



# World Tax Advisor

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## In this issue:

Six takeaways from proposed U.S. FATCA regulations .....	1
From FATCA to an automatic exchange of information between tax administrations .....	2
Belgium: Enacted and proposed measures under 2012 budget.....	3
United States: White House budget proposal takes aim at multinationals, upper income individuals .....	6
<a href="#">In brief</a> .....	11
Are You Getting Your Global Tax Alerts? .....	12

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## Six takeaways from proposed U.S. FATCA regulations

The U.S. Treasury Department and Internal Revenue Service (IRS) recently released nearly 400 pages of proposed regulations that detail their plans to implement the Foreign Account Tax Compliance Act (FATCA), which becomes effective on 1 January 2013. The proposed rules are intended to prevent U.S. taxpayers who hold financial assets in non-U.S. financial institutions and other offshore accounts from avoiding their tax payment obligations.

Under FATCA, certain U.S. financial institutions, foreign financial institutions (FFIs) and non-financial foreign entities are required to report information about offshore accounts and investments held by U.S. taxpayers to the IRS annually. These institutions include banks, insurance and real estate companies, hedge funds, mutual funds and private equity firms. FFIs must enter into agreements with the IRS. If they fail to enter into such agreements to report U.S. accounts, they will face a 30% withholding charge.

The following six points assist financial services executives as they examine the reach and implications of these new regulations.

### The rules simplify due diligence procedures for certain accounts

The Treasury Department has modified due diligence procedures relating to pre-existing accounts to permit FFIs to rely on electronic searches for accounts ranging from USD 50,000 to USD 1 million. For accounts with a balance of more than USD 1 million, FFIs will have to do paper searches that would be limited to documentation, current account files and certain correspondence. FFIs also would be required to question any relationship managers associated with these accounts to confirm that they do not have any knowledge that the client is a U.S. person. Searches are not required for accounts of less than USD 50,000 or for certain insurance contracts or entity accounts of less than USD 250,000. In many cases, including most instances of new account onboarding, banks would be able to rely on know your customer (KYC) and anti-money laundering rules they already have in place.

## The rules provide some relief on reporting

The proposed rules give FFIs additional time to make adjustments to their systems for reporting U.S. income. Through 2014, FFIs would only have to provide identifying information (name, address, taxpayer identifying number and account number) and the account balance or value of the U.S. accounts. Beginning in 2016, they will be required to report income. By 2017, full transactional reporting will be required.

## Treasury has extended the period for “grandfathered” obligations

The proposed rules extend the grandfathered period for certain obligations, such as debt securities, that would be exempt from the FATCA withholding tax requirement. The period has been extended to 1 January 2013. As a result, any obligation issued by an entity before this date would not be subject to the withholding requirement as long as the terms of the obligation have not been materially modified. Previously, obligations issued before 18 March 2012 would not have been subject to the requirement.

## The rules give members of expanded affiliated groups more time to comply

These rules would add a three-year transition period to the expanded affiliated group requirement to comply with FATCA. The rules previously required that each FFI in an expanded affiliate group needed to sign up either as a participating or deemed compliant FFI for FFIs to be in compliance – meaning none could participate if even one affiliate could not satisfy the requirement. The new rules now provide additional time for affiliates that are in restricted countries to enter into agreements. However, restricted FFIs will still have to go through due diligence requirements with respect to their accounts. And if they receive “withholdable” payments, they will be subject to withholding during this transition period.

## U.S. enlists help from five EU nations on tax evasion

At the same time Treasury released the proposed rules, the U.S. announced an agreement with five European governments to help combat tax evasion, under which these governments would jointly develop a framework to collect and send information about offshore accounts held by Americans from their banks to the IRS. Once the framework is finalized, banks in those countries would not have to enter into separate agreements with the IRS. (See also “From FATCA to an automatic exchange of information between tax administrations,” in this issue of the *World Tax Advisor*.)

**URL:** [http://newsletters.usdbriefs.com/2012/Tax/WTA/120217\\_2.html](http://newsletters.usdbriefs.com/2012/Tax/WTA/120217_2.html)

## These are proposed, not final, regulations

The rules released by Treasury and the IRS are not yet finalized. Industry can still submit written or electronic comments to Treasury and the IRS by 30 April. A public hearing is scheduled for 15 May.

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## From FATCA to an automatic exchange of information between tax administrations

The French Minister of Economy announced on 8 February 2012 that France, and four other European countries (Germany, Italy, Spain and the U.K.) have reached an agreement with the U.S. to pursue a government-to-government framework for establishing a multilateral system for the automatic exchange of tax information instead of the Foreign Account Tax Compliance Act (FATCA) obligations that are scheduled to be imposed on non-U.S. financial institutions (“foreign financial institutions” or FFIs). (See also “Six takeaways from proposed U.S. FATCA regulations,” in this issue of the *World Tax Advisor*.)

