



Tax

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Senate to consider temporary five-year NOL carryback as part of unemployment insurance extension

The Senate is expected the week of November 2 to take up an unemployment insurance extension bill (H.R. 3548) with an amendment by Finance Committee Chairman Max Baucus, D-Mont., and Majority Leader Harry Reid, D-Nev., that would provide for a five-year net operating loss (NOL) carryback for businesses with losses in tax years 2008 or 2009.

The Reid-Baucus proposal, which the Joint Committee on Taxation staff estimates would cost \$10.4 billion over 10 years, would allow businesses to elect to carry back NOLs for up to five years (from the current-law two years) for losses incurred either in 2008 or 2009 – but not both. (An earlier draft that Reid and Baucus circulated October 22 would have permitted a three- or four-year carryback for losses in tax years beginning or ending in 2008 or tax years beginning or ending in 2009.)

Businesses would be able to offset 50 percent of taxable income in the fifth year and 100 percent in the remaining four carryback years. The 20 percent “haircut” on NOLs that was included in the earlier draft has been eliminated.

Small businesses that have already elected to carry back 2008 losses under the American Recovery and Reinvestment Act of 2009 (ARRA, P.L. 111-5) would be permitted to carry back losses from 2009.

The extended carryback would not be available to taxpayers in which the government has taken or has the right to take an equity interest under the Emergency Economic Stabilization Act of 2008 (Troubled Assets Relief Program recipients) or taxpayers that are part of a consolidated group that includes a TARP recipient.

The proposal does not contain a gross receipts test, so it would be available to all businesses other than those specifically excluded.

The amendment also would extend the \$8,000 first-time homebuyer tax credit that was included in the ARRA to May 1, 2010, and make other modifications to the credit.

These provisions would be offset by an additional seven-year delay (through 2017) in the effective date of the worldwide interest allocation election and an increase to \$195 in the penalty for failure to file a partnership or S corporation return.

Outlook

According to comments Reid made on the Senate floor on October 29, House Majority Leader Steny Hoyer, D-Md., has said the House would support the Baucus-Reid amendment in its current form. (The House approved a 13-week extension of unemployment benefits on September 22, but that legislation does not include any significant tax provisions.)

Since the House is expected to be preoccupied with its health care reform legislation in the near term, the timing for possible consideration of an NOL carryback extension in that chamber is currently uncertain.

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Rangel, Baucus take aim at offshore tax evasion

House Ways and Means Committee Chairman Charles Rangel, D-N.Y., and Senate Finance Committee Chairman Max Baucus, D-Mont., concurrently introduced legislation October 27 aimed at preventing the use of offshore financial institutions, foreign trusts, and foreign corporations to evade U.S. tax obligations.

The Foreign Account Tax Compliance Act of 2009 (H.R. 3933, S. 1934) draws on the Stop Tax Haven Abuse Act introduced by Sen. Carl Levin, D-Mich., the Obama administration's FY 2010 budget package, and a draft anti-tax haven proposal circulated by Baucus earlier this year. It does not, however, include many of the most controversial elements of these earlier proposals – for example, provisions treating certain foreign corporations as U.S. companies if they are managed and controlled in the United States and establishing a list of “offshore secrecy jurisdictions.” Likewise, the legislation does not include any controversial business and international tax revenue raisers related to carried interest income, publicly traded partnerships, and the check-the-box election.

Key provisions

Reporting certain foreign accounts – The bill would add new sections 1471-74 in a new chapter under Internal Revenue Code Subtitle A devoted to the enforcement of information reporting. The new sections would impose 30 percent withholding on any income from U.S. financial accounts or assets held by a foreign financial institution *unless* that institution enters into and complies with an agreement with the Treasury Secretary to report U.S. account/asset holders and other related account information. Such an agreement would require the financial institution to request waivers (from account holders) of any applicable foreign secrecy law and to close any account for which the holder(s) refuse to provide such a waiver.

Similar requirements (withholding in the absence of reporting) would apply with respect to income of nonfinancial foreign entities, such as corporations or trusts.

A “U.S. person” would not include most public corporations, tax-exempt organizations, banks, real estate investment trusts, or regulated investment companies.

Individual reporting requirement – Under a new section 6038, an individual holding an interest in a foreign financial asset in any taxable year would be required to attach a disclosure statement to his or her tax return for that year if the aggregate value of all such assets exceeds \$50,000. Applicable assets would include financial accounts, foreign stock and securities, and other financial instruments and contracts.

Failure to disclose for any taxable year would subject the individual to a \$10,000 penalty. If the individual were to continue such failure after notification by the Secretary, an additional \$10,000 penalty would apply for each 30-day period following the 90-day period after the Secretary mails such notice. The “continuation” penalty would not exceed \$50,000. The bill would provide a penalty exception for reasonable cause.

Any entity “formed or availed of for purposes of holding” such assets would be treated as if the entity were an individual.

Section 6662 amended – The bill would amend section 6662 to make the underpayment penalty applicable to understatements attributable to undisclosed foreign financial assets. For such understatements, the penalty imposed by section 6662 would be 40 percent, rather than 20 percent.

Increased statute of limitations – As proposed in previous bills, this legislation would extend the statute of limitations on assessments to six years for significant omissions of income.

Disclosure requirement for material advisors – Under the bill, any person who provides “material aid, assistance, or advice” with respect to the direct or indirect acquisition of an interest in a foreign entity, and who derives substantial gross income for such services during any calendar year, would be required to submit a return disclosing the identities of both the foreign entity and the U.S. citizen or resident that acquires the reportable interest.

The bill would impose a penalty for nondisclosure by the material advisor equal to the greater of \$10,000 or 50 percent of the gross income derived from such services, with an exception for reasonable cause.

PFICs – Codifying the passive foreign investment company (PFIC) reporting requirements, the bill would require any person who is a shareholder of a PFIC to file an annual return, regardless of whether the shareholder has gain from the sale of PFIC stock.

Provisions related to trusts – Section 679 would be amended to provide that a trust would be treated as having a U.S. beneficiary even if the U.S. person’s interest is contingent. A trust would also be treated as having a U.S. beneficiary if any person has the discretion to determine beneficiaries, unless the trust identifies the class of persons to whom distributions may be made *and* none of those persons are U.S. persons.

If a U.S. person transfers property to a foreign trust, there would be a presumption that a foreign trust has a U.S. beneficiary unless the person discloses all required information and satisfies other requirements of section 679.

The penalty under section 6677 for failure to report foreign trusts would be amended to impose a minimum \$10,000 penalty for failing to file the required information return.

Dividend equivalent payments – Similar to the prior Levin legislation, the Rangel-Baucus bill would define dividends to include dividend equivalent payments made pursuant to notional principal contracts, and would require withholding.

Outlook

The Foreign Account Tax Compliance Act, which the Joint Committee on Taxation staff estimates will raise \$8.5 billion over 10 years, is expected to at least partially offset the extension of 2009 expiring provisions. While this is a modest compromise bill that suggests that the taxwriting committee leadership in both chambers remains inclined to stay away from controversial and de-stimulative revenue raisers in the near term, taxpayers should remain vigilant as lawmakers continue to look for revenue to offset health care reform or fill the remaining gap in funding 2009 extenders legislation.

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