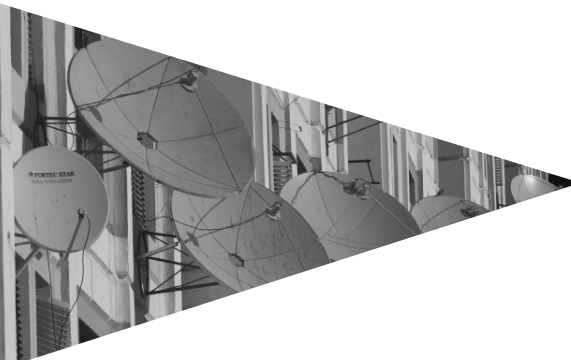


# Washington Dispatch



## In this issue...

### Legislation

- 1 Federal debt limit negotiations continue; hearings held on tax reform

### IRS news

- 2 Final regulations issued on certain triangular reorganizations involving foreign corporations
- 3 IRS rules subpart F income qualifies under 95% REIT income test
- 3 Section 6038D and 1298(f) information reporting requirements temporarily suspended

### Treasury news

- 3 Relief for reporting signature authority over FBAR, Form TD F 90-22.1 for accounts owned by publicly-traded or widely-held groups and affiliates of certain financial institutions

### Tax treaties

- 4 Senate Foreign Relations Committee holds hearing on new US-Hungary treaty, protocols to Swiss and Luxembourg accords

## Legislation

### Federal debt limit negotiations continue; hearings held on tax reform

The deficit, debt and the urgent need to raise the federal debt limit is taking center stage in Washington. While the last month has seen meetings and behind-the-scenes activity on the federal debt ceiling, it has been to little avail.

As we go to press, the President is hosting Senate Republican and Democratic leaders at the White House in an attempt to broker a deal. Leading Republican and Democrats in Congress meanwhile are calling for direct talks between President Obama and House Speaker John Boehner (R-OH) to break the ongoing impasse.

Deficit and debt reduction talks broke down on 23 June as key Republican lawmakers quit Vice-President Joe Biden's bipartisan deficit reduction group. House Majority Leader Eric Cantor (R-VA) and Senate Republican Whip Jon Kyl (R-AZ) announced that they would no longer participate in the discussions, saying that tax increases to reduce the deficit are a non-starter for Republicans in both chambers. House Speaker Boehner has repeatedly said that a tax increase as part of deficit reduction would not pass the House.

In the meantime, the clock is ticking on the need to raise the federal debt limit, currently set at \$14.3 trillion. Treasury is employing what it terms "extraordinary measures" to extend borrowing authority until sometime in early August, leaving a little over a month before the US government defaults.

### Tax reform

Although the primary focus is on the debt limit, Congress is also reviewing options with regard to comprehensive tax reform. Both the House Ways and Means Committee and Senate Finance Committee have continued to hold hearings on various aspects of tax reform.

On 24 May, Ways and Means held a tax reform hearing that focused on the tax systems of four countries with territorial tax or exemption systems. Congressional lawmakers are considering whether the US should adopt a territorial-type tax system as part of fundamental tax reform in order to make US multinationals more competitive in the global market. The committee hearing was the second such hearing to focus on international tax issues this year, with the first, on 12 May, featuring testimony from CFOs of US-based companies.

The committee invited Frank Schoon, an Ernst & Young Dutch Desk partner in Chicago, and Jörg Menger, an Ernst & Young German Desk partner in New York, to testify on the Dutch and German tax systems, respectively, focusing on those countries' experience with their exemption systems. Asked whether a territorial system would result in companies shifting jobs overseas, Schoon said there was no evidence in the Netherlands that its tax system caused jobs to be shifted overseas. Menger said the German government believes that capital import neutrality—a premise underlying the German international tax system—generates German jobs.

At another Ways and Means Committee hearing on tax reform that focused on the domestic side, representatives of four companies told the committee on 2 June that they would be willing to have major tax expenditures benefiting corporations eliminated in exchange

for a significantly lower corporate tax rate. The competitive disadvantages imposed by the current corporate rate and worldwide system of taxing foreign earnings were also detailed at the hearing.