**URL:** [http://newsletters.usdbriefs.com/2012/Tax/WTA/120217\\_1.html](http://newsletters.usdbriefs.com/2012/Tax/WTA/120217_1.html)

Under FATCA, which was enacted in March 2010 as part of the Hiring Incentives to Restore Employment Act and becomes effective on 1 January 2013, certain U.S. financial institutions, FFIs and non-financial foreign entities are required to report information about offshore accounts and investments held by U.S. taxpayers to the U.S. Internal Revenue Service (IRS)

annually. These institutions include banks, insurance and real estate companies, hedge funds, mutual funds and private equity firms. FFIs must enter into agreements with the IRS. If they fail to enter into such agreements to report U.S. accounts, they face a 30% withholding charge.

During a conference held on 19 January 2012, the French tax authorities (FTA) expressed the view that the U.S. measure involves a very complex search of information by FFIs, creating substantial legal, practical and financial obstacles. Even though the FTA fully shares the U.S. objective of fighting tax evasion, the FTA indicated it was seeking alternative arrangements, i.e. a simpler system based on administrative exchange of information between tax administrations that could be based on existing administrative assistance agreements concluded on a bilateral basis between the U.S. and other countries. This position was shared by the other four European countries.

After many months of discussion, the U.S. and the five European countries jointly issued a statement, announcing their intent to explore a common approach to FATCA implementation through domestic reporting and reciprocal automatic exchange based on existing bilateral tax treaties. This would allow the FFIs concerned to report the necessary information to their respective governments, which will in turn send the information to the IRS. The joint statement may serve as a model for the U.S. in working with other countries.

In particular, this new multilateral approach would no longer require that a separate data disclosure agreement be concluded by each FFI with the IRS and would permit the U.S. to collect and share information with the five participating EU countries about accounts held by their citizens in U.S. financial institutions.

This approach may presage a new stage in the fight against fraud moving towards the reciprocal automatic exchange of tax information between countries. In their joint statement, the countries indicated their wish to work with other FATCA partners, the OECD and, where appropriate, the EU to adapt "FATCA in the medium term to a common model for automatic exchange of information."

As a side effect of the agreement, it is possible that full implementation of information reporting under the EU Savings Directive may be accelerated. Currently, not all signatories to the directive engage in information exchange but instead impose a 35% withholding tax on bank interest, bond interest and analogous income (including Austria, Luxembourg and Switzerland).

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## **Belgium: Enacted and proposed measures under 2012 budget**

Belgium enacted its first wave of 2012 budget measures on 28 December 2011 (with effect from 1 January 2012 unless otherwise noted), including changes to the notional interest deduction (NID) rules, as well as withholding and individual tax measures. A second wave of tax measures is in process and includes amendments to the capital gains exemption on shares, the thin capitalization and general anti-abuse rules, as well as further amendments to the NID rules. Notable measures, both enacted and proposed, are summarized below.

### **Corporate tax measures**

**Notional interest deduction (NID)** – The NID rate continues to be determined on the basis of the average annual rate for 10-year government bonds (OLO rate), but the prior maximum NID rates of 6.5% for large companies and 7% for small and medium-size enterprises have been decreased to 3% and 3.5%, respectively, with application as from tax year 2013 (generally the taxable period beginning in calendar year 2012). Without the new cap, the NID rates likely would have been 4.2% and 4.7% (rounded) for tax year 2013.

The government plans to eliminate the ability to carry forward excess NID (currently, a seven-year carryforward is allowed) as from tax year 2013. While the current "stock" of NID carryforwards would remain available, its use would be restricted. Specifically, NID carryforwards would become the last operation in the corporate tax return to determine the taxable base and the maximum NID carryforward that a company could use per tax year would be limited to 60% of the taxable base. This limitation would not apply, however, to the first EUR 1 million of the taxable base remaining before the deduction of the NID carryforward. Moreover, the remaining NID carryforward would continue to be carried forward until fully exhausted (regardless of the expiration of the seven-year carryforward period).

The following measures are proposed:

**Capital gains on shares** – While retaining the full exemption from capital gains tax on net gains, the government proposes subjecting the exemption to the requirement that the shares have been held in full ownership (i.e. full legal title – bare ownership or usufruct would be insufficient) for an uninterrupted period of one year. In the case of shares acquired in a tax-neutral transaction, the one-year period would be calculated as from the date of acquisition of the exchanged shares and not from the date of acquisition of the shares received in exchange (i.e. the tax-neutral transaction would be disregarded).

If the one-year holding period is not satisfied, the capital gains would be subject to a separate tax at a rate of 25.75%. As it is unclear how the separate tax will be applied, guidance is needed from the tax authorities on this issue. Nevertheless, capital gains on shares would be subject to one of the following treatments:

- Exempt if the ownership and holding period requirements are met;
- Taxed at 25.75% if the ownership, but not the holding period, requirement is met; or
- Taxed at 33.99% if the ownership requirement is not met.

The rules would not be amended with respect to capital losses and write-offs on shares: the deduction of such would remain disallowed unless – subject to certain limitations – there is a liquidation of the company in which the shares are held.

