Chairman Baucus Issues a Discussion Draft on Tax Reform

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Chairman Max Baucus has issued a discussion draft that offers some interesting and provocative proposals on corporate international tax reform. Designed to ?reform international tax rules to spark economic growth, create jobs, and make U.S. businesses more competitive,? the discussion draft would end tax deferral on foreign earnings, historical and future, and replace the deferral system with a new system that sounds like subpart F for all offshore income, passive and active. It also would repeal the IC DISC rules and other incentives for exporting products manufactured in the United States.

Key provisions

- Eliminates parts of the "check-the-box" rule under which U.S. multinationals can disregard certain foreign subsidiaries for U.S. tax purposes (it does not change the domestic application of the "check-the-box" rules).
- Passive and highly-mobile income is taxed annually at full U.S. rates.
- Income from selling products and providing services to U.S. customers is taxed annually at fullU.S. rates with limited exceptions.
- The discussion draft includes two options for taxing income from products and services sold into foreign markets:
  - A minimum tax that immediately taxes all such income at 80% of the U.S. corporate tax rate with full foreign tax credits, coupled with a full exemption for foreign earnings upon repatriation;
  - A minimum tax that immediately taxes all such income at 60% of the U.S. corporate tax rate, if derived from active business operations, but at the full U.S. corporate tax rate if not, coupled with a full exemption for foreign earnings upon repatriation.
- Earnings of foreign subsidiaries from periods before the effective date of the proposal that havenot been subject to U.S. tax are subject to a one-time tax at a reduced rate of, for example, 20%, payable over eight years.

- Unless otherwise noted, credits are allowed for taxes paid to foreign jurisdictions to the extent the associated income is subject to U.S. tax.

Limit and repeal DISC and other U.S. deductions

- Limits interest deductions for domestic companies to the extent that the earnings of their foreign subsidiaries are exempt from U.S. tax and to the extent that the domestic companies are over-leveraged when compared to their foreign subsidiaries.
- Limits income shifting through intangible property transfers.
- Denies deductions for related party payments arising in a base erosion arrangement.
- Repeals the domestic international sales corporation rules.
- Limits the extent to which foreign tax credits can eliminate U.S. tax on income from investments in foreign companies that are not controlled foreign corporations.
- Restores withholding taxes on interest paid by domestic corporations to residents of countries not providing similar benefits for U.S. investors.
- Prevents foreign investors from using partnerships to avoid U.S. taxation.

Other International Tax Rules.

- Simplifies the foreign tax credit rules.
- Apportions interest expense on a worldwide basis for purposes of matching interest expense to income generated by borrowed funds.
- Modernizes the rules applying to overseas banking and insurance businesses.
- Simplifies the rules for taxing passive foreign investment companies.
- Updates rules addressing foreign investment in U.S. real estate.

It is hard to find simplification in these proposals. They replace one set of complex rules with a new and different set of complex rules. For example, how will we define foreign earnings? In addition, the proposed tax rates still appear to be too high.

These are interesting proposals, but on balance it is likely they would keep the USA in a position of relative weakness in the global tax rate arms war. When this happens, it can accelerate capital flight from the US.

In the current polarized political environment in D.C., it is not likely there can be meaningful consideration of comprehensive tax reform before the 2014 election. It is not even clear there could be a consensus on the definition of ?tax reform.? Following the release of this, and two other reform proposals this week, Republican Ranking Member Orrin Hatch (UT) offered this commentary ? ?the fact is that significant policy differences remain between both sides and a final agreement was never reached.? In addition, numerous business organizations, like the Business Roundtable, have issued statements critical of this discussion draft.

Nonetheless, we will probably continue to hear echoes of many of these proposals throughout the future debates on tax reform and budget negotiations, and we can expect to find some of these concepts incorporated into law at some point.

Chairman Baucus stated that he is seeking feedback from stakeholders on his international tax reform discussion draft and other reform proposals. Affected parties may wish to contact Chairman Baucus, their Senator, or their Congressman. The comment period will be open until January 17th, 2014.

Chairman Baucus is expected to release additional discussion drafts during December.

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