President Obama’s Fiscal Year 2016
Revenue Proposals

Proposals Relating to Taxation of Offshore Profits of U.S.
Corporations

SUMMARY

On February 2, 2015, the Obama Administration (the “Administration”) released the General Explanations of the Administration’s Fiscal Year 2016 Revenue Proposals (commonly known as the “Green Book”), which contains significant detail about the fiscal year 2016 revenue proposals.

This memorandum discusses certain aspects of the Green Book relating to taxation of offshore profits of U.S. corporations and their subsidiaries. Subsequent memoranda will address Green Book proposals relating to (1) other international taxation issues (including with respect to limiting so-called “excess” interest deductions under Section 163(j)), (2) domestic business taxation, and (3) individual, retirement plans, and estate and gift taxation, all of which may be obtained at a later date by following the instructions at the end of this memorandum.

The Green Book’s proposals relating to taxation of offshore profits of U.S. corporations and their subsidiaries intend to limit deferral of profits offshore and, at the same time, to reduce the disincentive in repatriating such profits onshore. The proposals include:

- imposing a 19% minimum tax on U.S. corporations’ future foreign profits, with generally an 85% credit for associated foreign taxes paid; and
- imposing a one-time, immediate 14% tax on U.S. corporations’ current accumulated overseas earnings, with generally a 40% credit for associated foreign taxes paid.
ANALYSIS

1. Impose a 19-Percent Minimum Tax on Foreign Income

Under current law, U.S. multinational companies generally do not pay U.S. tax on profits earned by their foreign subsidiaries until these profits are repatriated, except for certain generally passive types of income subject to current inclusion under the rules of subpart F.\(^1\)

The Green Book proposal would generally limit the offshore deferral of even “active” income, with a per-country, current minimum tax. (These proposals would not eliminate the Subpart F regime, which would operate concurrently.) The minimum tax would generally apply to a U.S. corporation that (a) is a United States shareholder of a controlled foreign corporation (“CFC”), or (b) has foreign earnings from a foreign branch or from the performance of services outside the U.S.\(^2\)

A taxpayer’s minimum tax for a particular country would be computed by multiplying (x) the taxpayer’s “residual minimum tax rate” for the country by (y) the taxpayer’s minimum tax base for the country.

A taxpayer’s “residual minimum tax rate” would be equal to 19 percent, less 85 percent of the per-country foreign effective tax rate. The foreign effective tax rate for a country would be computed on an aggregate basis with respect to all of the taxpayer’s earnings and associated taxes attributable to that country over a 60-month period. The foreign effective tax rate would take into account only foreign taxes that, under current law, would be eligible to be claimed for a foreign tax credit for U.S. federal income tax purposes.

Foreign earnings and associated foreign taxes would be assigned to countries based on tax residence under foreign law.

A taxpayer’s minimum tax base with respect to a non-U.S. country for a taxable year would be (x) the total amount of foreign earnings for the taxable year assigned to that country for purposes of determining the country’s foreign effective tax rate (the “tentative minimum tax base”), less (y) any allowance for corporate equity (“ACE”). The ACE would provide a risk-free return on equity invested in active assets in the foreign country.

As part of the Green Book’s proposal, the Treasury would implement rules to restrict the use of hybrid arrangements to shift earnings.

The minimum tax would be imposed on current foreign earnings regardless of whether the earnings are repatriated to the United States, and all foreign earnings could be repatriated without further U.S. tax. No tax would be imposed on the sale of CFC stock to the extent of gain reflecting earnings already subject to tax under the 14-percent (discussed below), 19-percent, or Subpart F regimes. Stock gain reflecting

\(^1\) 26 U.S.C. §§ 951-64.
\(^2\) Green Book, pages 20-22.
unrealized and untaxed gain in the CFC’s assets would be subject to either (i) the minimum tax, or (ii) tax at the full U.S. rate, depending on whether the underlying assets generate “active” or Subpart F income.

Under the Green Book’s proposal, foreign-source royalty and interest payments received by U.S. corporations would continue to be taxed at the full U.S. statutory rate, but would not be shielded by excess foreign tax credits associated with dividends from high-tax CFCs. However, a foreign branch of a U.S. corporation would be treated like a CFC. Accordingly, (i) a foreign branch that uses the intangibles of its owner would be treated as making royalty payments to its owner, and (ii) a deduction at the applicable residual minimum tax rate would be permitted for interest expenses incurred by a U.S. corporation that is allocated and apportioned to foreign earnings on which the minimum tax is paid. Current rules regarding CFC investments in United States property and previously taxed earnings would be repealed for United States shareholders that are U.S. corporations.

The minimum tax proposal, if enacted into law, would be effective for taxable years beginning after December 31, 2015.

2. Impose a 14-Percent One-Time Tax on Previously Untaxed Foreign Income

In connection with implementing the minimum tax, the Green Book proposes a one-time 14-percent tax on earnings accumulated in CFCs and not previously subject to U.S. tax, with a credit allowed for 40 percent of the amount of associated foreign taxes (the ratio of 14 percent, the one-time tax rate, to the maximum U.S. corporate tax rate, currently 35 percent). Accumulated income subject to the one-time tax would not be subject to any further U.S. tax when repatriated. The revenue raised by the one-time tax would be used to fund surface transportation spending.³

The one-time tax, if enacted into law, would be effective on the date of enactment and would apply to earnings accumulated for taxable years beginning before January 1, 2016. The tax would be payable ratably over five years.

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³ Green Book, page 23.
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