tax code more progressive."

NFIB

- Lower rates
- Reduce 1099 filing
- Repeal estate tax
- Define employee vs independent contractor
- Increase §179 expensing amount
- Health care deduction equity for self-employed
- Simplify to reduce tax gap
- Repeal AMT

http://www.nfib.com/advocacy/taxes/

Semiconductor Industry Association

- Reduce the corporate rate to 25% or less
- Convert from worldwide to a "competitive territorial tax system"
- "Enact permanent, robust incentives for research and innovation competitive with other countries."

http://www.semiconductors.org/issues/tax/tax/

http://www.semiconductors.org/clientuploads/directory/DocumentSIA/Tax%20Reform/SIA%20Comments%20on%20Finance%20Committee%20Drafts.pdf

SIA and R&D

Response to Baucus discussion draft:

- "Proposals to further limit the ability of companies to deduct the costs of U.S.-based research activities will act as a disincentive to research investment, particularly for small firms with limited cash flow, and combined with the failure to permanently extend and strengthen the R&D tax credit, will put current jobs at risk of moving abroad and jeopardize the expenditure of R&D funds in the U.S."
- "making the credit permanent, retaining the expensing provisions, renewing the research credit retroactively to January 1, 2014, and increasing the alternative simplified research credit (ASC) from 14 percent to 20 percent are all needed to make U.S. policy related to R&D internationally competitive."

Multi-industry groups

- Alliance for Competitive Taxation (ACT)
  - Members include BofA, Cisco, FedEx, Google, Intel, Walmart
  - 25% corporate rate
  - Int'l competitiveness
  - http://actontaxreform.com/
- Reforming America's Taxes Equitably (RATE)
  - Members include ATT, Boeing, FedEx, Intel, Macy's, Nike, Walmart, Disney
  - "creates a system that is fairer, simpler and promotes economic growth"
  - http://www.ratecoalition.com/

Multi-industry groups - more

- LIFT America Coalition
  - Let's Invest for Tomorrow
  - Modernize int'l rules, lower corporate tax rate
  - Members include 3M, Cisco, HP, Oracle, P&G, Coca-Cola, Walmart, FEI
  - http://www.liftamericacoalition.org/
- TIE Coalition
  - Tax Innovation Equality
  - Comprehensive tax reform to modernize and does not discriminate against any industry or intangibles
  - Members include Adobe, Amgen, Microsoft, Netflix
  - http://www.tiecoalition.com/

Building groups

- Businesses United for Interest and Loan Deductibility (BUILD)
  - Comprehensive tax reform and “preserve 100 percent interest deductibility”
  - http://buildcoalition.org/
- Performance Based Building Coalition (PBBC)
  - Use of public-private partnerships for infrastructure
  - 4/15/13 testimony to House Ways & Means Committee
    - http://waysandmeans.house.gov/uploadedfiles/performance_based_building_coalition.pdf

American Sustainable Business Council

- Positions include:
  - End use of offshore tax havens such as in Cayman Islands
  - Mainstreet fairness for sales tax collection
  - Generate revenue from corporate tax reform
- Members include Ben & Jerrys’s, Patagonia, Stonyfield Farm
- http://asbcouncil.org/

Coalition for Fair Effective Tax Rates

- Mission – "to educate Congress and key stakeholders that tax reform should be viewed through the lens of effective tax rates, the amount of taxes businesses actually pay."
- Members include NFIB, National Restaurant Association and numerous trade organizations
- http://www.faireffectivetaxrates.com/

Business Roundtable

- Revenue neutral, 25% rate with modernization of int'l rules
- http://businessroundtable.org/committees/fiscal-policy/
- *Comprehensive Tax Reform: The Time in Now*, 7/22/13
  - http://businessroundtable.org/studies-and-reports/comprehensive-tax-reform-the-time-is-now/

National Association of Manufacturers

- 10/28/13 letter to Congress related to budget conference
- Tax reform should include:
  1. 25% corporate rate
  2. Lower taxes for S corp owners
  3. Permanent and competitive research incentive
  4. Competitive int'l system
  5. "robust capital recovery system to spur business investment and expansion in the United States."
- Reach bi-partisan solution to SS long-term funding w/o higher ER costs; look at COLA adj; fix Medicare and Medicaid

http://www.nam.org/~/media/58E50CF28DDB44D0AFD388ED6BF2D203/1028_ltrbudgetconferees10_13.pdf

- 2/26/14 comment on Camp plan:
  - "NAM will be examining the draft closely, working with our members to ensure that comprehensive tax reform will result in placing manufacturers and the entire U.S. economy on a path to growth, job creation and competitiveness."

New Democrat Coalition

- 13 members of Congress
- 10 principles:
  1. Reform both individual and corporate income taxation
  2. Promote international competitiveness
  3. Revitalize domestic manufacturing
  4. Encourage innovation, high-tech manufacturing and entrepreneurialism
  5. Recognize the international mobility of capital
  6. Spur innovation and creativity through an educated workforce
  7. Encourage growth though responsible financing mechanisms
  8. Restore transparency and trust in government
  9. Build a predictable, stable tax system and process
  10. Establish effective transition rules

http://newdemocratcoalition-kind.house.gov/issue/innovation-competitiveness-tax-reform-task-force

Key points for domestic tax reform proposals

What are the goals for the following and are they achieved?

1. Lower tax rates with revenue neutrality
   - Which tax expenditures are cut back or eliminated? Why? How?
   - What is the effect on distributional neutrality?
   - Marginal tax rates and transparency.
   - Simple?
   - Phase-out versus immediate elimination?
     - Phase-out appropriate perhaps if preference tied to an earlier financial commitment.
   - What is not cut back and why?
2. Entity structure and differences
   - Effect of changes on choice of entity and neutrality and fairness.

What are the goals for the following and are they achieved?

3. Appropriate tax incentives for economy
   - How identified?
   - Why needed – rationale beyond lower taxes? Competitiveness considerations? Alternatives?
4. Administrative reforms
   - Appropriate given the other reforms?
   - Will they help lower the tax gap?
   - Use of more technology to simplify compliance?
   - Comments from the National Taxpayer Advocate and tax practitioner groups addressed?

Resources

Excerpt

Recent Reports and Actions on Tax Reform (including discussion drafts from Camp and Baucus)

- Comprehensive Tax Reform website of the congressional tax committees
- Table comparing concepts, principles, proposals and items analyzed from reports of President Obama' Administration (Nellen)
- White House and Treasury Department, *The President's Framework for Business Tax Reform*, Feb 2012.
- General Explanations of the Administration's Revenue Proposals for FY2013, FY2012, FY 2011 ("Greenbook").
- **Senator Baucus Discussion Drafts** (here):
  - International Proposal (11/19/13) - Option Y Option Z Provisions Common to Y & Z summary 1-pager JCT report
  - Administrative Proposals (11/20/13) - full text summary 1-pager JCT report
  - Cost Recovery and Accounting Proposals (11/21/13) full text summary 1-pager JCT report
  - Energy Tax Reforms (12/18/13) full text summary 1-pager JCT report
- **Congressman Camp's Discussion Drafts:**
  - Territorial System (2011)
  - Financial Products Reform (2013)
  - Small Business Reform (2013)
- Congressmen Camp and Levin Tax Reform Working Groups (Feb 2013) - here
  - Joint Committee report for the working groups - JCS-03-13 (5/6/13)
- Senate Finance Committee's Tax Reform Option Papers (2013)
- Senator Baucus and Senator Hatch call for a "blank slate" approach inviting people to tell them why any special tax rule should remain (6/27/13 press release)
  - 21st Century Taxation blog posts
- Simpson/Bowles - Moment of Truth proposal revised
- Berkeley Research Group - *Implications of a Switch to a Territorial System in the US* (Nov 2013)
- OECD, *Restoring Fairness to the Tax System*, April 2013.
- GAO, *Guide for Evaluating Tax Expenditures* (GAO-13-167SP)

Links to hearings, reports, bills and more:
http://www.cob.sjsu.edu/nellen_a/txrefupd.html

SAN JOSE STATE UNIVERSITY | Lucas Graduate School of Business
The State Bar of California
The Taxation Section, Tax Policy Committee
TAX EXECUTIVES INSTITUTE, INC.
Tax Policy Conference
Federal Tax Reform: Dealing with the Known and Unknown
Friday, February 28, 2014

State Impacts of Federal Tax Reform Proposals

Dean Andal, Pricewaterhouse Coopers
David Slater, Intel Corporation
Greg Turner, Council on State Taxation (COST)
Oksana Jaffe, Assembly Committee on Revenue and Taxation

State Impacts of Federal Tax Reform Proposals

- Agenda
  - State Corporate Income Tax Formula
  - State Conformity to Federal Law
  - Federal Reform Proposals and State Impact
    - Rate Reduction
    - Territorial Tax System
    - Accelerated Depreciation
    - Streamlined Due Dates
  - Federal Reforms of State Tax Issues
    - Internet Tax Freedom Act
    - Market Place Fairness Act
    - Business Activity Tax Simplification Act
    - Mobile Workforce State Income Tax Simplification Act
  - Is there a VAT or Federal Sales Tax in our Future?
  - Impacts on California

State Corporate Income Tax Formula (Simplified)

- Starting point for state taxable income is usually Line 28 or Line 30 of the Federal Tax Return.
- Modifications (additions and subtractions) are made to conform to state law (i.e. state tax deduction add-back)
- Subtract out non-business income
- Tax base is apportioned to each particular state based on payroll, property and sales (general rule)
- Add back any business income
- State tax rate applied to get to tax liability
- Subtract any state tax credits

State Conformity to Federal Law

- Fixed or Static – Conform to the IRC as it existed on a specific date (About half the states including California)
  - States not beholden to federal changes. Adds complexity and administrative burden
  - State legislature can conform in whole as of a certain date or pick and choose conformity to IRC changes
- Moving or Rolling Conformity – Changes to the IRC are automatic (New York)
  - Reduces complexity and administrative burden but beholden to federal changes
  - State legislature can choose to de-couple from certain provisions for budgetary reasons (i.e. bonus depreciation)

Federal Reform Proposals

- Federal Rate Reduction
- Territorial Tax System
  - Dividend exemption
  - Reduced rate for previously untaxed CFC income
  - CFC treatment for US parent foreign branches
  - Interest expense limitation
- Accelerated Depreciation
- Streamlined Due Dates

Impact of Federal Rate Reduction

- Camp proposes reducing rate to 25% and foreign royalties at 15%
- Possible elimination of many tax expenditures and preferences
- Federal allows a deduction for state income taxes
- Some states allow federal tax deduction (i.e. LA) so that will increase tax in those states.
- Additional disposable corporate income will increase spending and increase state sales and use tax revenue

Impact of Territorial Tax System

- Current Tax System
  - US companies taxed on worldwide income
  - Foreign earning of CFCs is deferred (exception for Sub F)
  - Foreign dividends remitted out of previously untaxed income are taxable at full US tax rate
- What is "Territorial" Tax System
  - Tax income earned in the U.S.
  - Eliminate deferral of tax on foreign earnings
  - Complicated "mechanics" to make it work

Impact of Territorial Tax System

- Domestic DRD of 95% allowed for foreign-source portion of dividends received form CFCs.
  - Proposal will increase foreign dividends as federal tax cost to companies to repatriate would be very low
  - Most state allow a state DRD for foreign dividends but percentages vary (AZ 100%, OR 80%, ME 50%)
  - State revenue will generally increase in those states with static conformity due to increase in dividends
  - State revenue will generally decrease in those states with rolling conformity due to federal 95%DRD.
  - California has static conformity and would not conform.
    - California has a 75% DRD for foreign dividends after elimination
    - Water's Edge Filers – Likely to pay more tax paid due to increased level foreign dividends (25% taxable after 75% DRD)
    - Worldwide Filers – No impact due to elimination of foreign dividends as CFCs already part of taxable combined group

Impact of Territorial Tax System

- CFCs undistributed and previously untaxed income taxed at federal rate of 5.25%
  - How will feds classify this income?
  - If dividend income then tax cost in those states with rolling conformity and less than 100% DRD
  - If non-dividend income then significant expansion of tax base in states with rolling conformity
  - Some states offer full or partial exemptions on foreign source income
  - Most cost in states with rolling conformity that have no intercompany elimination (i.e. single entity) or foreign income exclusions
  - Federal election to pay net liability over 10 years. States may not follow the federal election
  - California worldwide filers will get elimination so no impact

Impact of Territorial Tax System

- Foreign branches of U.S. parent companies treated as CFCs (effectively allows an exclusion for foreign earnings)
  - Currently foreign source income of a US company is included in the 1120. Some states offer full or partial exemptions for foreign source income (i.e. Colorado)
  - Excluded income will need to be added back in fixed conformity states. This will be a complex calculation to track and report fed/state tax differences
  - Reduction to tax base in rolling conformity states. States may choose to de-couple
  - Little or no impact tax impact for CA worldwide filers. Mechanics of tax return may become more complex depending on whether companies start with 1120 or do a legal entity consolidation for all entities.
  - CA water's edge filers will need to add-back excluded income to federal tax base starting point.

