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Alert

President Obama's 2011 Budget Proposes International Tax Reform

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Earlier this month, the Obama Administration ("Administration") presented its 2011 federal budget to Congress. The Administration proposes tax reforms, including major reforms to U.S. taxation of foreign source income and foreign activities, intended to raise $122 billion in revenue. The Administration contends that these reforms will stimulate the struggling U.S. economy by fostering domestic job growth and reducing incentives for U.S. companies to ship jobs overseas.

In a prior *Tax Alert*, we reviewed the Administration's proposal to generate revenue by attacking common tax planning strategies used by multinational enterprises. (See Obama Administration Shelves Assault on Multinational Corporations' Deferral of Foreign Source Income, Oct 2009). This *Tax Alert* focuses on the Administration's latest effort. Major international tax provisions in the 2011 federal budget proposal include the following:

- **Defer Interest Expense Deductions.** The Administration proposes to defer interest expense deductions attributable to deferred foreign source income. In contrast, Congressman Rangel (D-NY) proposes to defer almost all expenses related to deferred foreign source income.

- **Limit Foreign Tax Credits.** The proposed budget contains several provisions designed to curb manipulation of the foreign tax credit. First, companies would calculate their foreign tax credit by consolidating all foreign subsidiaries into a single pool, which would create a blended foreign tax rate. Second, domestic companies could take a foreign tax credit only when the foreign levy is paid to a country that typically enforces an income tax. Third, domestic corporations could no longer transfer intangibles to foreign subsidiaries in low-tax nations just to produce artificially excessive returns and increase their foreign tax credit.

- **Eliminate Dividend Withholding Tax Exemption for 80/20 Companies.** The Administration proposes to eliminate the provision under current law that permits a domestic corporation earning 80 percent of its gross income from an active foreign trade or business to be exempt from withholding tax on interest or dividends paid.

- **Impose Information Reporting Requirements.** The Administration proposes to require third parties to report information whenever foreign financial accounts are created and whenever assets are transferred to and from those accounts.

- **Preserve Check-the-Box Rules.** Unlike last year, the Administration's 2011 budget proposal does not seek to remove the check-the-box rules that allow domestic companies to exclude a portion of their foreign earnings from their taxable U.S. income.

The reforms in the Administration's proposed budget must endure Congressional committee hearings before they become law. As always, Congress is highly likely to modify or even reject these reforms. If Congress does adopt them, they will take effect in 2011.

Williams Mullen advises numerous multinational clients with regard to their tax planning strategies. The firm recommends that its multinational clients examine their tax reporting positions to determine if the Obama Administration's proposals impact their tax planning strategies. If your enterprise has multinational operations, or expects to initiate multinational activities, please feel free to contact a member of the firm's International Tax Practice Group to discuss the latest international tax legislative proposals.

For more information about this topic and Williams Mullen's International Tax practice, please contact Sean M. King at sking@williamsmullen.com or 804.644.9812.

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