"Trading companies" governed by the Royal Decree of 23 September 1992 (i.e. credit institutions, investment entities and management companies of collective investment undertakings) would not be affected by the new rules to the extent the shares recorded as part of their trading portfolio are concerned (e.g. shares held as trading stock to resell within a short period of time). Capital gains on such shares would remain fully taxable and capital losses and write-offs would be fully deductible. Special rules, however, are foreseen for internal transfers of shares from and to the trading portfolio.

The new rules would apply as from tax year 2013, as well as to capital gains (and capital losses and write-offs) realized or recorded as of 28 November 2011 during a taxable period closing on or after the date of publication of the law. Any modification to the closing date of the annual accounts made as of 28 November 2011 would be disregarded for purposes of the new rules.

**Thin capitalization** – Belgium currently does not have general thin capitalization rules, but specific legislation establishes the following debt-to-equity requirements:

- A 1:1 debt-to-equity ratio for financing obtained from certain direct shareholders/individuals or from directors, executive managers and liquidators (individuals or legal entities) of the company, unless the director is a company resident in an EU/EEA Member State (the interest is recharacterized as a dividend); and
- A 7:1 debt-to-equity ratio for financing where the beneficial owner of the interest is a person that is not subject to tax or if the interest income is subject to a tax regime that is substantially more advantageous than the Belgian tax regime ("tainted" financing).

The proposed measure would replace the 7:1 ratio with a 5:1 ratio that also would apply to all intra-group loans (with "group" defined by reference to the concept of affiliated companies as provided in article 11 of Belgium's Companies Code). Bonds and other debt issued by public offering remain excluded, as would loans granted by banks and other financial institutions. The new rule also would not apply to loans contracted by:

- Companies engaged in the leasing of movable assets and companies with factoring or the leasing of real estate as their main activity, provided these companies belong to the financial industry and only to the extent the amounts borrowed are effectively used for leasing and factoring activities; and

- Companies whose main activity is the execution of a public-private partnership project awarded in accordance with public procurement law.

Equity would continue to be defined as the sum of the taxed reserves at the beginning of the taxable period and the paid-in capital at the end of the taxable period.

An anti-abuse measure would apply under which loans guaranteed or funded by a tainted third party (bearing part or all of the risks of the loan) would be deemed to be granted by the third party.

**General anti-abuse provision** – The general anti-abuse provision in the Income Tax, Inheritance Tax and Registration Tax Codes would be rewritten, primarily to remove the requirement that the tax authorities demonstrate that their recharacterization of the legal act(s) executed by the taxpayer achieves identical or at least similar legal consequences as the legal act(s) executed by the taxpayer.

Under the proposed anti-abuse provision, a rebuttable presumption of tax abuse in favor of the tax authorities would exist if the tax authorities could demonstrate (based on objective circumstances or other means of proof) that, through a legal act or a series of legal acts, the taxpayer (i) has placed himself, contrary to the objectives of the law, outside the scope of application of a tax provision in Belgium's Income, Registration or Inheritance Tax Code or an executing decree, or (ii) claims a tax benefit provided by one of these tax codes or an executing decree, the granting of which would be contrary to the objectives of the law, and the essential goal of the taxpayer's act(s) is to obtain such benefit. Application of the anti-abuse provision could be avoided if the taxpayer could show that the act(s) is (are) justified by motives other than tax avoidance. If the taxpayer fails to demonstrate one or more sufficient non-tax motives, the tax authorities would be permitted to "restore" the taxable base and tax computation in such a way that taxation in accordance with the objectives of the legislator is possible (i.e. as if the abusive transactions had not taken place).

For income tax purposes, the new provision would apply as from tax year 2013, as well as to any legal act (or set of legal acts) accomplished during tax year 2012 provided the taxable period ends on or after the date of publication of the budget law. (The tax authorities would be allowed to disregard any change to the closing date of the annual accounts as of 28 November 2011). For registration tax and inheritance tax purposes, the new provision would apply to acts (or series of acts) accomplished as of the first day of the second month following the month the law is published.

### Withholding tax rates

The default withholding tax rate for dividends remains 25% and existing exemptions were not affected. The reduced rate, however, is increased from 15% to 21%, but continues to apply to (i) dividends related to shares publicly issued from 1994; (ii) dividends related to shares issued in exchange for private (non-public) cash contributions made from 1994; and (iii) dividends relating to shares in recognized investment companies. While liquidation dividends remain subject to the special 10% withholding tax rate, share buybacks are now subject to the 21% rate.

The default withholding tax rate on interest is increased from 15% to 21%, with a carve-out for government bonds issued and subscribed during the period from 24 November to 2 December 2011 (which remain subject to the 15% rate).

The increased withholding tax rates apply to dividends and interest paid or attributed as from 1 January 2012. The withholding tax rate for royalties remains at 15%.