Impact of International Tax Reform

- Interest Expense Limitation
  - Fed may limit interest expense deduction related to excluded foreign income
  - Will generally increase tax base in rolling conformity states
  - Some states (i.e. GE) however have intercompany interest expense add-back rules so may have little impact if expense/income are in separate legal entities
  - But state rules for disallowed interest expense may be different from federal.
  - Fixed conformity states will need to deduct the excluded interest expense

Accelerated Depreciation

- Could be in the form of bonus depreciation or Section 179 expensing
- Many states have chosen to de-couple from accelerated depreciation due to the lost revenue in the early years
- Essentially amounts to no more than a timing difference
- Administrative inconvenience for taxpayers. Second and sometimes third set of books required (i.e. non-bonus and CA).

Streamlined Compliance Due Dates

- Many states conform to the federal due date (MN and NE)
- Some states conform to federal due date plus 15 or 30 days (FL and OR)
- Majority of states have their own due date per statute so those states may need to change there law through legislative action if federal due dates are altered.

Federal Tax Reform: Direct and Indirect Impact on California

- Potential changes to the federal corporate tax law:
  - *Repeal of the Federal CT* will most likely lead to a repeal, or a substantial revision, of California's corporate tax system. The state will lose all the benefits of federal enforcement efforts, which may lead to increased tax penalties or augmentation of FTB's enforcement budget.
  - *If a Flat Tax or Some Type of a Federal Business Tax* is imposed, California may repeal its CT system and conform to a new federal tax regime (provided the new tax is broad-based, imposed at a low rate and easily implementable).
  - *A Simple Reduction of the Federal CT Rate* will not have much impact on California (other than a potential push to lower the state tax rate). However, a lower tax rate reduces the incentive for taxpayers to engage in tax avoidance. California may benefit because fewer taxpayers will find it cost-effective to engage in creative tax planning.
    - ✓ Most likely, the federal rate reduction will be implemented in conjunction with the corporate tax base broadening, which will impact CA.

Federal Tax Reform: Direct and Indirect Impact on California

- A *Pure Territorial* Approach – an exclusion of foreign source income – would be detrimental to California's administration of its CT laws. Federal Form 1120 is a starting point for the CA corporate tax return. If foreign source income is excluded, CA will have no information readily available to it to identify if the taxpayer should have included that income in its CA return. Thus, it would present certain compliance and enforcement issues for the FTB.
- *Expansion of the definition of Subpart F income* by creating additional categories of Subpart F income will directly impact California because of the state's automatic conformity to the definition of Subpart F income (Sec. 25116, Cal. Revenue and Taxation Code).
- The *95% DRD Exclusion* will not affect California's law but California may see an increase in revenues because of the potential increase in the amount of repatriated earnings brought back to the US and a lower 75% DRD in the case of a water's-edge election. It may even act as an incentive for companies to move back to worldwide combined reporting, instead of a water's-edge election, because intercompany dividends are generally eliminated under the worldwide method.
- *Limitations on Interest Expense Deduction* will not have much of an impact on California's tax system because California has its own rules governing interest expense deduction.

Federal Tax Reform: Direct and Indirect Impact on California

- Broadening or Narrowing the Federal Tax Base:
  - Elimination, revision or extension of certain tax incentives that would *directly* impact the state of California:
    - Exclusion of interest on state and local bonds (federally-subsidized debt, removal of which will significantly raise the borrowing costs for state and local governments).
    - Deduction for state and local taxes.
    - Special tax incentives, such as the new markets tax credit, low-income tax housing credit, empowerment zone employment credit and others that indirectly benefit state and local governments.
  - Elimination, revision or extension of certain tax incentives that would *indirectly* impact California through its corporate or individual taxpayers:
    - The research and development credit, accelerated depreciation, adoption of a "patent box" idea, etc.
    - The mortgage interest deduction, charitable contribution deduction, employer-provided health insurance, earned income tax credit, etc.

Permanent Internet Tax Freedom Act of 2013

- Would make permanent the existing ban on state or local taxes on internet access and on multiple or discriminatory taxes on e-commerce, while allowing "grandfather clause" to lapse.
- The most recent extension of ITFA is scheduled to expire on November 1, 2014.
- Bar on discriminatory taxes on e-commerce will get more attention after the *Direct Marketing* (Ill. S. Ct.) decision.

17

Federal Reforms of State Taxes

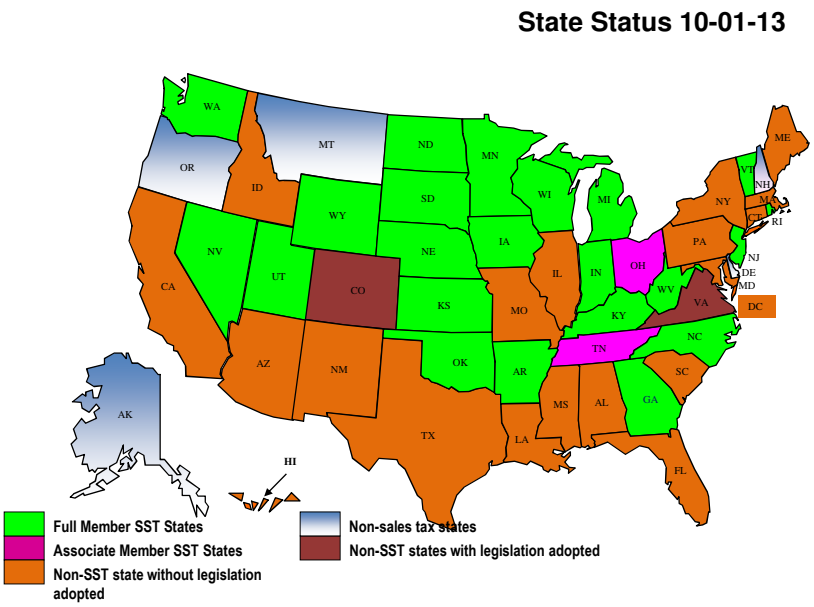
Remote Sales Tax Collection

The Public's View:
(Don't tax my Internet!)

Marketplace Fairness Act

- **Creates a federal standard for state remote seller use tax collection authority.**

- Legislation (S. 743; S. 336; HR 684) introduced
- Senate passed S. 743 on 5/6/2013 (69 to 27); and referred to House on 5/20/2013
  - Significant opposition in the House
  - Rep. Goodlatte issued a set of "principles" on September 18
- S. 743 provides two alternatives for states to affirmatively choose to exercise MFA authority:
  - **(1)** SSUTA member states (so long as SSUTA contains minimum simplification requirements and the state *publishes* its intent to collect tax with 180 days notice), or
  - **(2)** SSUTA non-member states that *enact legislation* and meet the minimum simplification requirements (but cannot commence prior to the first day of the calendar quarter that is at least 6 months after the enacted legislation and implementation of simplification requirements)



Marketplace Fairness Act

- For non-member states, enacting legislation must:
  - Specify the taxable items that are excluded from the Act
  - Provide for single administrative agency (return, audit, etc.)
  - Provide uniform tax base
  - Provide free compliance software
- Small seller exception
  - The remote seller must have total remote sales **in the U.S.** exceeding $1,000,000. For purposes of determining total remote sales, sales of affiliated entities are aggregated
- Sourcing
  - Member states must comply with the agreement's destination-based sourcing provisions, while non-member states must source according to delivery destination

Marketplace Fairness Act

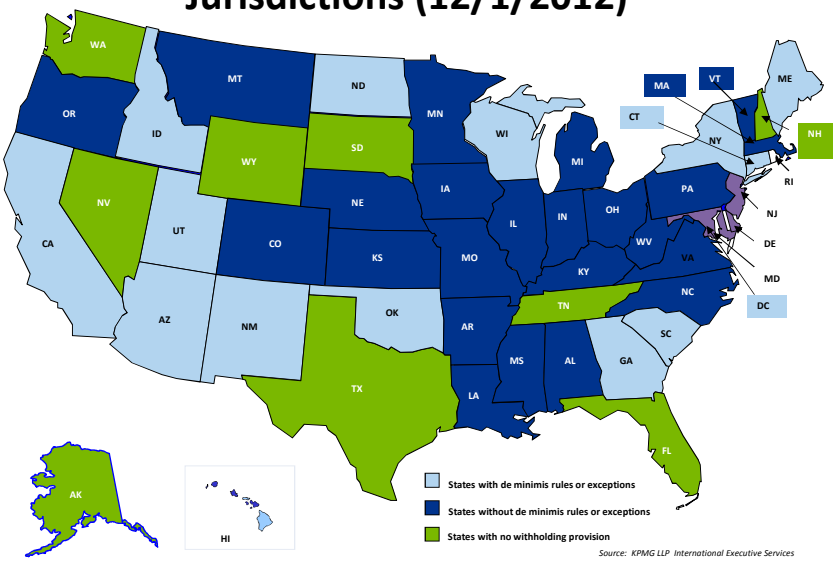
What it doesn't include:

- Simplification requirements for nexus sellers
- Vendor compensation
- Relaxed good faith standard for exemption certificates (non SST states)
- Requirement that a state must be in compliance with the SSUTA
- State review mechanisms to ensure compliance for the non SST states
- Legal path into federal court

Business Activity Tax Simplification Act ("BATSA")

- Would modernize P.L. 86-272:
  - All business activity taxes (not just net income taxes).
  - All sellers (not just sellers of tangible personal property.
  - Other qualitative de minimis activities (not just solicitation).
- Physical presence:
  - Economic nexus would be outlawed.
  - Tangible property or employees allowed in a jurisdiction for more than 14 days during the tax year (*de minimis).*
- In the context of a consolidated/combined return, the group return can only include in its apportionment factor numerators the in-state apportionment factors from corporations that have a physical presence in the state (*Joyce*).

