H.R. 5893
"Investing In American Jobs and Closing Tax Loopholes Act of 2010"

July 28, 2010

I. INFRASTRUCTURE JOBS INVESTMENTS

Build America Bonds ("BABs"). To date, the Build America Bonds program has been used by State and local governments to make more than $106 billion of infrastructure investments nationwide. The bill would extend this program for two years (through 2012). For direct-pay Build America Bonds issued in 2011, the amount of the direct payment would be reduced from 35% to 32% of the coupon interest. For such bonds issued in 2012, the amount of the direct payment would be reduced to 30% of the coupon interest. The bill would also allow issuers to issue Build America Bonds to effect a current refunding of outstanding Build America Bonds; as a result, issuers and the Federal government could save money if interest rates fall in the future. *This provision is estimated to cost $4.042 billion over 10 years.*

Recovery Zone Bonds ("RZBs"). The *American Recovery and Reinvestment Act* authorized $10 billion in Recovery Zone economic development bonds and $15 billion in Recovery Zone facility bonds. These bonds could be issued during 2009 and 2010. Each state received a share of the national allocation based on that state's job losses in 2008 as a percentage of national job losses in 2008, with each state receiving a minimum allocation of these bonds. These allocations were then sub-allocated to local municipalities. Municipalities receiving an allocation of these bonds would be permitted to use these bonds to invest in infrastructure, job training, education, and economic development in areas within the boundaries of the State, city or county (as the case may be) that has significant poverty, unemployment or home foreclosures. Because the formula that was used in the *American Recovery and Reinvestment Act* looked to net job losses instead of unemployment, some areas of the country with significant numbers of unemployed individuals did not receive any allocation of Recovery Zone bonds. The bill would make an additional allocation of Recovery Zone bonds to ensure that each local municipality receives a minimum allocation equal to at least its share of national unemployment in December 2009. The bill would also extend the authorization for issuing Recovery Zone bonds through 2011. *This provision is estimated to cost $2.375 billion over 10 years.*

Water and sewer exempt-facility bonds excluded from state volume caps. Under current law, State agencies are generally subject to a cap with respect to the volume of private activity bonds they may issue. Certain bonds are not subject to these state volume caps. For example, bonds to finance airports, docks and wharves are excluded from state volume caps. Furthermore, qualified 501(c)(3) bonds are also excluded from state volume caps. The bill would exclude bonds financing facilities that furnish water and sewage facilities from state volume caps. The bill would also exclude bonds financing facilities that furnish water and sewage facilities from

certain limitations on tribal government issuances. *This provision is estimated to cost $371 million over 10 years.*

Eliminate costs imposed on State and local governments by the alternative minimum tax. The alternative minimum tax (AMT) can increase the cost to State and local governments of issuing tax-exempt private activity bonds. In general, interest on tax-exempt private activity bonds is generally subject to the AMT. This limits the marketability of these bonds and, therefore, forces State and local governments to issue these bonds at higher interest rates. The *American Recovery and Reinvestment Act* excluded private activity bonds from the AMT if the bond was issued in 2009 or 2010, and allowed AMT relief for current refunding of private activity bonds issued after 2003 and refunded during 2009 and 2010. The bill would extend both of these *American Recovery and Reinvestment Act* provisions for one year (i.e., exempt from AMT tax-exempt private activity bonds issued in 2011 and current refunding of private activity bonds issued after 2003 and refunded during 2011). *This provision is estimated to cost $224 million over 10 years.*

New Markets Tax Credit. Through the New Markets Tax Credit (NMTC) program, the federal government is able to leverage federal tax credits to encourage significant private investment in businesses in low-income communities. For each dollar of qualified private investment, the NMTC program provides investors with either 5 cents or 6 cents of federal tax credits (depending on the amount of time that has passed since the original investment was made). The value of these tax credits depends on a taxpayer's ability to use these credits to offset tax liability. The NMTC program will not encourage investors to make investments in low-income communities if these investors are unable to use these credits to offset tax liability. Taxpayers that are subject to the alternative minimum tax (AMT) are unable to use NMTC to offset their AMT tax liability. In order to ensure that the NMTC encourages AMT taxpayers to make qualifying investments, the bill would allow NMTC to be claimed against the AMT with respect to qualified investments made between March 15, 2010 and January 1, 2012. *This provision is estimated to cost $444 million over 10 years.*

