

C-Corps in a Sea of Change: Sub-C International Tax Update

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What's New?

Key Provisions in The American Jobs Creation Act of 2004

- I. Extraterritorial Income Tax Regime Repeal ("ETI")
- II. Tax Relief for Manufacturers
- III. Foreign Tax Credit Reform
- IV. Incentive to Reinvest Foreign Earnings in the United States
- V. Anti-Deferral Reform: Sub-Part F, etc.
- VI. Other Foreign Highlights
- VII. International Tax Studies
- VIII. Key Non-Foreign Provisions

I. Extraterritorial Income Tax Regime Repeal ("ETI")

A. Repeal Phase-Out

- ETI is a replacement for Foreign Sales Corporation (FSC). FSC was ruled illegal by WTO.
- ETI has also been ruled illegal by the WTO
- Phase Out: Transactions through 2004: 100% of ETI benefits
 Transactions during 2005: 80% of ETI benefits
 Transactions during 2006: 60% of ETI benefits
 Transactions after 2006: No ETI benefits
- Binding contract exception: Contracts at 9/17/03
- Foreign corps which elected to be treated as domestic to claim ETI can reverse election within 1 year of enactment without triggering gain/loss

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I. ETI Repeal (cont'd.)

ETI Phase Out/MFG Deduction Phase In

B. Table—Compare Phase-Out/Phase-In

		Phase-Out of ETI (Raises \$49 Billion)						
		2004	2005	2006	2007	2008	2009	2010
ETI Benefit	Allowed	100%	80%	60%	0%	0%	0%	0%
		Phase-In of Manufacturing Deduction (Costs \$77 Billion)						
		2004	2005	2006	2007	2008	2009	2010
Percentage	Deduction	0%	3%	3%	6%	6%	6%	9%

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II. Tax Relief for Manufacturers: Manufacturing-Production Incentives

A. The New Deduction

- Years beginning in 2010, deduction of 9% of LESSER of:
 - “Qualified production activities income” or
 - Taxable income
- Phase in, tax years beginning in:
 - 2005/6 - 3%
 - 2007/8/9 - 6%
- Limit on deduction: No more than 50% of W-2 wages
- Affiliated groups (50% instead of 80%):
 - All members of affiliated group treated as 1 corporation
 - Deduction allocated among members

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II. Manufacturing-Production Incentives (cont'd.)

- Production property must be manufactured, produced, grown or extracted “in whole or significant part within the US”
- Qualified production property includes computer software
- Also: Motion pictures, electricity, natural gas or potable water, construction, engineering and architectural services
- Don’t qualify:
 - Sale of food and beverages prepared at retail
 - Transmission of electricity, natural gas or water
 - Gross receipts from property leased, licensed or rented by any related person
- B. Issue: What constitutes “manufacturing”—Bausch & Lomb, sunglasses “manufacturing” example

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II. Manufacturing-Production Incentives (cont'd.)

- Qualified production activities income:

Domestic Production Gross Receipts	\$x,xxx,xxx
Less: COGS	<\$ xxx,xxx>
Less: (Directly) Allocable Deductions	<\$ xxx,xxx>
Less: (Indirectly) Allocable Deductions	<\$ xxx,xxx> **

Qualified Production Activities Income	xxx,xxx
	=====

** Note: Regulations to be issued
 Issue: How complex will rules be?
 Analogous Foreign tax credit allocation rules
 (Section 861) very complex

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III. Foreign Tax Credit Reform

- Reduction in baskets – 9 to 2 (12/31/2006)
- Carryover periods – 1 back, 10 forward (enactment)
- Repeal AMT 90% limitation (12/31/2004)
- Interest expense allocation rules (12/31/2008)
- “Base difference” items (12/31/2006)
- Recharacterization overall domestic loss (12/31/2006)
- 10/50 companies; new look-through rule (12/31/2002)
- Intangible property transfers (8/5/1997)
- Average exchange rate election (12/31/2004)
- Stock ownership through partnerships (enactment)
- Recapture of overall foreign losses, sale of CFC (enactment)

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IV. Incentive to Reinvest Foreign Earnings in the United States

- A. Reduced tax on repatriated foreign earnings
 - Election
 - 85% DRD for CASH dividends received from CFC
 - Must be invested in US pursuant to a reinvestment plan
 - Reinvestment plan must be approved by top officer before dividend paid and then approved by board
 - DRD only if dividend exceeds base period amount
 - Ceiling: Greater of \$500,000,000 or amount previously "permanently reinvested" per F/S (on or before 6/30/03)
 - Taxable income floor: 15% non-deductible dividend
- B. **Effective:** Only for 1st year beginning on or after enactment date or last year beginning before enactment date

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V. Anti-Deferral Reform: Sub-Part F, etc.

- A. Simplification-repeal of FPHC and FIC rules and incorporation into Subpart F (12/31/2004)
- B. Commodities transactions in Subpart F (12/31/2004)
- C. Elimination of most international aircraft leasing and shipping from Subpart F (12/31/2004)
- D. Modification of active financing exception (12/31/2004)
- E. Changes to the definition of US property for certain CFC's (12/31/2004)
- F. Look-through treatment for sales of partnership interests (12/31/2004)

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VI. Other Foreign Highlights

- A. "Tonnage Tax" election (enactment)
- B. Delay effective date for "Freight Tax" (to years after 9/24/2004)
- C. Eliminate certain secondary dividend withholding tax (12/31/2004)
- D. Favorable RIC dividend treatment (generally 2005-2007 only)
- E. Liberalization of certain REIT dividends to foreigners (enactment)
- F. Reduction of US withholding on dividends to Puerto Rican corporations (enactment)
- G. Sourcing changes—equal treatment for foreign partnerships and corporations (12/31/2003)
- H. Withholdings on horse/dog race winnings to foreigners generally eliminated (12/31/2003)

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VI. Other Foreign Highlights (cont'd.)

- I. Revenue raisers and anti-abuse provisions
 - Foreign financial accounts-enhanced penalties and enforcement
 - Corporate inversions subject to special rules (3/4/2003)
 - 80% or more
 - At least 60%
 - Excise tax on stock compensation of insiders in expatriated corporations (enactment)
 - Enhanced reporting of taxable mergers (enactment)
 - Reinsurance of US risk by foreign insurers (risks after enactment)
 - Liquidations of US holding companies are taxable dividends (enactment)
 - Less than 5 years
 - Tax avoidance motive
 - Foreign source interest income effectively connected

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VII. International Tax Studies

What's next? These studies will be guidelines for future reform.

- A. Earnings stripping (due 6/30/2005)
- B. Transfer pricing (due 6/30/2005)
- C. Income tax treaties (due 6/30/2005)
- D. Inversions, study of effectiveness of reforms (due 12/31/2006)

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VIII. Key Non-Foreign Provisions

- A. Executive compensation and employee benefits
- B. Tax shelter, anti-abuse and administrative provisions
- C. Depreciation and cost recovery
- D. S Corporations
- E. Business incentives and revenue raisers
- F. Individual incentives and revenue raisers
- G. Energy, fuel, excise taxes

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