Finally, the House Ways and Means Subcommittee on Select Revenue Measures held a hastily called tax reform hearing on 23 June that focused on inbound foreign direct investment (FDI) into the United States. The Subcommittee heard testimony that FDI would increase if the US corporate tax rate were reduced and earnings stripping rules loosened, or at least attempts to make them more stringent were resisted. Several academics and economists suggested to the Subcommittee, however, that Congress should tighten the earnings stripping rules, in the context of tax reform.

In other tax reform developments, Treasury Secretary Timothy Geithner in June was quoted as saying that the Obama Administration will release a corporate tax reform proposal in the form of a white paper in late summer or early fall. According to the tax press, the proposal will address corporate tax "loopholes" outlined in the State of the Union address as well as a proposal to tax large pass-through entities in the same manner as corporations.

Also, Sen. Saxby Chambliss (R-GA), a member of the new "Gang of Five," said the group's long-term deficit reduction plan would include revenue-neutral corporate tax

reform proposals. According to press reports, the group has identified approximately \$4.7 trillion in savings as part of a long-term deficit reduction plan.

## IRS news

### Final regulations issued on certain triangular reorganizations involving foreign corporations

On 17 May 2011, the government issued final regulations and removed temporary regulations under Section 367(b) addressing the treatment of property used by a subsidiary corporation to acquire shares of its parent corporation in connection with certain triangular reorganizations under Section 368(a)(1) involving one or more foreign corporations.

The temporary regulations, issued on 27 May 2008 (the 2008 Regulations), applied to certain triangular reorganizations in which a subsidiary (S) purchases, in connection with the reorganization, stock of its parent corporation (P) in exchange for property, and exchanges the P stock for the stock or property of a target corporation (T), but only if P or S (or both) is a foreign corporation. The 2008 Regulations generally required that adjustments be made that have the effect of a distribution of property from S to P under Section 301(c), and, in certain cases, followed a contribution of a similar amount from P to S. The final regulations generally adopt the provisions of the 2008 Regulations with some modifications.

The final regulations are generally consistent with the 2008 Regulations and do not break much additional ground. Significantly, the application of these regulations continues to be limited to Section 368(a) reorganizations, consistent with the limited scope of Section 367(b).

The final regulations apply to transactions occurring on or after 17 May 2011.

### **IRS rules subpart F income qualifies under 95% REIT income test**

In PLR 201119001, the Service ruled that a real estate investment trust's (REIT's) Subpart F inclusions, Section 956 inclusions, and PFIC inclusions attributable to a REIT's investments in foreign taxable REIT subsidiaries (TRSs) constitute qualifying income for purposes of the 95% income test of Section 856(c)(2).

PLR 201119001 is the first private letter ruling, or guidance of any kind, that specifically addresses whether Subpart F inclusions, Section 956 inclusions, and PFIC inclusions may constitute qualifying income for purposes of the 95% income test. Advisors have previously argued that such income is essentially in the nature of dividend income, and thus ought to constitute qualifying income for purposes of the 95% income test. However, the Service appears to have looked through to the underlying nature of the income and activity of the TRSs in making its determination.

This ruling will be of interest to REITs that invest outside the United States through foreign corporations. REITs and their advisors will want to review this ruling, and consider whether they need to obtain their own rulings.

Also of interest is that PLR 201119001 appears to be the first private letter ruling in which the Service has invoked its authority under Section 856(c)(5)(J) (effective for tax years beginning after 30 July 2008) in issuing a private letter ruling.

### **Section 6038D and 1298(f) information reporting requirements temporarily suspended**

The IRS on 21 June 2011 issued Notice 2011-55, temporarily suspending information reporting requirements under Sections 6038D and 1298(f) for taxpayers that may be subject to reporting under those sections for taxable years beginning on or after 18 March 2010.

The suspension applies to income tax or information returns that are required to be filed prior to the release of new Form 8938 - "Statement of Foreign Financial Assets" and a revised Form 8621 - "Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund." Note that Form 8938 and revised Form 8621 have not yet been released by the IRS.

After the release of Form 8938 or revised Form 8621, taxpayers for which the reporting requirements mandated by Sections 6038D and 1298(f) which were suspended by Notice 2011-55 will be required to attach Form 8938, Form 8621, or both relating to the suspended period to their subsequent income tax or information return.