### Individual tax measures

**Stock options** – The percentages used to determine taxable benefits in kind for non-quoted stock options are increased for options offered as from 1 January 2012. The default taxable benefit in kind is 18% (increased from 15%) of the value of the underlying shares at the time of offer. If the option can be exercised after a period of five years, the amount of the taxable benefit is increased by 1% of the value of the underlying shares per additional year (or part of a year). A reduced percentage of 9% (increased from 7.5%), plus 0.5% per additional year exceeding five years, applies if certain conditions are satisfied.

**Taxation of investment income** – In addition to the changes discussed above under "Withholding tax rates," individual taxpayers with dividends and interest exceeding (on a net basis) EUR 20,020 per year are subject to a separate 4% surcharge tax on the amounts exceeding this threshold.

## United States:

### White House budget proposal takes aim at multinationals, upper income individuals

Building on the principles he laid out in his State of the Union address last month, President Obama on 13 February 2012 unveiled a fiscal year 2013 budget package that thematically aligns with his campaign promises to provide tax incentives for domestic manufacturers, continue current law tax rates for middle-income taxpayers and shift the tax burden to multinationals and upper income individuals.

#### International tax reform proposals

As it has in previous budget plans, the administration has proposed significant changes to the international tax rules. The fiscal 2013 budget repeats the international proposals from last year's budget and adds four more for a combined total of almost USD 150 billion in new revenue over 10 years. The administration also proposes to extend the exception under the controlled foreign company (CFC) regime for active financing income and look-through treatment for payments between related CFCs under the foreign personal holding company income rules. (For additional commentary on the international tax proposals, see United States Alert in this issue of the *World Tax Advisor*.)

**URL:** [http://newsletters.usdbriefs.com/2012/Tax/WTA/120217\\_alerts.html](http://newsletters.usdbriefs.com/2012/Tax/WTA/120217_alerts.html)

Proposals new to this year's budget include:

**Look-through on partnership sale** – Under current law, capital gain on the sale or exchange of a partnership interest by a nonresident alien individual or foreign corporation is subject to federal income tax if the gains are treated as income that is effectively connected with the conduct of a trade or business in the U.S. (ECI). Rev. Rul. 91-32 provides that gain or loss on such a sale or exchange is effectively connected to the extent the partner's distributive share of unrealized gain or loss is attributable to property used or held for use in the partnership's U.S. trade or business (ECI property).

The administration believes that nonresident aliens and foreign corporations may take a position contrary to Rev. Rul. 91-32 and proposes codifying its holding. The proposal also would require the transferee of a partnership interest to withhold 10% (or less if the transferor provides a certificate from the U.S. Internal Revenue Service (IRS) that establishes the transferor's federal income tax liability is a lesser amount) of the amount realized on sale or exchange of the interest unless the transferor certifies that it is not a nonresident alien or foreign corporation. This proposal would be effective for sales or exchanges after 2012 and would raise about USD 2.5 billion over 10 years.

**Leveraged distributions** – The administration believes that current ordering rules of section 301 of the U.S. Internal Revenue Code permit a corporation to effectively repatriate the earnings and profits (E&P) as a return of stock basis, rather than a dividend, by using a related corporation that has no E&P. To the extent a foreign corporation funds a related foreign corporation with the principal purpose of avoiding dividend treatment on distributions to a U.S. shareholder, this proposal would disallow the U.S. shareholder's basis in the stock of the distributing related corporation from being taken into account for determining treatment under section 301. The proposal would apply to distributions after 2012 and would raise approximately USD 3.3 billion over 10 years.

**Section 338(h)(16) extension** – Section 338(h)(16) currently prevents a corporation from using a section 338 election to increase allowable foreign tax credits in a qualified stock purchase of a target corporation. The administration proposes extending the application of section 338(h)(16) to any covered asset acquisition under section 901(m). This proposal would apply to acquisitions after 2012 and would raise USD 960 million by 2022.

**Section 902 corporations** – The administration believes that domestic companies should not be able to claim an indirect credit under section 902 for foreign taxes paid by a foreign corporation when certain transactions have reduced or eliminated the foreign corporation's E&P. The proposal would reduce the amount of foreign taxes paid by the foreign corporation in the event the foreign corporation's E&P is reduced by a transaction other than a dividend, deemed dividend

or section 381 transaction. This proposal would be effective for transactions after 2012 and would raise about USD 390 million over 10 years.

The following proposals are largely the same as last year:

**Deferral** – Similar to previous budgets, the administration proposes restricting the ability of companies to take current interest expense deductions allocated to foreign-source income that is not currently subject to U.S. tax. This provision would be effective for taxable years beginning after 31 December 2012 and would raise more than USD 37 billion by 2022.