Extension of tax-exempt eligibility for loans guaranteed by Federal Home Loan Banks. State and local governments currently face significant costs when issuing tax-exempt municipal bonds to finance state and local projects. The *Housing and Economic Recovery Act of 2008* helped these municipalities by temporarily allowing bonds that are guaranteed by Federal home loan banks to be eligible for treatment as tax-exempt bonds regardless of whether the bonds are used to finance housing programs. Allowing these bonds to be guaranteed by Federal home loan banks has helped State and local governments obtain financing for necessary projects (e.g., constructing roads, repairing bridges, building and renovating schools and hospitals, funding college loans, etc) at a lower cost. The bill would extend this benefit for bonds issued through 2011. *This proposal is estimated to cost $148 million over 10 years.*

Extension of temporary small issuer rules for allocation of tax-exempt interest expense. Under current law, financial institutions are not allowed to take a deduction for the portion of their interest expense that is allocable to such institution's investments in tax-exempt municipal bonds. For purposes of this interest disallowance rule, bonds that are issued by a "qualified small issuers" are not taken into account as investments in tax-exempt municipal bonds. Under

current law, a "qualified small issuer" is defined as any issuer that reasonably anticipates that the amount of its tax-exempt obligations (other than certain private activity bonds) will not exceed $10,000,000. The *American Recovery and Reinvestment Act* increased this dollar threshold to $30,000,000 when determining whether a tax-exempt obligation issued in 2009 and 2010 qualifies for this small issuer exception. The small issuer exception would also apply to an issue if all of the ultimate borrowers in such issue would separately qualify for the exception. For these purposes, the issuer of a qualified 501(c)(3) bond shall be deemed to be the ultimate borrower on whose behalf a bond was issued. The bill would extend this benefit for bonds issued through 2011. *This proposal is estimated to cost $254 million over 10 years.*

II. INVESTING IN AMERICAN JOBS

Extension of Emergency Fund for Job Creation and Assistance – *The American Recovery and Reinvestment Act* created an emergency fund to help States with increasing expenditures on: basic assistance for families in the TANF program; short-term, one-time aid for needy families; and subsidized employment programs (such programs temporarily pay for all or part of the wages of a worker in a public or private job). This emergency fund is now scheduled to expire on September 30, 2010 -- threatening the over 247,000 jobs that are now supported by the fund. The bill would extend this fund through FY 2011, as well as clarify certain program rules. *This provision is estimated to cost $3.5 billion over 10 years.*

III. CLOSING FOREIGN TAX LOOPHOLES TO PROMOTE INVESTMENT IN AMERICA

Summary. The bill includes a package of provisions developed jointly by the Treasury Department, the Committee on Ways and Means and the Senate Finance Committee to curtail abuses of the U.S. foreign tax credit system and other targeted abuses. This system is intended to ensure that U.S.-based multinational companies are not subject to double taxation. However, taxpayers have taken advantage of the U.S. foreign tax credit system to reduce the U.S. tax due on completely unrelated foreign income in a manner that has nothing to do with eliminating double taxation. The bill would eliminate $11.6 billion of foreign tax credit loopholes.

Rules to prevent splitting foreign tax credits from income. To prevent double taxation (i.e., full taxation by both a foreign country and by the United States on the same item of income), taxpayers are permitted to claim foreign tax credits with respect to foreign taxes paid on income earned offshore. Taxpayers have devised several techniques for splitting foreign taxes from the foreign income on which those taxes were paid. With these techniques, the foreign income remains offshore and untaxed by the United States, while the foreign taxes are currently available in the U.S. to offset U.S. tax that is due on other foreign source income. In many cases, the foreign income is permanently reinvested offshore such that it likely will never be repatriated and taxed in the U.S. This use of foreign tax credits has nothing to do with relieving double taxation. The President's FY2011 Budget proposes to adopt a matching rule to prevent the separation of creditable foreign taxes from the associated foreign income. The bill would adopt the President's Budget proposal by implementing a matching rule that would suspend the

recognition of foreign tax credits until the related foreign income is taken into account for U.S. tax purposes. The bill targets abusive techniques and does not affect timing differences that result from normal tax accounting differences between foreign and U.S. tax rules. The provision would apply to all "split" foreign taxes claimed by taxpayers after December 31, 2010. *This proposal is estimated to raise $4.250 billion over 10 years.*