Nonresident Withholding *De Minimus* Jurisdictions (12/1/2012)



Mobile Workforce State Income Tax Simplification Act of 2013

- **In general, the bill protects nonresident employees (and employers) from a state's income tax if a person works in the state 30 days or less.**

- 112th Congress: HR 1864, by Reps. Howard Coble (R-NC) and Hank Johnson (D-GA), passed the House on May 15, 2012 on Consent Calendar / Voice Vote
- **HR 1129**; introduced on March 13, 2013 by Rep. Howard Coble (R-NC) and Rep. Hank Johnson (D-GA), identical bill to that which passed the full U.S. House in May 2012 on voice vote. In House Judiciary Committee.
- **S. 1645**; introduced on November 5, 2013 by Sens. Sherrod Brown (D-OH) and John Thune (R-SD), and 6 additional original cosponsors (Menendez (D-NJ); Nelson (D-FL); Johnson (D-SD); Portman (R-OH); Collins (R-ME); Blunt (R-MO).) In Senate Finance Committee.
- COST & AICPA are leading effort;
- Efforts continue to work with New York State
- Letter of support continues to grow: 263 total supporters!

Federal Tax Reform: Direct and Indirect Impact on California

- Potential Federal Requirements for State and Local Tax Uniformity
  - Exercising Federal authority to establish uniform rules among the states (e.g., economic nexus, apportionment formula, tax incentives for in-state based taxpayers, taxation of digital goods and services, etc.)
  - Authorizing states to require out-of-state vendors to collect use tax (Marketplace Fairness Act)
  - Prohibiting the imposition of certain state and local taxes (the moratorium on Internet access taxes, new local and state taxes on wireless services, occupancy taxes on booking fees of online travel companies, etc.)

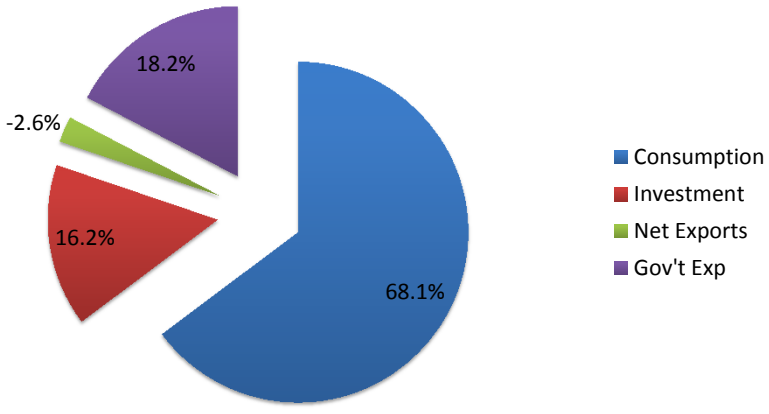
Is a VAT In our Future?

What is a VAT?

- Currently 135 Countries have a VAT – US is only OECD Country without.
- **EU VAT Rate** a 15% - 27% (Avg. 20%)
- How it works (Cr Inv) (Assume a 10% VAT):

Stage	Sale	VAT Rtn	Gov't Gets
Supplier (Raw Materials)	$100 + $10 (Vat)	$10	$10
Mfg. (Px $110)	$200 + $20	$20-10 = $10	$10
Wholesaler (Px $220)	$300 + $30	$30-20 = $10	$10
Retailer (Px $330)	$400 + $40	$40-30 = $10	$10
Consumer Pays	$440		$40

Components of US GDP



Federal Tax Reform: Direct and Indirect Impact on California

- Potential New Federal Taxes:
  - Value-Added Tax
    - Competition for consumption tax base
    - Would states conform?
    - If the federal income tax is repealed, what does it mean for the states?
  - Federal Sales Tax
    - Federal-state coordination
    - Is it an encroachment on states' authority to tax?

INNOVATION POLICY AND THE HIDDEN DEVELOPMENTAL STATE IN THE USA

Fred Block
TEI-SJSU
Tax Policy Conference
February 28, 2014

A Major Historical Shift

- For most of the 20th century, large firms were central to the innovation system.
- Dramatic change has occurred over the last three decades.
- We now have a new and very different innovation system.

Old vs. New

Innovation depends on research labs at large firms.	Innovation comes from small firms and public-private collaborations.
Government role limited to defense industries.	Government role is pervasive.

Federal Initiatives

- Most launched between 1981-1992 under Republican Presidents—Reagan and Bush I
- Designed to leverage federal investments to accelerate commercialization of new technologies.
- Idea was to learn from and build on the successes of Advanced Research Projects Agency (ARPA) in the Department of Defense.

ARPA's Key Achievements

- Funded the first university computer science departments.
- Supported key breakthroughs in computer hardware, software, and user interfaces.
- The internet was first developed as the ARPAnet linking together government funded research computers.

The Key Features of this New Model

- Mobilize university based researchers to focus on critical technology challenges.
- Use the federal laboratories as key sites for public-private collaboration.
- Encourage and support new small firms that will compete directly with established firms.
- Highly decentralized; multiple initiatives to overcome key technological barriers co-exist often with little coordination.

Programs Include:

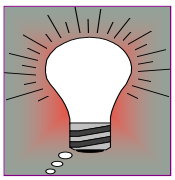
- Advanced Technology Program [1988-2007] at National Institute of Standards and Technology in the Commerce Department.
- National Science Foundation—Industry/University Cooperative Research Centers [1979]. (IUCRC)
- [1982]Small Business Innovation Research (SBIR) and [1992]Small Business Technology Transfer (STTR) administered through 11 federal agencies.

Program Descriptions

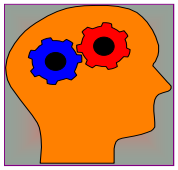
- **SBIR: Set-aside program for small business concerns to engage in federal R&D --with potential for commercialization.**
- **STTR: Set-aside program to facilitate cooperative R&D between small business concerns and U.S. research institutions -- with potential for commercialization.**

SBIR/STTR: 3-Phase Program

- **PHASE I**
  - Feasibility study
  - $100K and 6 months (SBIR)
    or 12 months (STTR)



- **PHASE II**
  - Full R/R&D
  - 2-Year Award and $750K (SBIR)
    or $500K (STTR)



- **PHASE III**
  - Commercialization Stage
  - Use of non-SBIR Funds

R&D 100 Awards

"The Oscars of Invention"- *The Chicago Tribune*

For 45 years, the prestigious R&D 100 Awards have been helping companies provide the important initial push a new product needs to compete successfully in the marketplace. The winning of an R&D 100 Award provides a mark of excellence known to industry, government, and academia as proof that the product is one of the most innovative ideas of the year.

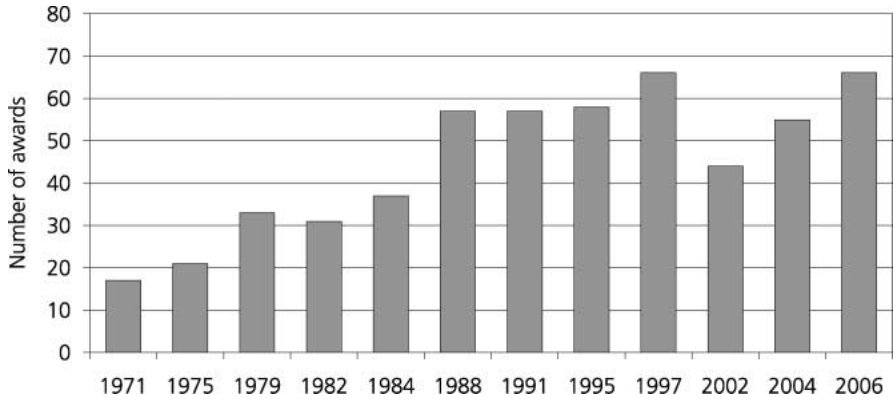
Past Winners

Past winners of R&D 100 Awards include "Polacolor film (1963), the flashcube (1965), the automated teller machine (1973), the halogen lamp (1974), the fax machine (1975), the liquid crystal display (1980), the printer (1986), the Kodak Photo CD (1991), the Nicoderm antismoking patch (1992), Taxol anticancer drug (1993), lab on a chip (1996), and HDTV (1998).

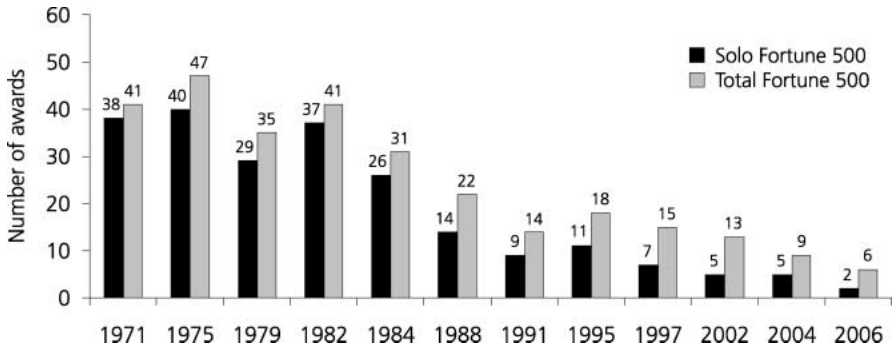
2008 Winners Include:

- **Antibody Profiling Indentification-AbP ID**
  Idaho National Laboratory, Idaho Falls, ID
  Identity Sciences, Alpharetta, GA
- **Rynaxypyr Insecticide**
  DuPont Crop Protection, Newark, DE
- **Formulator**
  Formulatrix, Inc., Waltham, MA
- **Berkeley Lab PhyloChip**
  Lawrence Berkeley National Laboratory, Berkeley, CA

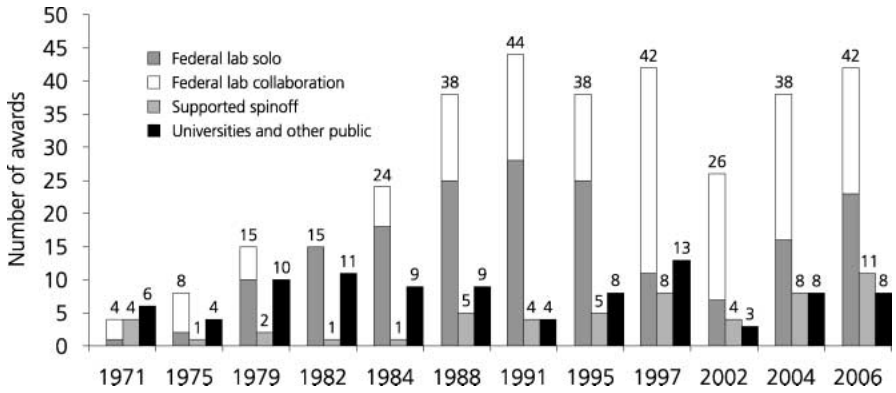
Awards to Inter-organizational collaborations