**Foreign tax credits** – The administration again proposes to require taxpayers to determine their deemed-paid foreign tax credits on a consolidated basis. The taxpayer would have to calculate the aggregate foreign taxes and E&P of all foreign subsidiaries (including lower tier ones) for which the taxpayer can claim a deemed foreign tax credit. The deemed credit would then be limited to an amount proportionate to the taxpayer's pro rata share of the consolidated E&P of the foreign subsidiaries repatriated to the U.S. taxpayer in that taxable year that are currently subject to U.S. tax. Deferred foreign taxes would be creditable in subsequent taxable years to the extent the current year deemed paid foreign taxes are less than the annual limitation for that year. This provision would raise almost USD 61 billion by 2022 and would be effective for taxable years beginning after 31 December 2012.

**Intangible property transfers** – Under the first proposal, if a U.S. person transfers an intangible from the U.S. to a related CFC that is subject to a low foreign effective tax rate, certain excess income from transactions connected with or benefitting from the intangible would be treated as income subject to the CFC regime in a separate foreign tax credit limitation basket. For purposes of the proposal, transfers would include sales, leases, licenses or shared risk or development agreements, including cost sharing agreements. This proposal would be effective for transactions in taxable years beginning after 31 December 2011 and would raise almost USD 23 billion by 2022.

In the other proposed change for intangibles, the definition of intangible property would include workforce in place, goodwill and going concern value. For transfers of multiple intangibles, the proposal would allow the IRS Commissioner the option to value the intangible property on an aggregate basis. The proposal also would allow the Commissioner to value intangible property by taking into consideration "the prices or profits that the controlled taxpayer could have realized by choosing a realistic alternative to the controlled transaction undertaken." This proposal would be effective for taxable years beginning after 31 December 2012 and would raise about USD 1.6 billion over 10 years.

**Reinsurance** – Current law generally allows insurers a deduction for premiums paid for reinsurance. In addition, reinsurance policies issued by foreign insurers covering U.S. risks are generally subject to an excise tax equal to 1% of the premiums paid, unless waived by treaty. The administration believes that these rules provide improper tax advantages and create incentives for foreign-owned domestic insurers to reinsure U.S. risks with foreign affiliates. The administration has recycled its proposal from last year and would deny an insurance company a deduction for reinsurance premiums paid to affiliated foreign reinsurers to the extent the foreign reinsurer or its parent is not subject to U.S. tax on those premiums. The proposal would further exclude from an insurance company's income any ceding commissions received or reinsurance recovered on policies for which a premium deduction is wholly or partially denied.

A foreign company that receives premiums that would be denied a deduction could elect to treat the premiums and associated investment income as effectively connected to the conduct of a U.S. trade or business and attributable to a permanent establishment for tax treaty purposes. According to the Treasury explanation, reinsurance income that is treated as ECI under this provision would be placed in a separate foreign tax credit limitation basket.

The proposal would be effective for policies issued in taxable years beginning after 31 December 2012 and would raise approximately USD 2.4 billion over 10 years.

**Earnings stripping** – The administration proposes tightening the earnings stripping rules under section 163(j) and limit the deductibility of interest paid by "expatriated entities" to related entities. Expatriated entities would be defined by applying section 7874 (dealing with corporate inversions) and its regulations as if they were in effect beginning 10 July 1989, but the definition would not include surrogate foreign corporations that are treated as domestic under section 7874. For expatriated entities, the current debt-to-equity safe harbor would be eliminated, and the 50% adjusted taxable income threshold for the limitation would be reduced to 25% of adjusted taxable income for disqualified interest. The carryforward for disallowed interest would be limited to 10 years, and the carryforward of excess limitation would be eliminated. This proposal would be effective for taxable years beginning after 31 December 2012 and would raise USD 4.4 billion by 2022.

**Dual capacity taxpayers** – Taxpayers that are subject to a foreign levy and also receive a specific economic benefit from the levying country (dual capacity taxpayers) may not claim a foreign tax credit for the portion of the foreign levy paid for the specific economic benefit. Under Treasury regulations, if a foreign country has a generally imposed income tax, a dual capacity taxpayer may credit the portion of the levy in the amount of what the generally imposed income tax would be.

The administration proposes allowing a dual capacity taxpayer to treat as a creditable tax that portion of a foreign levy that does not exceed the foreign levy the taxpayer would pay if it were not a dual capacity taxpayer. The administration also proposes replacing the current regulatory provisions, including the safe harbor, on the determination of what amount of a foreign levy paid by a dual capacity taxpayer qualifies as a creditable tax. Further, the proposal would convert the special foreign tax credit limitation rules of section 907 into a separate category within section 904 for foreign oil and gas income. The proposal would yield to U.S. treaty obligations that allow a credit for taxes paid or accrued on certain oil and gas income. This proposal would be effective for taxable years beginning after 31 December 2012 and would raise USD 10.7 billion over 10 years.

### **Incentives for domestic manufacturing**

In its budget, the administration fleshes out the details of credits for “Manufacturing Communities,” advanced technology vehicles and medium- and heavy-duty alternative fuel commercial vehicles. The budget also would permanently extend the research and experimentation credit and increase the rate of the alternative simplified research credit from 14% to 17%, effective after 31 December 2011 (the date the credit most recently expired), at a cost of almost USD 109 billion over 10 years.