Denial of foreign tax credit with respect to foreign income not subject to United States taxation by reason of covered asset acquisitions. There are certain rules that permit taxpayers to treat a stock acquisition as an asset acquisition under U.S. tax law. Taxpayers can obtain similar results by acquiring interests in entities that are treated as corporations for foreign tax purposes, but as non-corporate entities (such as partnerships) for U.S. tax purposes. These transactions ("covered asset acquisitions") result in a step-up in the basis of the assets of the acquired entity to the fair market value that was paid for the stock (or interest in the business entity). In the foreign context, this step-up usually exists only for U.S. tax purposes, and not for foreign tax purposes. As a result, depreciation for U.S. tax purposes exceeds depreciation for foreign tax purposes, such that the U.S. taxable base is lower than foreign taxable base. Because foreign taxes – and therefore foreign tax credits – are based on the foreign taxable base, there are more foreign tax credits than are necessary to avoid double tax on the U.S. tax base. Taxpayers are using these additional foreign tax credits to reduce taxes imposed on other, completely unrelated foreign income. The bill would prevent taxpayers from claiming the foreign tax credit with respect to foreign income that is never subject to U.S. taxation because of a covered asset acquisition. The provision would generally apply to transactions occurring after December 31, 2010, with special transition rules for certain transactions between unrelated parties. *This proposal is estimated to raise $3.645 billion over 10 years.*

Separate application of foreign tax credit limitation to items resourced under tax treaties. To prevent double taxation (i.e., full taxation by both a foreign country and by the United States on the same item of income), taxpayers are permitted to claim foreign tax credits with respect to foreign taxes paid on income earned offshore. To appropriately limit use of the foreign tax credit system to avoidance of double taxation, foreign tax credits are limited to the maximum amount of U.S. tax that could be imposed on the taxpayer's foreign source income (i.e., thirty-five percent (35%) of the taxpayer's foreign source income). Taxpayers have devised a technique to use the U.S. treaty network to enhance foreign tax credit utilization – well beyond what is needed to avoid double taxation – by artificially inflating foreign source income. With this technique, ownership of income-producing assets that would ordinarily be held by U.S.-based multinational companies in the United States (e.g., investments in U.S. securities) is shifted to foreign branches and disregarded entities. This income is often lightly taxed on a net basis by the foreign country, but the treaty prevails in categorizing the entire gross amount of the income generated by the U.S. assets as foreign source. This artificially inflates the taxpayer's foreign source income and allows the taxpayer to use foreign tax credits to reduce taxes on foreign source income beyond the maximum amount of U.S. tax that could be imposed on such income. This unintended tax planning technique has nothing to do with relieving double taxation. The bill respects the treaty commitment to treating such income as foreign source, but segregates the income so that it is not the basis for claiming foreign tax credits that have nothing to do with double taxation. In doing so, the bill conforms the foreign tax credit treatment of taxpayers operating abroad through foreign branches and disregarded entities to the treatment already afforded to taxpayers operating

through foreign corporations. The provision would apply to taxable years beginning after the date of enactment. *This proposal is estimated to raise $250 million over 10 years.*

Limitation on the use of section 956 for foreign tax credit planning (i.e., the "hopscotch" rule). U.S.-based multinational companies typically have complex foreign structures designed to mitigate their worldwide tax expense. In many cases, these structures include companies located in low-tax jurisdictions (e.g., tax havens such as Bermuda and the Cayman Islands) in a multi-tier chain of subsidiaries. If a foreign subsidiary with a relative high tax expense distributes a dividend up through a chain of companies, the foreign tax credit on the dividend ultimately received by the U.S. shareholder is a blend of the tax rates of each foreign subsidiary in that chain. If there is a tax-haven company in that chain, the U.S. tax due on the dividend may be significantly higher than the tax would have been if the foreign subsidiary's dividend could have simply "hopscotched" over the chain as a direct distribution to the U.S. shareholder. Affirmative use of section 956, which was originally enacted as an anti-abuse provision, readily accomplishes this "hopscotch" by deeming a dividend from a foreign subsidiary directly to the U.S. shareholder. By taking advantage of this "hopscotch" rule, the foreign tax credit on this "deemed dividend" can be greater than the foreign tax credit would be on an actual dividend. The bill would limit the amount of foreign tax credits that may be claimed with respect to a deemed dividend under section 956 to the amount that would have been allowed with respect to an actual dividend. The provision would apply to the affirmative use of section 956 after the date of December 31, 2010. *This proposal is estimated to raise $704 million over 10 years.*