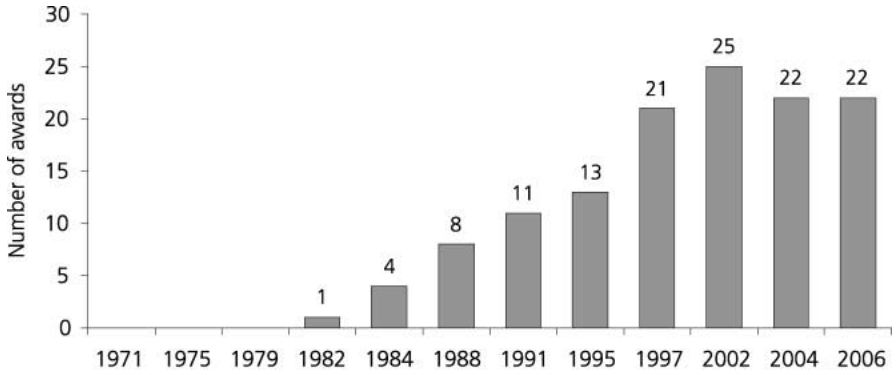
Awards to Fortune 500 Companies



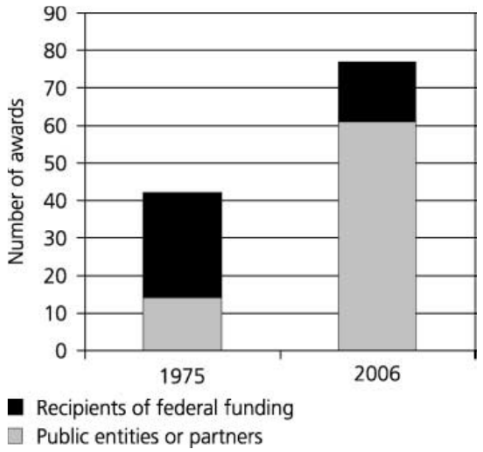
Awards to Public and Mixed Entities



Awards to SBIR Firms

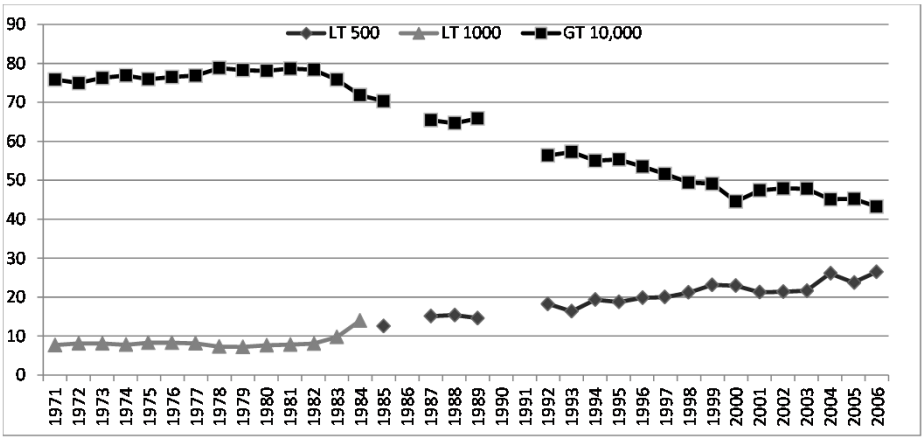


Winners with federal funding

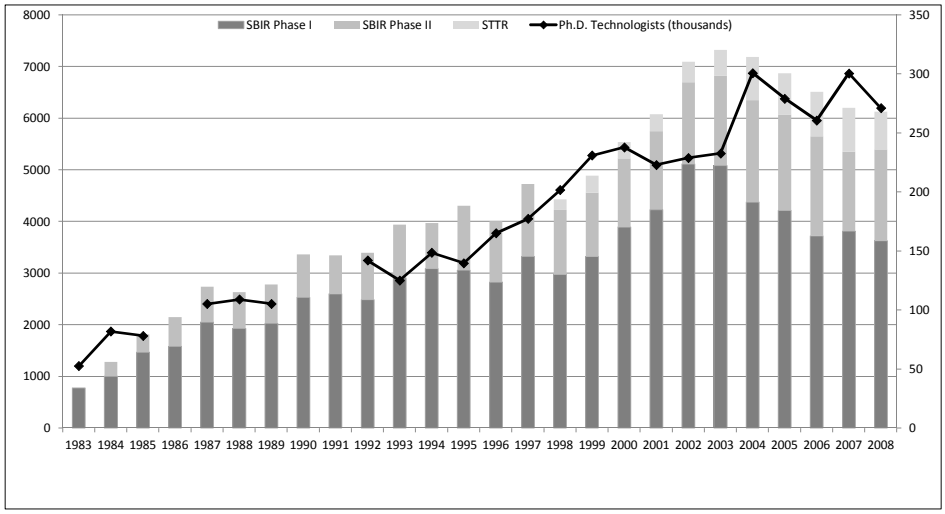


Shifts in scientific employment

Figure 1: Percentage of FTE Scientists and Engineers employed in R&D Performing Companies, by Size of Company, 1971-2006



SBIR Grants and Employment



The Risk-Reward Issue

- U.S. Government spends tens of billions on R&D and commercialization programs.
- Big corporations benefit as they increasingly use the strategy of "open innovation".
- But the yield on the corporate income tax continues to decline with increasingly elaborate tax avoidance strategies.

Table 3.2 Federal Support for Leading Biotechnology Therapeutics (2006 sales exceeding $1 Billion)

Product	*Company*	*2006 sales*[a]	*Indication*	*Role of Federal Support*
Significant Federal Support for Drug Discovery, Development and Clinical Trials:				
Epogen, Procrit, Eprex	Amgen, Kirin, J&J	$6.10	Anemia	NIH funding leads to patent at Columbia University
Enbrel	Amgen, Wyeth, Takeda	$4.40	Rheumatoid arthritis	NIH funding leads to patent at SW Texas Medical Center
Neupogen, Neulasta	Amgen, Kirin	$4.00	Neutropenia	NIH research for initial development (NIH licensed patent rights)
Rituxan/Mab Thera	Biogen, Idec, Genentech, Roche	$3.90	Non-Hodgkins Lymphoma	NIH (SBIR) funding, leading to IPO of Idec (now Biogen-Idec)
Remicade	J&J, Schering-Plough, Tanabe	$3.60	Crohn's disease,	NIH funding for research at NYU
Avonex	Biogen Idec	$1.70	MS, arthritis	NIH funding and market protection under Orphan Drug Act
Syagis	Medimmune	$1.10	RSV infection	NIH research, plus extensive SBIR funding
Cerezyme	Genzyme	$1.00	Gaucher's disease	NIH research, plus market protection under Orphan Drug Act
Significant Federal Support for Clinical Trials:				
Herceptin	Genentech, Roche	$3.10	Breast cancer	Corporate support (Revlon) for research; federal support for testing
Avastin	Genentech, Roche	$2.40	Cancer	Corporate support for development; significant federal support for clinical testing
Humira	Abbott	$2.00	Autoimmune diseases	Limited federal support for development; significant federal support for clinical testing
Humalog	Eli Lilly	$1.30	Diabetes	Limited federal support for development; extensive federal support for clinical testing
Betaseron/Betaferon	Bayer Schering	$1.20	Multiple sclerosis	Federal support for testing; market protection under Orphan Drug Act
Little or No Federal Support:				
Aranesp	Amgen	$4.10	Anemia	Modification of Epogen o gain patent approval
Erbitux	ImClone, Bristol-Myers, Merck, KGaA	$1.10	Cancer	No evidence of federal support found

a. *Source:* Nature Biotechnology 25, 380 - 382 (2007). Published online: 3 April 2007. Accessed June 2009.

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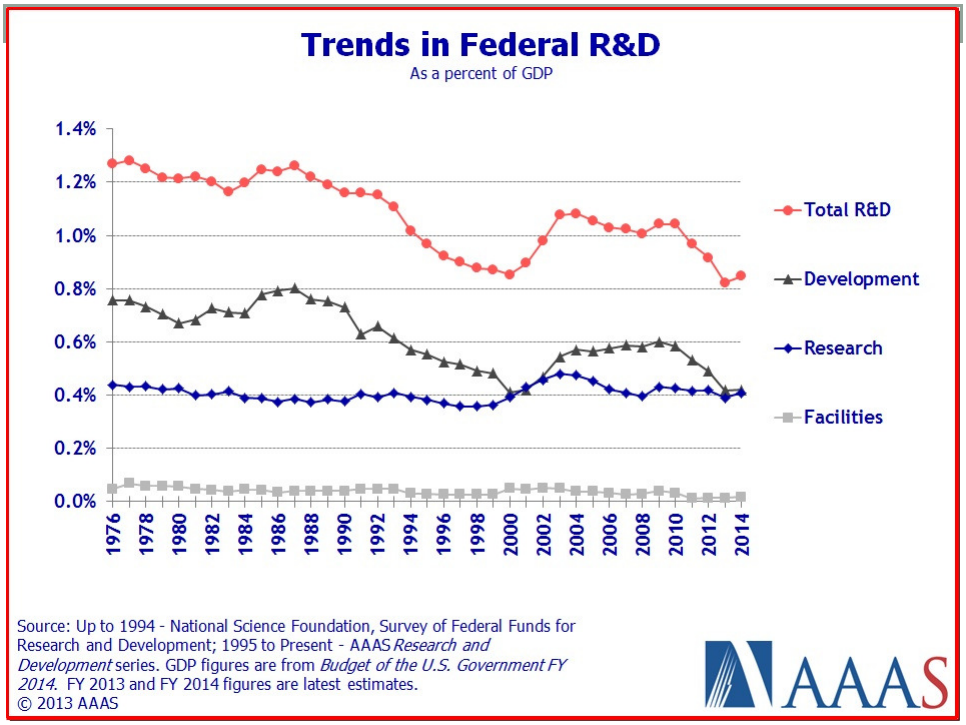
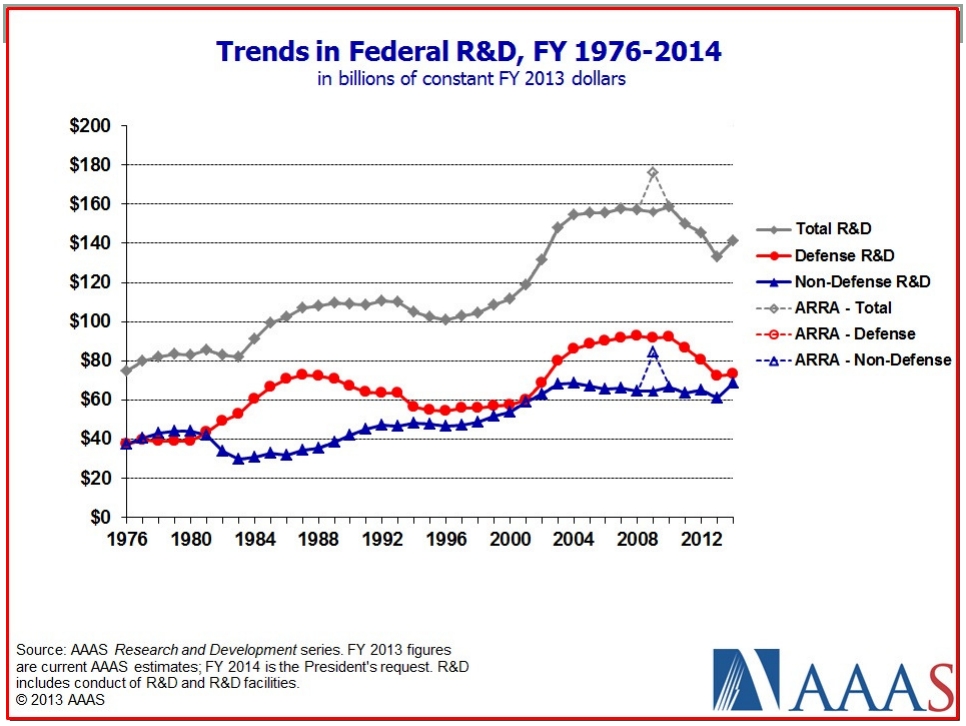




R&D Tax Credit

- About $6 billion per year
- 549 large firms accounted for 65% of the credits in 2005 (GAO Report)
- Complex and difficult accounting process
- Struggling startups without revenue get few benefits

National Innovation Foundation

- All newly incorporated businesses would deposit a 2% stake in the new firm with the foundation.
- The foundation would be required to hold the shares for at least 10 years.
- When firms had become profitable, the foundation could sell its shares in an orderly fashion and revenues would be used to fund an expansion of government R&D outlays.