**Tax credit for insourcing, no deduction for outsourcing** – This proposal would create a new general business credit equal to 20% of eligible expenses paid or incurred to “insource” business activity, i.e. to reduce or eliminate a trade or business currently conducted outside the U.S. and start up, expand or otherwise move the same trade or business within the U.S. in a manner that results in an increase in U.S. jobs. Such costs would be creditable for U.S. tax purposes even if incurred by the foreign subsidiary of a U.S. multinational company.

To pay for this new credit, the administration proposes to disallow deductions for expenses paid to outsource business activity, i.e. to reduce or eliminate a trade or business currently conducted within the U.S. and start up, expand or otherwise move the same trade or business outside the U.S. in a manner that results in a loss of U.S. jobs. Additionally, the subpart F income attributable to a CFC could not be reduced by any such expenses.

Expenses eligible for the credit and subject to the deduction disallowance would be limited solely to those associated with the relocation of the trade or business and would not include capital expenditures or costs for severance pay or similar expenses. The proposal is estimated to cost USD 90 million over 10 years and would be effective for expenses paid or incurred after the date of enactment.

### **Energy provisions**

The president’s FY 2013 budget reflects the energy goals outlined in his recent State of the Union address. On the incentive side, the budget proposal provides three significant provisions: (1) a credit for advanced energy manufacturing projects; (2) a credit (replacing the existing deduction) for energy-efficient commercial buildings; and (3) an extension of the production tax credit for wind facilities and the investment tax credit for wind facility property to facilities and property placed in service in 2013, as well as an extension of the 1603 grant program (payments for specified energy property in lieu of tax credits) to all otherwise qualifying property placed in service after 2012, including property on which construction begins in 2012.

**Extenders** – The budget proposal also would extend through 2013 a number of temporary energy tax incentives including: incentives for biodiesel and renewable diesel and for alternative fuel and alternative fuel mixtures; the cellulosic biofuel producer credit; the special depreciation allowance for cellulosic biofuel plant property; the special rule to implement electric transmission restructuring; the section 25C credit for nonbusiness energy property; credits for alternative fuel vehicle refueling property, plug-in hybrid conversions, energy-efficient appliances and the construction of energy-efficient new homes; and Green bonds.

**Revenue offsets** – On the revenue side, the FY 2013 budget package repeats many of the targeted offsets that were included in prior budgets. These changes would be effective beginning in 2013 and would generate nearly USD 51 billion over 10 years. The proposals would repeal: the section 199 deduction for oil and gas companies (but increase the deduction

for other domestic manufacturing activity); the passive loss exception for working interests in oil and gas companies; certain incentives for exploration; and incentives for energy production from coal mining activities. The budget includes proposals to reinstate superfund taxes and increase the oil spill liability trust fund.

## Financial services and products

The administration has recycled several proposals that would affect the banks, securities dealers and insurance companies.

**Financial crisis responsibility fee** – In January 2010, the administration proposed a fee on the covered liabilities of financial firms with assets in excess of USD 50 billion. A tweaked version of that proposal appeared in last year's budget, and it reappears in this budget with further changes. Most importantly, the latest proposal sets the fee at 17 basis points (0.17%), up from 7.5 basis points in the FY 2012 version and 15 basis points in the original 2010 proposal. Further, the budget message notes that the fee would be in place for more than 10 years to recoup amounts paid to banks under the Troubled Asset Relief Program, as well as to offset the cost of the mortgage refinance program that President Obama highlighted in his State of the Union address. The fee would apply to U.S.-based bank holding companies, thrift holding companies, certain broker-dealers (or the companies that control them) and insured depository institutions. The fee would apply to U.S. companies that owned or controlled these types of entities on 14 January 2010 and it also would apply to the U.S. subsidiaries of foreign firms that are of this type and have assets in excess of USD 50 billion. For purposes of calculating the fee, covered liabilities would be the firm's consolidated risk – weighted assets, less its capital, insured deposits and certain small-business loans. Insurance companies would be able to deduct certain policy reserves and other policyholder obligations in computing their covered liabilities. The fee would be deductible for corporate income tax purposes. The proposal would be effective beginning 1 January 2014 and would raise more than USD 60 billion by 2022.

**Financial institutions and instruments** – Three other proposals that would affect financial institutions and products make a return in this budget and would raise about USD 3.4 billion by 2022:

- **Forward stock sales** – Under current law, a company must recognize interest income on the current sale of its own stock for deferred payment, but it does not recognize interest income on the forward sale of its own stock, i.e. the future issue of stock in exchange for a future payment. The administration sees no economic difference between the two situations and would align their tax treatment by requiring a corporation that enters into a forward contract to issue its stock to treat a portion of the payment as interest. The proposal would be effective for forward contracts entered into after 31 December 2012.
- **Ordinary treatment for dealers** – Current law allows commodities dealers, commodities derivatives dealers, dealers in securities and options dealers to treat the income from certain day-to-day dealer activities as capital gain, and treat 60% of this income (or loss) as long-term capital gain and 40% as short-term capital gain. The administration proposes ending this treatment entirely and taxing dealers' income from day-to-day dealing activities at ordinary rates. This year's proposal notes that it would be effective for individuals and partnerships. The proposal would be effective for taxable years beginning after the date of enactment.
- **Control** – The budget includes a proposal from last year to amend the definition of control under section 249 to include indirect control relationships. Congress recently approved a long-term Federal Aviation Administration funding bill that includes this provision as an offset. President Obama has yet to sign the bill but is expected to do so.