Special rule with respect to certain redemptions by foreign subsidiaries. Where a foreign-based multinational company owns a U.S. company, and that U.S. company owns a foreign subsidiary, the earnings of the foreign subsidiary are generally subject to U.S. tax when they are distributed to the U.S. shareholder. When those earnings are then distributed by the U.S. company to its foreign shareholder, a thirty percent (30%) withholding tax applies, unless reduced by treaty or some other provision of the tax code. Foreign-based multinational companies have devised a technique for avoiding U.S. taxation of such foreign subsidiary earnings. This technique involves a provision of the tax code that was originally enacted as an anti-abuse rule that treats certain sales of stock between related parties as a dividend. For example, under this provision, where a foreign-based multinational corporation sells stock in the U.S. company to its foreign subsidiary, the cash received from the foreign subsidiary in this sale is treated as a dividend from that foreign subsidiary. This deemed dividend allows the foreign subsidiary's earnings to completely – and permanently – bypass the U.S. tax system. The bill would eliminate this type of tax planning by preventing the foreign subsidiary's earnings from being reduced and, as a result, the earnings would remain subject to U.S. tax (including withholding tax) when repatriated to the foreign parent corporation as a dividend. The provision would apply to acquisitions after December 31, 2010. *This proposal is estimated to raise $203 million over 10 years.*

Modification of affiliation rules for purposes of rules allocating interest expense. To prevent double taxation (i.e., full taxation by both a foreign country and by the United States on the same item of income), taxpayers are permitted to claim foreign tax credits with respect to foreign taxes paid on income earned offshore. To appropriately limit use of the foreign tax credit system to avoidance of double taxation, foreign tax credits are limited to the maximum amount of U.S. tax

that could be imposed on the taxpayer's foreign source income (i.e., thirty-five percent (35%) of the taxpayer's foreign source income). Taxpayers have used various techniques to minimize the amount of foreign source interest expense, which has the effect of artificially boosting foreign source income. In turn, this permits taxpayers to utilize more foreign tax credits than would otherwise be possible, and the use of such additional foreign tax credits has nothing to do with relieving double taxation. To prevent taxpayers from avoiding these rules, Treasury regulations prevent taxpayers from excluding foreign interest expense from the foreign tax credit limitation by placing it in foreign subsidiaries. The regulations achieve this result by including certain subsidiaries in the U.S. affiliated group. As a result, foreign source interest expense will be taken into account in the determination of the foreign tax credit limitation. The bill would modify the affiliation rules to strengthen these anti-abuse rules. The provision would apply to taxable years beginning after the date of enactment. *This proposal is estimated to raise $390 million over 10 years.*

Repeal of 80/20 rules. Under current law, dividends and interest paid by a domestic corporation are generally considered U.S.-source income to the recipient and are generally subject to gross basis withholding if paid to a foreign person. If at least eighty percent (80%) of a corporation's gross income during a three-year period is foreign source income and is attributable to the active conduct of a foreign trade or business (a so-called "80/20 company"), dividends and interest paid by the corporation will generally not be subject to the gross basis withholding rules. Furthermore, interest received from an 80/20 company can increase the foreign source inxome of, and therefore the amount of foreign tax credits that may be claimed by, a U.S. multinational company. Treasury has become aware that some companies have abused the 80/20 company rules. As a result, the President's 2011 Budget proposes to repeal these rules. The bill would adopt the President's Budget proposal to repeal the 80/20 company rules. The bill would also repeal the 80/20 rules for interest paid by resident alien individuals. The bill would include relief for existing 80/20 companies that meet specific requirements and are not abusing the 80/20 company rules. Subject to the relief for these existing 80/20 companies, the provision would apply to taxable years beginning after December 31, 2010. *This provision is estimated to raise $153 million over 10 years.*

Source rules on guarantees. Under current law, the treatment of guarantee fees under the source rules is unclear. If guarantee fees are sourced like services, they are sourced according to the location in which the services were performed. If the guarantee fees are sourced like interest, they are sourced by reference to the country of residence of the payor. A recent court case determined that guarantee fees should be sourced like services. Sourcing guarantee fees in a manner similar to services would permit U.S. subsidiaries of foreign corporations to engage in earning stripping transactions by making deductible payments to foreign affiliates (thereby reducing their U.S. income tax liability) without the imposition of U.S. withholding tax on the payment. The bill would provide that guarantees on indebtedness issued after the date of enactment will be sourced like interest and, as a result, if paid by U.S. taxpayers to foreign persons will generally be subject to withholding tax. No inference is intended with respect to the treatment of guarantees on indebtedness issued before the date of enactment. *This proposal is estimated to raise $2.000 billion over 10 years.*

Technical correction to statute of limitations provision in the HIRE Act. The bill would make a technical correction to the foreign compliance provisions of the *Hiring Incentives to Restore Employment (HIRE) Act* that would clarify the circumstances under which the statute of limitations will be tolled for corporations that fail to provide certain information on cross-border transactions or foreign assets. Under the technical correction, the statute of limitations period will not be tolled if the failure to provide such information is shown to be due to reasonable cause and not willful neglect. *This proposal is estimated to not have any revenue effect over 10 years.*