Hunton & Williams

Client Alert

May 2009

Obama Proposes International Tax Changes

On May 4, 2009, President Obama and Secretary Geithner announced four tax proposals relating to offshore investments that will be included in the Obama administration's (the "Administration") full budget, which will be released later in May. A general description of the proposals is presented below. The Administration indicated that additional international tax reforms also will be included in the full budget. The budget is also expected to provide for an additional 800 Internal Revenue Service employees devoted to international tax enforcement. A copy of the Administration's press release regarding the tax proposals is attached below.

Eliminate "Check the Box" Rules for Certain Foreign Entities

President Obama's proposal would eliminate the ability of a foreign entity with a single beneficial owner to "check the box" to be treated for U.S. federal income tax purposes as a "disregarded entity" that is a non-corporate branch of its single beneficial owner. Such a foreign entity would instead be treated as a separate foreign corporation for U.S. federal income tax purposes. As a result, such a foreign entity and its beneficial owner or other affiliated foreign entities would be more likely to be subject to increased taxation in the United States under the rules that apply to controlled foreign corporations, including subpart F. This provision would take effect in 2011. There is no exception in President Obama's proposal for existing entities.

Expense Deductions

President Obama's proposal continues to allow deferral on the unrepatriated active earnings of a controlled foreign corporation. It would not, however, allow U.S. parent companies to take deductions for expenses supporting such offshore investments (including, in particular, expenses for interest paid, but excluding expenses for research and experimentation) until the companies pay U.S. tax on their offshore profits upon repatriation. This provision would take effect in 2011. This proposal is less than the complete repeal of the tax-deferral rules that some international companies had feared.

Foreign Tax Credit

President Obama's proposal would determine a taxpayer's foreign tax credit based on the amount of total foreign tax the taxpayer actually pays on its foreign earnings. In addition, the proposal would eliminate foreign tax credit for foreign taxes on income not subject to U.S. tax. It is unclear at this time how the proposal will be implemented to modify the already complicated and cumbersome foreign tax credit rules. These provisions would take effect in 2011.

Provisions Affecting Individuals

President Obama's proposal would require foreign financial institutions to share information with the United States about their customers or face having taxes withheld on U.S. payments from U.S. financial institutions to their customers. The proposal is not entirely clear on which kinds of payments will be subject to withholding. The proposal would also enhance reporting requirements, increase penalties, extend the statute of limitations for enforcement and place the burden of proving that an individual does not own an offshore account on the individual, rather than requiring the Internal Revenue Service to prove that the individual does own the account.

The tax lawyers at Hunton & Williams LLP have extensive experience working with the international tax provisions of the Internal Revenue Code, and are able to help you determine the impact of the Administration's proposed changes on your business as well as aid you in planning for any restructuring that may be necessary. If you would like to receive more information about President Obama's proposal or if you would like to discuss issues regarding offshore investments generally, please contact any of the lawyers listed below.

Click here for the press release from the U.S. Department of the Treasury regarding the proposals.

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