## Other revenue offsets affecting companies

**Insurance companies** – The budget repropose a handful of items that would affect insurance companies. These proposals would raise more than USD 15 billion by 2022 and address corporate-owned life insurance, the sales of life insurance contracts and the dividends received deduction for separate accounts. The budget package also includes proposals related to: insurance company information reporting and insurance company special loss discount accounts.

**Tax accounting methods** – As it has in previous years, the administration also proposes three changes to tax accounting rules: disallow the last-in, first-out (LIFO) inventory accounting method; prohibit the use of the lower-of-cost-or-market and subnormal goods methods and require a change in method of accounting for inventory for taxpayers currently using such methods; and disallow all deductions for punitive damages paid or incurred by a taxpayer upon a judgment or in settlement of a claim.

**Unemployment insurance provisions** – The administration would raise nearly USD 13.9 billion over 10 years through several proposals, effective upon enactment and largely carried over from last year's budget, to the unemployment tax rules: reinstate and make the 0.2% temporary surtax on unemployment insurance permanent, effective for wages paid on or after 1 January 2013; expand the Federal Unemployment Tax Act (FUTA) wage base; and provide short-term relief to employers by suspending interest payments on state unemployment insurance debt and suspending the FUTA credit reduction for employers in states borrowing from the federal unemployment insurance trust in 2012 and 2013.

**Worker classification** – This year's budget repeats last year's proposals concerning worker classification, with several rolled into one proposal, to include permitting Treasury and the IRS to issue generally applicable guidance on the proper classification of workers under common law standards and permitting the IRS to require prospective reclassification of workers who are currently misclassified and whose reclassification has been prohibited under current law.

**Miscellaneous offsets** – Various measures in the budget would increase the tax burden on companies by: eliminating special depreciation rules for purchases of general aviation passenger aircraft; repealing gain limitation for dividends received in reorganization exchanges; streamlining audit and adjustment procedures for large partnerships; extending partnership basis limitation rules to nondeductible expenditures; expanding the definition of built-in loss for purposes of partnership loss transfers; and limiting the importation of related party losses under section 267(d).

### **Small-business tax relief**

The budget package includes a number of incentives to promote job growth and encourage the development of small businesses. In addition to expanding and simplifying the tax credit provided to qualify small employers for non-elective contributions to employee health insurance, among other measures, the budget includes the following proposals.

**Extension of 100% first-year depreciation deduction for certain property** – Under the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, additional first-year depreciation was increased to 100% of the adjusted basis of qualified property acquired and placed in service after 8 September 2010 and before 1 January 2012 (with an extension of the placed-in-service deadline to 1 January 2013 for certain longer-lived and transportation property). Corporations are allowed to claim additional alternative minimum tax (AMT) credits in lieu of claiming the additional depreciation. The administration proposes to extend 100% first-year depreciation for one year, effective for qualified property acquired and placed in service before 1 January 2013 (1 January 2014 for certain longer-lived and transportation property). The administration also proposes to continue the corporate election to claim additional AMT credits in lieu of the additional depreciation for property placed in service in 2012 regardless of prior-year elections of this provision.

**Permanent small-business capital gains exclusion** – Subject to conditions, the administration would permanently permit taxpayers other than corporations to exclude 100% of the gain from the sale of small-business stock acquired at original issue and eliminate the AMT preference item for gain excluded under this provision. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 had previously allowed this 100% exclusion for eligible stock acquired before 1 January 2012.

### **Highlight of individual provisions**

For individuals, the budget calls for reinstating top rates of 39.6% and 36% on upper income taxpayers (defined as unmarried individuals with adjusted gross income over USD 200,000 a year and married couples with adjusted gross income over USD 250,000) and reverses previous administration policy by proposing to separate the tax treatment of long-term capital gains and qualified dividends for upper income taxpayers – taxing qualified dividend income at ordinary rates up to 39.6% (for a rate of 43.4% when combined with the 3.8% surtax on investment income set to begin in January 2013). The top rate for capital gains for upper income taxpayers would also increase to 20%. The president also renewed his pledge to reintroduce an expanded version of his proposal to limit the tax benefit of certain itemized deductions and income exclusions for upper income taxpayers.

The budget largely repeats a proposal from last year to tax income from carried interests as ordinary income, but also adds a few modifications from the carried interest proposal included in the American Jobs Act. Similar to last year's budget, the proposal would require the partner receiving a carried interest to pay self-employment taxes on that income, and gain recognized on the sale of such an interest would be taxed as ordinary income.