SAN JOSÉ STATE UNIVERSITY | Lucas Graduate School of Business

The State Bar of California
The Taxation Section, Tax Policy Committee

TAX EXECUTIVES INSTITUTE, INC.

Tax Policy Conference

Federal Tax Reform: Dealing with the Known and Unknown

Friday, February 28, 2014

International Taxation Reform: Camp v. Baucus v. OECD

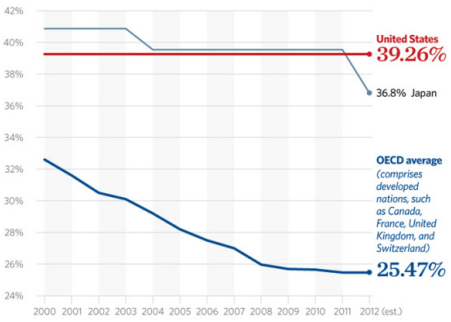
Sanford I. Millar, MILLARLAW P.C.
Grace Chu, Senior Director Tax, Brocade
Lance Martin, Partner, Baker & McKenzie LLP
Eric D. Ryan, Partner, DLA Piper LLP (US)

Agenda

- Background
- BEPS Overview and Recent Events
- US Proposals Overview
  - Camp Discussion Draft
  - Baucus Discussion Draft
- Examples
- Possible Action Items Now
- Q&A

US Corporate Tax Regime

- Since Japan lowered its rate in 2011, the US now has *highest* statutory corporate tax rate among all OECD members
  - Most OECD members have gradually reduced rates, year after year
- US is also one of the few remaining OECD members with a *worldwide* (WW) tax system (but has a Foreign Tax Credit mechanism)
  - Others include Chile, Ireland, Israel, Korea, and Mexico
  - Most OECD members now use a *territorial* system (generally not taxing foreign profits)
- Highest corporate tax rate + WW tax system = US may also have the highest average *effective* tax rate of any OECD member
- Notwithstanding, US companies (Apple, Google, Amazon, and Starbucks) are at the forefront of criticism for inappropriate tax planning



Source: OECD Tax Database (2012)

OECD BEPS Project

- What is "Base Erosion and Profit Shifting" (BEPS)?
  - Segregation between the location of actual business activities and investments take place and the location where profits are reported for tax purposes
  - International planning to minimize profits in high-tax jurisdictions and maximize profits in low- or zero-tax jurisdictions. For example:
    - Tax planning to minimize income and maximize expenses in high-tax jurisdictions
    - Structuring organization to minimize taxable presence in high-tax jurisdictions
    - Taking arguably inconsistent positions in different jurisdictions on characterization of transactions / entities

BEPS Timeline To-Date

BEPS Action Plan

Action	Deadline	Action	Deadline
1. Tax challenges of the digital economy	**Sept. 2014**	9. TP for risks and capital	**Sept. 2014**
2. Hybrid mismatch arrangements	**Sept. 2014**	10. TP for other high-risk transactions	Sept. 2015
3. CFC rules	Sept. 2015	11. Development of data on BEPS and actions addressing it	Sept. 2015
4. Deductibility of interest and other financial payments	Sept. 2015/Dec. 2015	12. Disclosure of aggressive tax planning arrangements	Sept. 2015
5. Harmful tax practices	**Sept. 2014**/Sept. 2015/Dec. 2015	13. TP documentation	**Sept. 2014**
6. Treaty abuse	**Sept. 2014**	14. Treaty dispute resolution mechanisms	Sept. 2015
7. Artificial avoidance of PE status	Sept. 2015	15. Multinational instrument for amending bilateral tax treaties	**Sept. 2014**/Dec. 2015
8. TP for intangibles	**Sept. 2014**/Sept. 2015		

Country Reactions: Positive Embrace of BEPS

- 5/15/12: **Spanish lower court** holds the Dell's Irish principal had a "virtual PE" in Spain—even though its servers were outside Spain—due to selling computers to Spanish customers via a website managed by employees of a Spanish affiliate
  - Case is currently on appeal
- January 2013: **French government** published a commissioned report written by two economists (Collin & Colin), which recommended that the treaty definition of PE be expanded to include "users" of social media websites
  - Report also proposed a tax on the collection of data
- 12/23/13: **Italian parliament** passed the first BEPS legislation, the "Google tax," which requires that Italian companies purchase their internet ads from companies registered for Italian VAT
  - Law likely violates EU principle on non-discrimination
  - Due to controversy, Italy delayed implementation of law until July 2014
- Soon: **UK Task Force** is expected to release a long report (103 pages) which sets out options for a taxation approach that would expand the definition of PE in order to allow market countries to capture profits from digital economy businesses that currently are exempt
  - This would be a deviation from the approach that was originally announced, which was not supposed to focus on PE

Country Reactions: More Modest Embrace of BEPS

- 10/22/13: **Ireland** passed a law eliminating Double Irish "stateless" structures -> companies incorporated in Ireland but managed and controlled in an EU / treaty partner country (e.g., the US) will be treated as Irish tax resident unless such companies are tax residents in those countries
- 12/12/13: **US Treasury officials** generally endorse BEPS, but publicly stated that any measures proposed by the Digital Economy Task Force must not strip income out of the US (implying that the definition of PE should not be expanded)
- 1/1/14: **the Netherlands** codified substance requirements for obtaining treaty benefits, requiring declaration on tax return
  - No indication certain special purpose Dutch entities will be eliminated
- 2013: **Australia** strengthened its General Anti-Avoidance Rules, modernized its Transfer Pricing Regime, and now requires publication of taxes paid by largest Australian companies

Comments on Digital Economy (Action 1)

- "[A] useful and pragmatic solution of any of the ambiguities associated with the taxation of digital economy enterprises lies in the provision of guidance and consistent application of existing taxing rights principles, rather than a restructuring of the legal principles underpinning them." **Consultative Committee of Accountancy Bodies – Ireland**
- "[T]he location of developers and content providers will be broadly the same for non-digital businesses and any tax system should attempt to value and tax such contributions on the same basis. It is also important to recognise the value produced, for some digital business models, by the interaction between the business and the consumer, referred to as 'the network effect' in some discussions." **Deloitte LLP**
- "[T]he return on making risky investments to create value and the return on commercializing a business's valuable assets are different, and tax policy should not allow the value created by investment to be taxed in jurisdictions whose only connection to the business is commercialization. " **Digital Economy Group**
- Thus, it is apparent that taxpayers and their advisors have a desire to maintain the status quo

Discussion Draft on CbC Reporting

- On 1/30/14, the OECD released a discussion draft on TP documentation and country-by-country (CbC) reporting (Action 13). Will replace Chapter V of the TP Guidelines
- Two-tiered approach: **Master File** and **Local File**
- Master File needs to include:
  - Detailed description of the overall business (full legal entity chart, flows of goods globally, services, etc.)
  - Detailed description of all intangibles (where are they, who pays for them, etc.)
  - Detailed description of intercompany loans
- Proposed Master File includes things like: Who are your top 25 employees in terms of remuneration? Where are they located? And a requirement to disclose all APAs and ATRs
- Master File can be in English; Local File in the local language

Larger version included at end of these materials.

Discussion Draft on CbC Reporting cont'd

- Master File needs to include CbC reporting
- Compliance costs are certainly going to increase, not decrease…

CONFIDENTIAL CTPA/CFA/NOE2(2014)4/REV1/CONF

Annex III to Chapter V: A Model Template of Country-by-Country Reporting

Overview of allocation of income, taxes and business activities on a country-by-country basis

Country	Constituent Entities Organised in the Country	Place of Effective Management	Important business activity code(s)	Revenues	Earnings Before Income Tax	Income Tax Paid (on Cash Basis)		Total Withholding Tax Paid	Stated capital and accumulated earnings	Number of Employees	Total Employee Expense	Tangible Assets other than Cash and Cash Equivalents	Royalties Paid to Constituent Entities	Royalties Received from Constituent Entities	Interest Paid to Constituent Entities	Interest Received from Constituent Entities	Service Fees Paid to Constituent Entities	Service Fees Received from Constituent Entities
						(a) To Country of Organisation	(b) To All Other Countries											
	1.																	
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Discussion Draft – Hybrids (Action 2)

- An October 2013 discussion draft on hybrid instruments was recently leaked to Tax Notes. Draft contains the following proposals:
- Hybrid Payments
  - Hybrid Payment Rule – participation exemption is denied when the payment has been deducted by the payor in a financing / funding transaction
    - Rule applies even if the income is picked up by the CFC rules of the payee's parent
  - Secondary Rule – deduction is denied when the payment is taxable to the recipient
  - Rules only apply to actual payments and payments-in-law (e.g., accruals). Do not apply to *notional* interest deductions
  - No tax avoidance motive required
  - Rules apply even where the payor and payee are unrelated
- Disregarded Entities
  - Interest deduction for a payment by a foreign sub (treated as a branch under the CTB rules) to its US parent *won't* be denied by the payor jurisdiction
  - *Nothing in the draft about the CTB rules specifically.* Will likely surface when Action 3 (CFC rules) is addressed (by Sept. 2015)

US PROPOSALS

History of US Proposals

- Legislative Hearings
  - In May 2013, the Subcommittee on Investigations released a report on Apple's tax strategies, followed by testimony at a public hearing by Apple executives, stating: "There is no shifting going on. We pay all the taxes we owe."
  - This was Part 2 of a series of investigations into "Offshore Profit Shifting and the U.S. Tax Code." Part 1 had previously focused on Microsoft and HP
  - Resulting recommendations:
    - Strengthen §482
    - Reform CTB and look-thru rules
    - Tax CFCs under US management and control
    - *Properly enforce* the Subpart F same-country exception
    - *Properly enforce* the Subpart F manufacturing exception
- Tax Extenders
  - On December 31, 2013, 55 temporary tax provisions expired, including the R&D credit, bonus depreciation, CFC look-thru rule, and Subpart F active financing exception
  - New Chair of the Senate Finance Committee, **Senator Wyden**, has publicly stated that addressing the tax extenders will be a top priority

Camp – Option A

- Obama's Excess Profits Tax
- Taxes currently excess income to foreign affiliates receiving US IP
- New §954(e) contains a new Subpart F category, "foreign base company excess intangible income" (FBCEII), that is defined as the sum of the gross income derived from the sale / license of a "covered intangible," and the provision of services related to the IP, over 150% of the costs allocable to such income
- There is a same-country exception
- There is also an exception for the percentage of income that equals a ratio that the ETR minus 5% bears to 10%
  - For example, 75% of income taxed in Ireland would be excludable ((12.5% – 5%) ÷ 10% = 75%)
  - Needs to be clarified whether disregarded entities under a CFC are to be considered in determining the CFC's effective tax rate
- FBCEII would also be placed in a separate FTC basket
- This new Subpart F category only applies in prospective tax years, but there is no provision explicitly grandfathering out prior transfers of IP (e.g., from CSAs)