## **Treasury news**

### **Relief for reporting signature authority over FBAR, Form TD F 90-22.1 for accounts owned by publicly-traded or widely-held groups and affiliates of certain financial institutions**

On 31 May 2011, Treasury's Financial Crimes Enforcement Network (FinCEN) issued Notice 2011-1, granting a limited one-year extension to the deadline for filing Forms TD F 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR) to report signature authority over certain accounts, by officers and employees of US publicly-traded, widely-held groups and affiliates of certain regulated financial services companies.

This relief essentially applies to employees who were exempt from reporting signature authority over accounts for 2009 and prior years, but who otherwise would have been required to report such authority for 2010, by 30 June 2011. Instead, such reports must be filed under the notice by 30 June 2012.

Note that Notice 2011-1 does not provide additional time to report financial interests in foreign financial accounts. Nor does it provide additional time to report signature authority over accounts owned by (1) closely-held entities that are not financial institutions, (2) foreign-listed publicly traded groups, or (3) customers or clients.

Many companies that have been working diligently to prepare FBAR returns for employees to file by 30 June 2011, to report signature authority over their accounts should carefully assess the notice and their facts to determine which of those returns must still be filed by 30 June 2011. Also, note that at this time, it is not clear whether FinCEN intends to modify the final regulations before 30 June 2012.

## Tax treaties

### Senate Foreign Relations Committee holds hearing on new US-Hungary treaty, protocols to Swiss and Luxembourg accords

The Senate Foreign Relations Committee on 7 June 2011, held a hearing on the new US-Hungary income tax treaty as well as protocols to the US-Switzerland and US-Luxembourg tax conventions. As we go to press, the proposed treaty and protocols have not been reported out of Committee. Once that occurs, the tax agreements will go to the full Senate for advice and consent, after which there will be an exchange of instruments of ratification.

The new US-Hungary Treaty would replace the 1979 convention. It generally follows the 2006 US Model Income Tax Treaty and other recently concluded US income tax treaties and protocols. The major provisions of the Hungary Treaty include:

- ▶ A comprehensive limitation on benefits (LOB) article, including a headquarters test and a triangular provision

- ▶ Exemption from withholding for interest and royalties, and continued 5% and 15% withholding rates for dividends
- ▶ Taxation of US investors by Hungary upon their sales of shares in Hungarian real property holding companies

The Diplomatic Note to the proposed treaty defines certain terms and provides additional guidance on

## Get the world – to go Now getting tax rates is easier than ordering take out

You can now access corporate income tax rates of over 50 countries whenever and wherever using your mobile device. Rates are updated quarterly.

Type into your mobile web browser:  
[www.ey.mobi/ITS/rates](http://www.ey.mobi/ITS/rates)



several provisions in the convention, including the treatment of fiscally transparent entities, the active trade or business test, and discretionary grant of benefits in the LOB article of the treaty.

Hungary has already taken the necessary steps for ratification, Although it cannot be predicted as to whether the new Hungarian treaty will be ratified by the United States or enter into force by year end, the Committee will likely take prompt action to move the process along.

The highlights of the new Swiss Protocol include:

- ▶ Expanded exchange of information provisions

- ▶ New rules for mandatory and binding arbitration
- ▶ Rules providing that individual retirement accounts are eligible for the benefits afforded under the Swiss Treaty

The changes to the scope and application of the new Swiss exchange of information article should bring the treaty provision into line with US domestic laws governing information gathering. The updated provisions, combined with the new domestic laws under FATCA, are expected to provide the IRS with the data it needs to effectively audit the foreign accounts of US taxpayers.

A Treasury official's testimony at the hearing confirmed that Switzerland intends to interpret the treaty provisions in a manner consistent with international standards, which should lead to efficient information exchange between the United States and Switzerland.

The most significant aspect of the Luxembourg Protocol is the improvement it represents to the current information exchange agreement and the fact that it broadens the current standard so the United States can obtain information with regard to any issue necessary to enforce US tax laws.