Along with proposing to permanently extend the 2009 estate, gift and generation-skipping transfer (GST) tax parameters, the White House continues to push for the closing of perceived loopholes in the area of estate and gift taxation. These proposals would make permanent the portability of unused exemption amounts between spouses, require consistent treatment of asset basis for transfer and income tax purposes, place limits on valuation discounts, require a minimum term for grantor retained annuity trusts (GRATs) and limit the duration of the GST tax exemption.

## Comments

The delivery of the budget proposal to Capitol Hill sets the stage for a confrontation between the White House and congressional Republicans who have adamantly refused to approve any new tax increases and who have shown no signs of backing down from that stance. As a result, the prospects for quick action on most of the president's proposals in the near term are slim.

That said, there are some significant tax policy issues that lawmakers will be unable to avoid in 2012 and that will require taxpayer vigilance. The individual tax cuts enacted in 2001 and 2003 and extended under the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 are set to expire at the end of this year. Unless Congress acts, rates on ordinary income, capital gains and qualified dividends and estates and gifts will revert to their pre-2001 levels. In addition, the most recent "patch" for the individual AMT expired at the end of 2011, which means congressional intervention will be required to prevent millions of taxpayers from being swept into the AMT regime. Although this situation is likely to dominate the tax policy discussion on Capitol Hill and on the campaign trail in the coming months, we expect that resolution will have to wait until a lame-duck session after the elections.

On the business side, we are now awaiting the release of Treasury's corporate tax reform "roadmap." Given the new tax provisions in the budget package, however, it could be argued that many of the administration's tax proposals actually move further away from, rather than closer to, corporate tax reform as traditionally conceived. Expanding current tax expenditures and proposing new tax expenditures cannot be easily reconciled with a vision of corporate tax reform that lowers the rate and broadens the base. Also, although the White House is now dangling new "carrots" in the form of incentives to promote domestic manufacturing, we could still see additional "sticks," such as the imposition of a minimum tax on companies with profits and jobs overseas.

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## In brief

**United States** – The Financial Crimes Enforcement Network issued Notice 2012-1 on 14 February 2012, further extending to 30 June 2013 the filing due date for Form TD F 90-22.1 (FBAR) for those individuals whose due date was previously extended by Notices 2011-1 (as revised) and -2. The extension under Notice 2012-1 is limited to the reporting of "signature authority" held during the 2011 calendar year and all years previously extended by Notices 2011-1 and -2 (i.e. limited to certain individuals with signature authority over but no financial interest in one or more reportable accounts). Under the generally applicable FBAR reporting requirement, "U.S. persons" are required to file annually if they have a financial interest in or signature authority over "financial accounts" in a foreign country if the aggregate value of reportable accounts exceeds USD 10,000 at any time during the calendar year.

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### France-Germany

#### **"Green Book" on tax convergence published; German ruling coalition announces plan for further business tax reform**

The French and German Ministries of Finance have published a "Green Book" that summarizes the current discussions on convergence between the French and German tax systems. Additionally, the German coalition government has announced a "Twelve Points Plan" for further business tax reform. [Issued: 15 February 2012]

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### Italy

#### **Optional exit tax deferral introduced for deemed gains on intra-EU/EEA migration**

The government has approved Law Decree No. 1, amending the exit tax rules to provide an optional deferral regime for the exit tax on deemed gains when an Italian company migrates to a another jurisdiction within the EU/EEA. [Issued: 9 February 2012]

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### United States

#### **Foreign tax credit splitter and technical taxpayer rules issued**

The Treasury Department and Internal Revenue Service have filed temporary regulations under §909 addressing foreign tax credit splitter transactions and final regulations providing guidance on determining who is considered the taxpayer of foreign taxes. [Issued: 13 February 2012]

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#### **Temporary and proposed dividend equivalent regulations issued under §871(m)**

The Treasury Department and Internal Revenue Service have released temporary and proposed regulations under §871(m) (which provides that dividend equivalents on specified notional principal contracts constitute U.S.-source dividends for purposes of the U.S. gross basis tax on foreign persons). [Issued: 13 February 2012]

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#### **Administration releases FY2013 Budget and Treasury Department releases descriptions of international tax proposals in Greenbook**

The Obama Administration has released its FY2013 Budget and the Treasury Department has released the General Explanations of the Administration's Fiscal Year 2013 Revenue Proposals. The FY2013 Budget contains several carryover international tax proposals from the FY2012 Budget, but introduces four new proposals. [Issued: 14 February 2012]

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## IRS amends application of §367 to §304 transactions

The Treasury Department and Internal Revenue Service have issued Notice 2012-15, describing future amendments to the regulations under §367(a) and (b) applicable to transfers of stock to foreign corporations in exchange for property under §304 (redemptions through use of related corporations). The amendments apply to transfers occurring on or after 10 February 2012. [Issued: 14 February 2012]

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