Camp – Option B

- Minimum Tax on Foreign Earnings
- New category of Subpart F income
- Includes CFC's gross income, with exception for income that is either:
  - Derived in the CFC's home country; or
  - Subject to an ETR in excess of [10%]
- Home country requirement that income be derived in connection with property sold for use, consumption, or disposition in such country or services provided with respect to persons or property located in such country
- ETR determined separately on a CbC basis

Camp – Option C

- US Patent Box (Carrot) + Current Taxation of Foreign IP Income (Stick)
- **Stick** – New category of Subpart F income, "foreign base company intangible income" (FBCII)
  - Includes "intangible income" of a CFC, unless subject to a tax rate of 13.5% (90% of 60% of 25%)
  - Intangible income is gross income from goods and services attributable to §936(h)(3)(B) intangibles
- **Carrot** – US corporation may deduct [40%] of the "foreign intangible income" earned (i) directly (e.g., exports, foreign-source royalties) or (ii) indirectly through a CFC to the extent attributable to foreign intangible income, resulting in *current taxation of intangible income at a 15% tax rate*
  - Foreign intangible income is intangible income derived from (i) property sold for use, consumption, or disposition outside the US and (ii) services on such property outside the US
  - FBCII with respect to property sold into the US or services provided in the US would not be eligible for the 40% deduction. Instead, taxed at a 25% rate

Baucus – Option Y

- Minimum Tax on Foreign Earnings
- 100% DRD for foreign-source portion of dividends
- Two new categories of Subpart F income:
  - "US-related income" – imported property and services income
  - "Low-taxed income" – items of income of a CFC not subject to a foreign ETR of at least [80%] of US rate are subject to tax
    - Note that if the US corporate rate doesn't come down, 80% of 35% is **28%**!
- Eliminates FBC sales, services, and oil-related income rules
- §954(c)(6) look-thru rule not extended, but dividends between related CFCs are generally excluded from Subpart F
- Full exemption for foreign earnings upon repatriation
- FTC limitation calculated using *6 categories* of Subpart F income
- Denies interest expense deductions allocated to non-US income

Baucus – Option Z

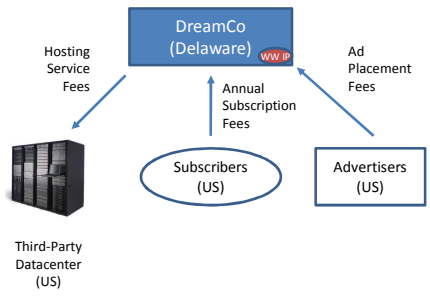
- Quasi-Territorial System
- "Active foreign market income" subject to tax at a rate of [60%] of the US corporate tax rate (i.e., [40%] of income exempted)
  - Full exemption for foreign earnings upon repatriation
  - No FTC upon repatriation of untaxed [40%] portion of active income
- For passive income, 100% of remaining income of the CFC would be currently taxed
- FTC limitation calculated using 3 baskets (new Subpart F definitions)
- Denies interest expense deductions allocated to non-US taxed income
- Repeals §1248 and replaces it with a similar provision
- Endorsed by Professor Kleinbard at the 2014 Pacific Rim Tax Institute

US Alignment with Pressure Areas

BEPS Key Pressure Area	US Proposal	Source
Entity / Instrument Characterization	Limit some foreign entities' ability to make a CTB election	Stop Tax Haven Abuse Act; Camp Discussion Draft; Baucus Discussion Draft
Application of Treaty Concepts to Digital Goods / Services	Reform ECI rules	Senate White Paper
Intergroup Financial Transactions	Prevent use of leveraged distributions from related foreign corps; treat interest received from related CFC as Subpart F income; repeal exemption for portfolio interest; apportion interest expense on a WW basis	2014 Green Book; Senate White Paper; Baucus Discussion Draft
Transfer Pricing	Expand §936(h)(3)(B) definition of "intangible property"	2014 Green Book; Stop Tax Haven Abuse Act; Baucus Discussion Draft
Anti-Avoidance Measures	Amend §163(j) so "expatriated entities" cannot deduct "excess interest expense" for 10 years regardless of debt / equity ratio	Senate White Paper
Availability of Harmful Preferential Regimes	Excess returns tax; minimum tax on foreign-source income	Camp Discussion Draft; Business Tax Reform; Baucus Discussion Draft

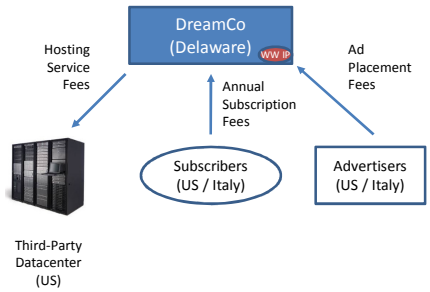
EXAMPLES

Example 1 – US Only / Startup



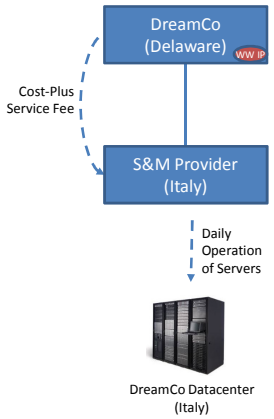
- **DreamCo** is a startup with a single entity, a Delaware corp. The corp owns all WW economic rights to DreamCo's IP
- DreamCo has developed a website that *automatically* analyzes your dreams (based on an algorithm)
  - Free version of the website contains ads (tailored to the content of the dreams)
  - For an annual fee, users can subscribe to a premium version of the site with no ads and deeper analysis
- DreamCo hosts its users' recorded dreams on US-based servers owned by a third party
- DreamCo's users / subscribers / advertisers are all located in the US. Pays ~40% total federal & state current tax on all income
- Why wouldn't DreamCo want International Tax Reform, if the US federal tax rate decreased from 35% to, say, 25%?
  - However, query if R&E credit is eliminated, advertising expense is capitalized, etc.
  - Might have NOLs and thus no immediate interest in Tax Reform

Example 2 – Global Customers



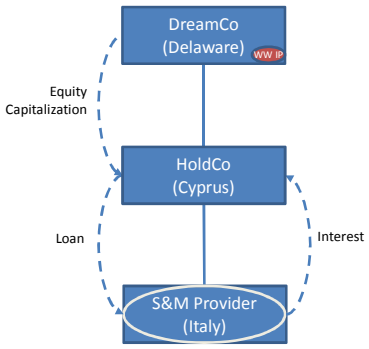
- DreamCo has decided to "go global." Targets Italy
- Under treaty, service fees are business profits. Servers remain in US, so no PE. Thus, fees not subject to Italian WHT or income tax
- But DreamCo still paying ~40% current US tax on income -> probably endorses Tax Reform
- Possible problem? Due to high volume of users, Italy feels entitled to tax some of the income
- **Action 1** – OECD could expand treaty definition of PE to include "virtual PEs." See *Dell (Spain 2012)*. OECD could also recharacterize subscription fees as royalties (subject to 5% WHT). Or Italy could (try to) tax ad fees that are not paid to Italian VAT registered companies
  - DreamCo should be able to credit Italian tax, so is indifferent, unless the IRS disagrees on the FTC or US changes to a Territorial tax system
- **Action 14 (treaty dispute resolution mechanisms)**
- **Action 15 (multilateral instrument)** – Rather than renegotiating 3,000+ treaties, OECD may ask all members to sign a multilateral treaty implementing the above proposals

Example 3 – Foreign Presence



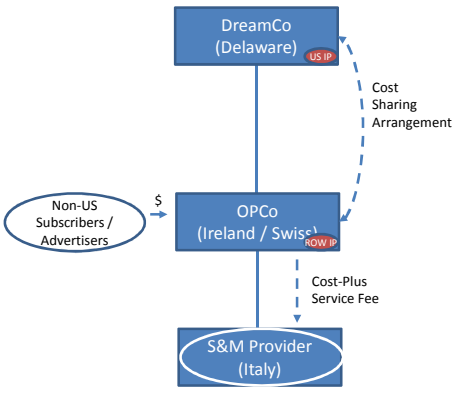
- DreamCo now has a sales &marketing entity *and* servers in Italy. Servers are owned and operated by local entity
- S&M Provider compensated by cost + small markup (e.g., 5%). Markup taxed by Italy
- Subscription / ad fees still currently recognized by DreamCo US at ~40%
- Problem? Italy feels sub not earning enough for functions performed (e.g., management / localization of Italian website)
- **Actions 8 (intangibles) and 10 (high-risk transactions):**
  - Could Italy impute a distributor arrangement with a larger margin (e.g., 3% of revenues)?
  - Could Italy assert that the sub has created valuable marketing intangibles?
  - Query: Should DreamCo book a FIN 48 reserve?
  - Formulary apportionment unlikely, but possible shift to use profit split methods?
- **Action 13 (TP documentation)** – DreamCo may need to document its intercompany services arrangement on a CbC basis

Example 4 – Finance/Holding Company



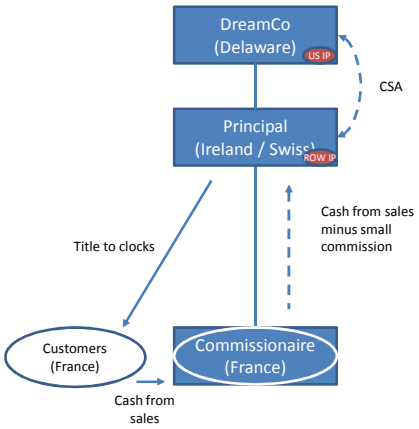
- DreamCo establishes Cyprus (EU member) HoldCo, which funds S&M Provider with debt. Interest income is taxed at low Cyprus rate (12.5%), strips earnings out of Italy, and is deferred from US tax due to CTB structure
- Problem? HoldCo may be "overcapitalized"
- **Action 9 (TP for capital)** – OECD initiatives could possibly deny the excess capitalization of HoldCo (bringing some income back to the US as a dividend) or recharacterize all or part of the capitalization as debt (thus imputing interest payments back to the US)
- **Action 6 (treaty abuse)** – Maybe Italy disregards Cyprus / re-characterizes loan
- **US Tax Reform** – Loss of CTB / look-thru rule -> Subpart F income to Cyprus

Example 5 – Single-Tier IP / OPCo



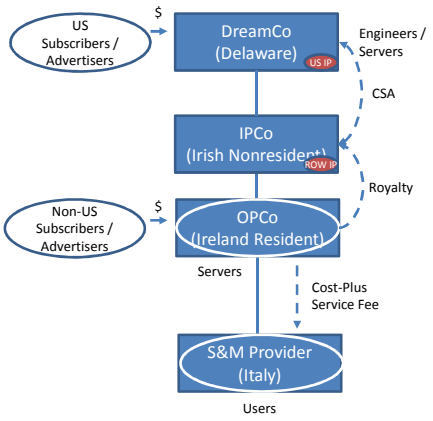
- DreamCo implements single-tier deferral structure (e.g., Ireland, Switzerland)
  - Ireland declares 12.5% rate will not change due to BEPS
  - Switzerland however seems moving to IP Box and away from Canton tax holidays
- Most non-US income is taxed at 10-12.5%
- **Action 3 (CFC rules)** – US Tax Reform initiatives for CFCs could tax some minor portion under new Subpart F
- **Actions 8 (TP for intangibles) and 10 (TP for high-risk transactions)** – IRS states that US TP rules on IP migrations are adequate
- **Actions 5 (harmful tax practices) and 12 (disclosure of aggressive tax planning arrangements):**
  - Will the Irish and Swiss regimes fall afoul of any new harmful tax practices rules?
  - Could require substantial activity for preferential ruling
  - Could require compulsory exchange of info re rulings for preferential regimes