## International Tax Services, Washington, DC

▶ <b>Margie Rollinson</b>	<b>+1 202 327 5757</b>
<b>Sal Vaudo</b>	<b>+1 617 375 8333</b>
▶ Robert Ackerman	+1 202 327 5944
▶ Barbara Angus	+1 202 327 5824
▶ Stephen Bates	+1 415 894 8190
▶ David Canale	+1 202 327 7653
▶ Doug Chestnut	+1 202 327 5780
▶ David Golden	+1 202 327 6526
▶ Liz Hale	+1 202 327 8070
▶ Lilo Hester	+1 202 327 5764
▶ Stephen Jackson	+1 212 773 8555
▶ Karen Kirwan	+1 202 327 8731
▶ Kyle Klein	+1 202 327 8843
▶ Richard Larkins	+1 202 327 7808
▶ David Levere	+1 212 773 4610
▶ Dick McAlonan	+1 202 327 6025
▶ Stephen Meadows	+1 202 327 6020
▶ Alan Munro	+1 202 327 7773
▶ Jose Murillo	+1 202 327 6044
▶ Peg O'Connor	+1 202 327 6229
▶ Al Paul	+1 202 327 7476
▶ Donald Proper	+1 212 773 6542
▶ John Turro	+1 202 327 8019
▶ Tim Wichman	+1 312 879 2282
▶ Ken Wood	+1 202 327 8018
▶ Steven Wrappe	+1 202 327 5956
▶ Jelena Budjevac	+1 202 327 5729
▶ Tom Coony	+1 202 327 5658
▶ Julio Jimenez	+1 212 773 5297
▶ Petya Kirilova	+1 202 327 6075
▶ Tammy LeGrys	+1 202 327 7757
▶ Katherine Loda	+1 212 773 6634
▶ John Morris	+1 202 327 8026
▶ Jasper Nzedu	+1 202 327 6203
▶ Ben Orenstein	+1 212 773 4485
▶ Karen Petrosino	+1 212 773 0375
▶ Julia Tonkovich	+1 202 327 8801
▶ fax number	+1 202 327 6721

## International Tax Services

- ▶ Global ITS, **Jim Tobin**, *New York*
- ▶ ITS Director, Americas, **Jeffrey Michalak**, *Detroit*
- ▶ ITS Director of National Washington, DC, **Margie Rollinson**, *Washington*

- |  |   |
|--|---|
| ▶ Northeast<br><b>Craig Hillier</b> , <i>Boston</i>          | ▶ West<br><b>Julie Wooldridge</b> , <i>Irvine, CA</i>                       |
| ▶ East Central<br><b>Johnny Lindroos</b> , <i>McLean, VA</i> | ▶ Canada<br><b>George Guedikian</b> , <i>Toronto</i>                        |
| ▶ FSO<br><b>Phil Green</b> , <i>New York</i>                 | ▶ Israel<br><b>Sharon Shulman</b> , <i>Tel Aviv</i>                         |
| ▶ Midwest<br><b>Simon Moore</b> , <i>Chicago</i>             | ▶ Mexico and Central America<br><b>Koen Van 't Hek</b> , <i>Mexico City</i> |
| ▶ Southeast<br><b>Scott Shell</b> , <i>Charlotte, NC</i>     | ▶ South America<br><b>Alberto Lopez</b> , <i>New York</i>                   |
| ▶ Southwest<br><b>Paul Palmer</b> , <i>Houston</i>           |   |

Ernst & Young

Assurance | Tax | Transactions | Advisory

### About Ernst & Young

Ernst & Young is a global leader in assurance, tax, transaction and advisory services. Worldwide, our 141,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve their potential.

Ernst & Young refers to the global organization of member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit [www.ey.com](http://www.ey.com).

### International Tax Services

About Ernst & Young's International Tax Services practice

Our dedicated international tax professionals assist our clients with their cross-border tax structuring, planning, reporting and risk management. We work with you to build proactive and truly integrated global tax strategies that address the tax risks of today's businesses and achieve sustainable growth. It's how Ernst & Young makes a difference.

The Washington Dispatch is a monthly communication prepared by Ernst & Young's Washington International Tax Services summarizing recent developments and "inside-the-beltway" news pertinent to multinational companies. For additional information, please contact your local international Tax professional.

ITS Washington, DC  
Margie Rollinson

[www.ey.com](http://www.ey.com)

© 2011 Ernst & Young LLP.  
All Rights Reserved.

SCORE no. CM2415

*This publication contains information in summary form and is therefore intended for general guidance only. It is not intended to be a substitute for detailed research or the exercise of professional judgment. Neither EYGM Limited nor any other member of the global Ernst & Young organization can accept any responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication. On any specific matter, reference should be made to the appropriate advisor.*