Example 6 – Commissionaire



- DreamCo now wants to alarm clocks to French customers using a low-risk "commissionaire"
- Commissionaire sells goods to French customers in own name but on account of Principal. Identity of Principal is not disclosed
- Under common law, Commissionaire would be dependent agent PE (because has authority to bind Swiss Principal), but France (a civil law jurisdiction) takes a formalistic approach. See *Dell (2010)*
- Problem? Contracts with French customers are negotiated / concluded by Commissionaire, but the profit margin is lower than a distributor
- **Action 7 (PE status):**
  - Could expand definition of dependent agent PE in Article 5 to include Commissionaire
  - Related profit attribution issues in Article 7

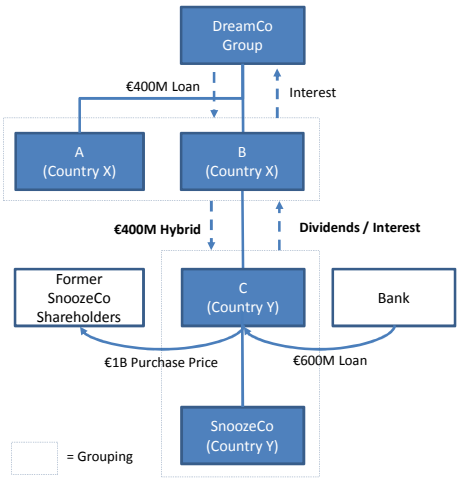
Example 7 – Two-Tier IP / OPs



- DreamCo expands to two-tier deferral structure (e.g., IR / INR). Further reduction of foreign ETR
- Problem? Disaggregation of functions (i.e., people) from profits (based on contractual risk)
- **Actions 8, 9, and 10 (TP of intangibles and risk):**
  - Higher substance requirement / functional alignment in TP Guidelines
  - Criteria to test whether IP ownership should be accepted
- **Actions 2 (hybrid entities) and 3 (CFC rules)** – Eliminate CTB and same-country royalty exception
- **Action 12** – DreamCo or Irish Revenue may need to disclose aggressive arrangement
- **Option A*** – If IPCo's ETR is <15% and income is >150% cost, IPCo's income may fall under new Subpart F category (FBCEII)
- **Option B*** – If IPCo's ETR is <10%, its income may be Subpart F
- **Option C*** – IPCo's IP income may fall under new Subpart F category (FBCII) if <13.5%, thus taxed currently in US at 15%
- **Option Y*** – If IPCo's ETR is <28%, IPCo's income may be Subpart F
- **Option Z*** – If the royalty is passive, IPCo's income may be Subpart F

* Some assumptions were made. Results may differ based on actual facts

Example 8 – Leveraged Acquisition*



* Adapted from Annex C, OECD BEPS Report

- DreamCo now wants to acquire SnoozeCo, a manufacturer of high-end alarm clocks, using debt
- Hybrid instrument (redeemable preferred shares) is treated as debt in Country Y yet equity in Country X. Concern here is that interest is deductible by SnoozeCo (due to grouping), yet dividends are exempt by Country X's participation regime
- Interest paid by B also reduces A's income due to grouping
- No withholding on hybrid's interest due to X-Y treaty
- Country X exempts capital gains and X-Y treaty relieves Country Y's capital gains tax; therefore, no tax when C is eventually sold
- **Actions 2 (hybrids) and 6 (treaty abuse):**
  - Could change Model Treaty to ensure hybrid instruments don't get treaty benefits
  - Members could collectively change domestic law to prohibit deduction of payments where receipt of income is not taxed. Cf. §267(a)(2)-(3) (matching principle); *Tate & Lyle* (requiring that accrual taxpayers defer deductions for interest owed to related foreign payees until the interest is paid)
- **Action 4 (base erosion)** – Could limit excessive interest deductions where the interest income is not taxed or taxed lightly

Possible Action Items Now

1. Model impacts of US / OECD proposals
   - Foreign effective tax rate under US alternatives
   - Increased FIN 48 reserves?
2. Educate Executives / Board of Directors
   - Company's overall ETR under US / OECD initiatives
3. Consider "de-risking" international structure
   - Align substance with key entities
   - Collapse two-tier structures into one-tier?
   - Obtain APAs for Principals / Distributors / S&M
4. Lobby for your interests
   - Industry trade groups, TEI, SVTDG, etc.

Q&A

Appendix – US Proposals

	2014 Green Book	Business Tax Reform	Camp Discussion Draft	Enzi Bill	Stop Tax Haven Abuse Act	Senate White Paper	Baucus Discussion Draft
System of taxation	World-wide	Worldwide	Territorial	Territorial	Worldwide	Territorial	Y: World-wide Z: Territorial
Corporate tax rate	35%	28%	25%	35%	35%	35%	[<30%]
Excess returns tax	Yes	Yes	Option A	No	Yes	Yes	No
Minimum tax rate on FSI	No	Yes	Option B	Yes	No	Yes	Option Y

Appendix – US Proposals cont'd

	2014 Green Book	Business Tax Reform	Camp Discussion Draft	Enzi Bill	Stop Tax Haven Abuse Act	Senate White Paper	Baucus Discussion Draft
Inclusion of pre-enactment undistributed income	No	No	Mandatory (85% deduction)	Elective (75% deduction)	No	Yes	Yes (20% rate)
FTCs pooled	Yes	Yes	No	No	Yes	No	No
Limit interest deduction	No	Yes	Yes	Yes	Yes	Yes	Yes
Foreign branches treated as CFCs	No	No	Yes	No	Ability to make CTB elections limited	Yes	Eliminates CTB regime for entities with ≥1 owner

Circular 230 Notice

- In compliance with U.S. Treasury Regulations, please be advised that any tax advice given herein was not intended or written to be used, and cannot be used, for the purpose of (i) avoiding tax penalties or (ii) promoting, marketing or recommending to another person any transaction or matter addressed herein.

Annex III to Chapter V: A Model Template of Country-by-Country Reporting

Overview of allocation of income, taxes and business activities on a country-by-country basis

Country	*Constituent Entities Organised in the Country*	*Place of Effective Management*	*Important business activity code(s)*	*Revenues*	*Earnings Before Income Tax*	*Income Tax Paid (on Cash Basis)*		*Total Withholding Tax Paid*	*Stated capital and accumulated earnings*	*Number of Employees*	*Total Employee Expense*	*Tangible Assets other than Cash and Cash Equivalents*	*Royalties Paid to Constituent Entities*	*Royalties Received from Constituent Entities*	*Interest Paid to Constituent Entities*	*Interest Received from Constituent Entities*	*Service Fees Paid to Constituent Entities*	*Service Fees Received from Constituent Entities*
						(a) To Country of Organisation	*(b) To All Other Countries*											
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SAN JOSE STATE UNIVERSITY | Lucas Graduate School of Business
The State Bar of California
The Taxation Section, Tax Policy Committee
TAX EXECUTIVES INSTITUTE, INC.

Tax Policy Conference
Federal Tax Reform: Dealing with the Known and Unknown
Friday, February 28, 2014

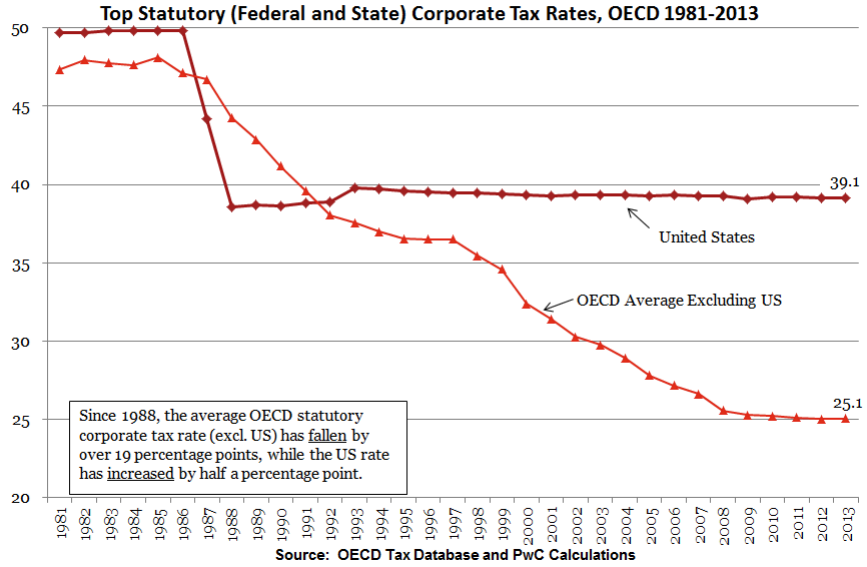
The Political Forecast for Tax Reform

Ron Dickel, Intel
Dan Kostenbauder, Hewlett-Packard

Our Topic

- What will it take politically for tax reform to occur
- Forecasts for something happening

International competitiveness



Model for U.S. Tax Reform -- 1986

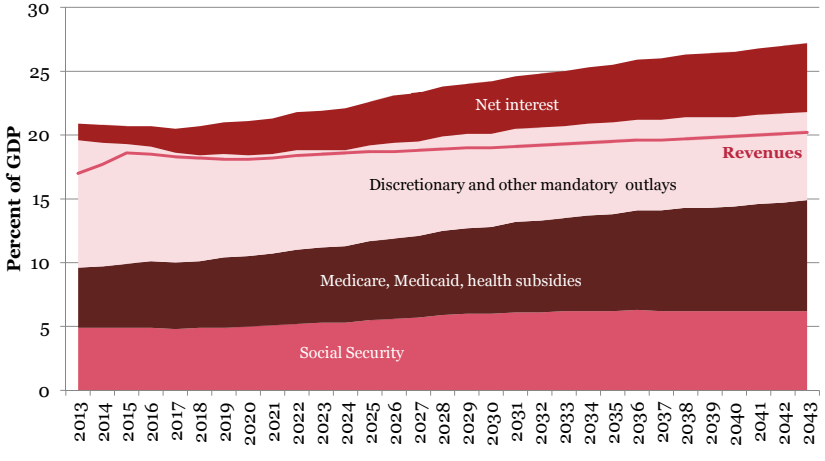
- Strong Presidential leadership
- Bi-cameral, bi-partisan intellectual leadership
- Bi-cameral, bi-partisan political leadership
- Slogan – "broaden the base, lower the rate"
- Agreement on revenue neutral approach
- Active involvement by US Treasury
- Running start from revenue perspective
  - Repeal of ITC
  - Tax shelters
  - Corporate AMT
- Tax cuts for most individuals

Macro Political Analysis

- Deficits
- Political polarization

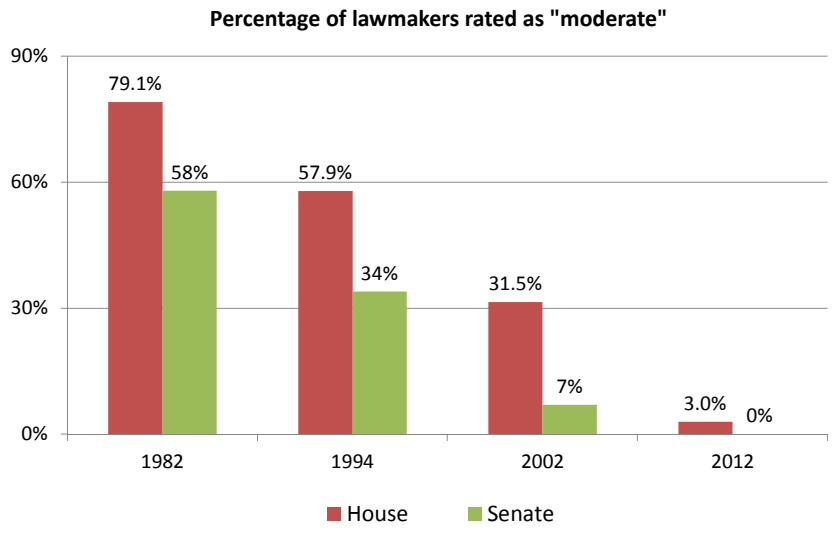
CBO long-term budget projections, 2013-2043

Extended baseline assumptions include "sequester" level spending caps and no extension of expiring tax provisions

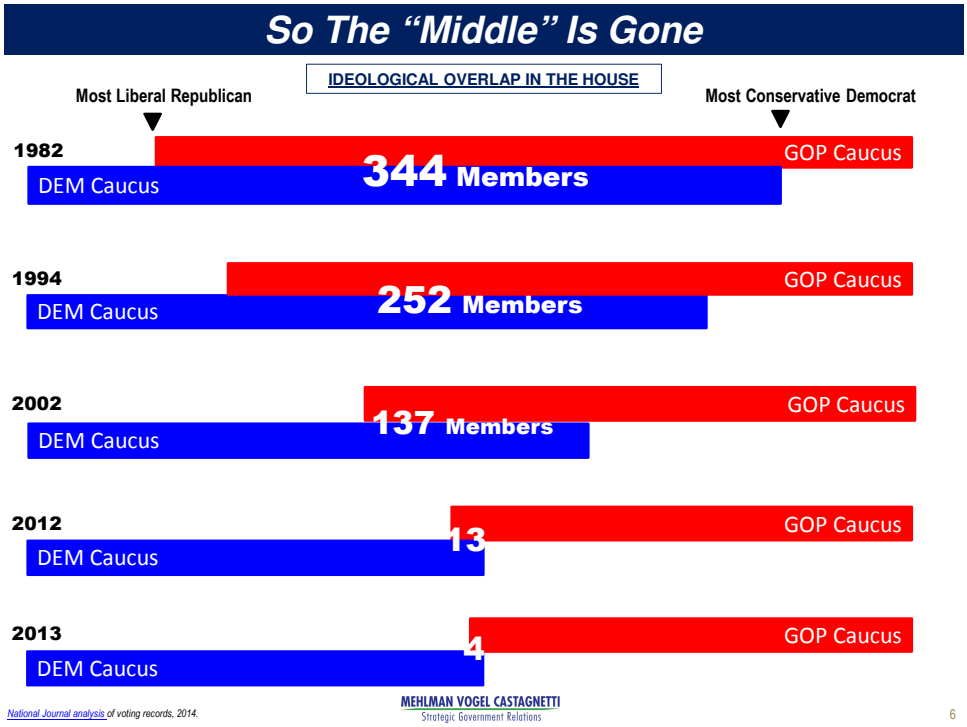


Source: CBO's Extended Baseline from the 2013 Long Term Budget Outlook, September 2013.

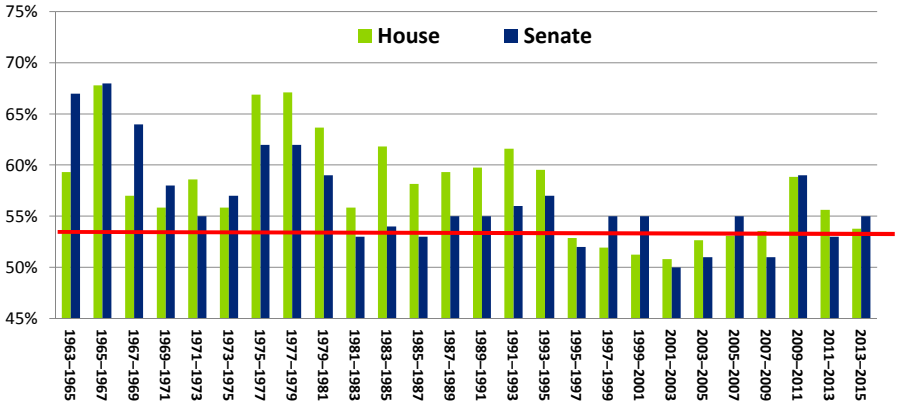
Difficulty of Getting a Bipartisan Compromise



Source: National Journal's 2012 Vote Ratings (February 2013)



Narrow Majorities on Capitol Hill Leave Little Margin for Error; Especially Challenging in Divided Government



Note: Average 1963-1995: 263.3 (H), 58.4 (S) 1995-2015 (excluding the 111th Congress): 230.1 (H), 53 (S)
Note: Members are not considered if the position is vacant.
Source: "Composition of Congress, by Political Party, 1855–2015." Information Please Database, available at http://www.infoplease.com/ipa/A0774721.html (last visited November 4, 2013).

Current Tax Reform Issues

- Revenue neutrality
  - President and Democrats want to raise revenue
  - Republicans want revenue neutrality (or cuts)
- Scope
  - Individual
  - Pass-through
  - Business
  - International

Current Tax Reform Players

- Chairman Dave Camp (R-MI)
  - Term-limited as W&M Chairman through 2014
  - Tax Reform needs to be part of a Republican economic agenda
- Chairman Ron Wyden (D-OR)
  - New Chairman of Senate Finance Committee
  - Has introduced bipartisan tax reform bills to lower the rate to 24% & broaden the base, but also repeals deferral
- Ranking Member Orrin Hatch (R-UT)
  - Next Chairman in 2015?
  - Chair of Senate Republican High-Tech Caucus

Current Tax Reform Players

- Obama Administration (Lew, Mazur, Koskinen)
  - Tax reform not a priority
  - Focused more on 'messaging' than tax policy
- Rep. Paul Ryan (R-IL) or Kevin Brady (R-TX)
  - Likely new chair of W&M in 2015
  - Ryan is big proponent of comprehensive tax reform
- Senate Democratic Leadership
  - Revenue, revenue, revenue
  - Concerns about 'off-shoring' with territorial system
- House Republican Leadership
  - Concerns about tax reform votes being politicized in an election year
  - Keep the focus on Obamacare

Current Tax Reform Activity So Far

- House
  - Camp working with Committee Rs to finalize his comprehensive tax reform bill.
  - Revenue neutral, 25% rate, territorial system with anti-base erosion rules
  - Government shutdown, Obamacare rollout, budget negotiations etc… delayed a 2013 mark up. Will he mark up in 2014?
- Senate
  - Summer 2013 - Baucus/Hatch solicited input from Senators.
  - Winter 2013 - Baucus released drafts on international, capital cost recover, energy & tax administration. Asked for input by 1/17/14.
  - Will Wyden pull from any of these drafts?
- White House
  - July 2013 tax reform fact sheet; no legislative language/specifics.
  - Revenue from repatriation/depreciation changes for an infrastructure bank.
  - 2015 Budget in early March

Revenue Estimating

- Cash basis with no net present value discounting
- Static, Dynamic, Reality-based
- Usually GNP is held constant in revenue estimated, but CBO is willing to score tax reform on dynamic basis
- 10-year window
- Timing differences

Potential Impact of Individual Tax Reform

Ten Largest Individual Tax Expenditures, 2014	2014 Expenditure Value (in $B)
Exclusion of employer health contributions	$143.0
Exclusion of pension plan contributions and earnings	$108.5
Reduced rates of tax on dividends and capital gains	$91.3
Mortgage interest deduction	$71.7
Earned income tax credit	$67.0
Exclusion of Medicare benefits	$66.0
Child tax credit	$57.9
Deduction for state and local taxes	$51.8
Exclusion of capital gains at death	$48.4
Deduction for charitable contributions	$46.4

Source: "Estimates of Federal Tax Expenditures For Fiscal Years 2012-2017," Joint Committee on Taxation, JCS-1-13, Feb. 1, 2013.

Tax Reform: Issues to Resolve

On One Hand	On the Other…
Revenue neutral tax reform	Tax reform that raises additional revenue
Tax code that maintains current progressivity	Tax code that increases tax burden for upper income
Passthroughs	Corporate entities
U.S. companies with mostly domestic operations	U.S. companies with substantial overseas operations
U.S. companies with "bricks & mortar" offshore operations	U.S. companies with liquid assets abroad
Outbound U.S. multinationals	Foreign-owned inbound companies
Highly leveraged companies	Well capitalized businesses
Governments looking to attract investment	Governments looking to raise revenue

2014 Elections

- House will likely stay Republican, but Senate is in play.
- How would Senate control impact tax reform?
  - Revenue raising vs. revenue neutral
  - International tax system
  - Individual rates

Tax Extenders

- Senate Democrats tried in December 2013
- Provisions including the R&D tax credit, CFC look-through & active finance provisions expired on 12/31/13.
- Final passage not likely until the 2014 lame duck congress because:
  - Do extenders need to be paid for (UI?)
  - Concerns from House Republicans that package is too big, includes special interest provisions
  - Chairman Camp pushing for broader reform
- Chairman Wyden sees extenders as “bridge to tax reform”

Other Issues and Tax "Vehicle"

- Other issues for Congress in 2014
  - Emergency Unemployment Insurance
  - Trade and TPA
  - Minimum wage
  - Comprehensive immigration reform
  - Climate change legislation
  - Military pension COLA (Shaheen amendment)
- Tax "Vehicles"
  - Medicare "doc fix" (SGR)
  - Highway bill

G20/OECD BEPS Project

- Will this project influence US tax reform?
- Base erosion
  - Camp Options A, B and C
  - Baucus Options Y and Z
- Hybrids
- CFC – controlled foreign corporation -- rules

The Tax Reform Act of 2014

Press release
2/26/14

[DISCUSSION DRAFT]

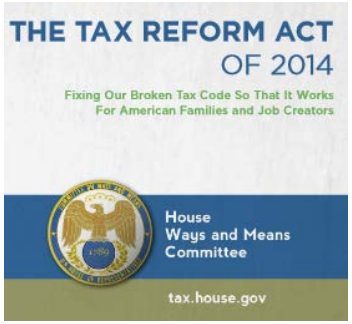
FEBRUARY 21, 2014

113TH CONGRESS
2D SESSION

H. R. _____

To amend the Internal Revenue Code of 1986 to provide for comprehensive tax reform.

Tax Reform Act of 2014
Discussion Draft
Section-by-Section Summary



Executive Summary

Joint Committee on Taxation

[JCT Technical Explanation Title I Individual JCX 12 14 022614]

[JCT Technical Explanation Title II AMT Repeal JCX 13 14 022614]

[JCT Technical Explanation Title III Business JCX 14 14 022614]

[JCT Technical Explanation Title IV Participation Exemption System JCX 15 14 022614]

[JCT Technical Explanation Title V Tax Exempt Entities JCX 16 14 022614]

[JCT Technical Explanation Title VI Tax Administration and Compliance JCX 17 14 022614]

[JCT Technical Explanation Title VII Excise Taxes JCX 18 14 022614]

[JCT Technical Explanation Title VIII Deadwood Provisions JCX 19 14 022614]

[JCT Revenue Estimate JCX 20 14 022614]

[JCT Distributional Effects JCX 21 14 022614]

[JCT Macroeconomic Analysis JCX 22 14 022614]

House Ways & Means Committee
Tax Reform website

Additional tax reform information and links from Professor Annette Nellen - http://www.21stcenturytaxation.com/.