2014
Tax Update

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Agenda

- The "Tangible Property Regulations"
- U.S. Tax Rates & Inversion Transactions
- Chairman Camp's Tax Proposal
- Current Status of Tax Extenders
- Questions

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THE "TANGIBLE PROPERTY REGULATIONS"

Tangible Property Regulations

- Materials & Supplies
- De minimis capitalization threshold
- Rotable spare parts
- Partial dispositions
- Building "systems"
- Effective in full as of 1/1/2014
- Accounting method change may be required to conform.

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Tangible Property Regulations

- Rev. Procs. 2014-16 and 2014-17
  - Provide automatic accounting method changes for many of the items addressed in the new Regs.
  - All taxpayers will need to consider the potential for an accounting method change under these Regs.
  - Watch for missteps by adoption of an accounting method by merely treating an item a certain way on your 2014 tax return.

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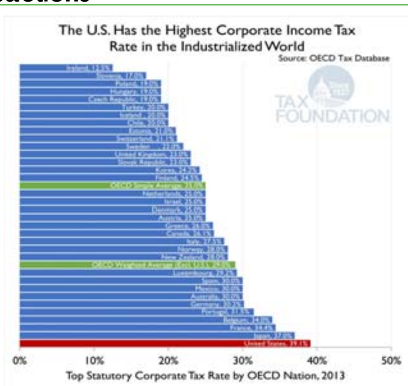
U.S. TAX RATES & INVERSION TRANSACTIONS

U.S. Tax Rates & Inversion Transactions



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U.S. Tax Rates & Inversion Transactions

- U.S. International Tax Scheme in General
  - "Worldwide Taxation"
  - If Headquartered (HQ) in the U.S., taxed on worldwide income.
    - Companies create offshore subsidiaries to house profits and defer U.S. taxation.
    - Taxation triggered upon repatriation of the earnings.
  - Prior "repatriation holidays" may not have achieved much in the way of jobs creation or direct U.S. investment, but primarily have been used to fund debt pay-down or returns to shareholders.

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U.S. Tax Rates & Inversion Transactions

- Majority of the OECD utilizes a "territorial tax" scheme.
  - All income earned within the borders of the taxing jurisdiction is directly and currently taxed, regardless of the domicile of the taxpayer.
  - Income earned in other jurisdictions outside the boundaries of the taxpayer's domicile is not taxed upon repatriation.

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U.S. Tax Rates & Inversion Transactions

U.S. corporation operating in country X vs. corporation headquartered in country X

Assuming country X uses territorial taxation with a 20 percent rate, and a 35 percent rate for the U.S.

Corporation headquartered in U.S.	Corporation headquartered in country X
Foreign subsidiary of a U.S. corporation earns $100 of income in country X	Country X corporation earns $100 of income in country X
$20 tax paid to country X	$20 tax paid to country X
$80 transferred from the foreign subsidiary to the U.S. corporation. Corporation must count the full $100 in income on its U.S. tax forms	$80 transferred to the corporation's home country. No tax is due.
$15 tax paid to U.S. government to achieve a 35 percent tax rate	
$65 remaining after taxes	$80 remaining after taxes

Source: Senate Republican Policy Committee

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U.S. Tax Rates & Inversion Transactions

- Favorite Quote
  - "The Nation should have a tax system that looks like someone designed it on purpose."
    - William Simon, Former U.S. Treasury Secretary
  - With the current worldwide taxation scheme full of deferral and expatriation motivators, a territorial system seems to better fit the bill of a "system that looks like someone designed it on purpose."

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U.S. Tax Rates & Inversion Transactions

- Pfizer / AstraZeneca
  - Pfizer bid to merge with AstraZeneca in order to, among many other strategic objectives, domicile HQ in the UK.
  - Pfizer pulled $118B bid (30% premium to pre-announcement stock price) and plans no hostile takeover bid.
  - Income tax savings were a significant consideration in the strategic plan for this takeover bid.

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U.S. Tax Rates & Inversion Transactions

- Valeant Pharmaceuticals Inc. / Allergan Inc.
  - Valeant launched a hostile bid for Allergan intending to expatriate Allergan's HQ from the U.S. to Canada, Valeant's country of domicile.
  - The favorable tax consequences of the deal were a major point argued in the hostile bid.
  - Valeant claims the deal would result in a "[h]igh single-digit tax rate for combined company in addition to cost synergies."
  - Allergan responds that "Valeant's multiple offshore tax deferral structures are aggressive, difficult to sustain and compound risk in multiple jurisdictions."

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U.S. Tax Rates & Inversion Transactions

- "…it's likely that the huge gap between US and foreign tax rates will result in America losing an huge corporate citizen before politicos get serious about solving the problem." – Kevin Chupka writing for finance.yahoo.com.

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CHAIRMAN CAMP'S TAX PROPOSAL

Chairman Camp's Tax Proposal

- The "Tax Reform Act of 2014"
- Whew! What a Bill this is
  - 979 pages of tax reform
  - 190 pages of "summary" of the Bill
  - Addresses virtually every aspect of current U.S. tax law
- You will not recognize the new tax code if this Bill becomes law.

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Chairman Camp's Tax Proposal

- Camp's arguments for his plan
  - JCT estimates the total package would not add to the budget deficit.
  - Creation of 1.8 million new private sector jobs.
  - Allows roughly 95% of taxpayers to get the lowest possible tax rate by simply claiming the standard deduction.
  - Strengthens the economy and increases GDP by $3.4 trillion (20% of today's GDP)

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Chairman Camp's Tax Proposal

- Individual Income Tax Changes
  - Too many to cover in this presentation, so we will hit the high points.
  - Some sacred cows survive
  - Individual rates are "simplified"
  - Many credits repealed
  - IRAs, SEPs and Simplified 401(k)s face multiple changes

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Chairman Camp's Tax Proposal

- Sacred Cows – The Good
  - Mortgage Interest deductible on indebtedness up to $500,000
  - Child tax credit increased and expanded
  - Standard deduction increased to $22,000 (MFJ) / $11,000 (single) with phase-out provisions still in place.
  - Charitable contributions made until due date of return are deductible (subject to 2% floor)

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Chairman Camp's Tax Proposal

- Individual Tax Rates
  - Current structure
    - Seven income brackets ranging from 10% to 39.6%
    - Net investment income tax of 3.8% for income over $250,000.
    - Dividends and capital gains at 0%, 15%, or 20% depending on regular income tax bracket.
    - Rates of 25% and 28% on unrecaptured Section 1250 gains
    - Itemized deduction and personal exemption phaseout levels differ from income tax bracket levels.

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Chairman Camp's Tax Proposal

- Individual Tax Rates
  - Camp Proposal
    - Three tax brackets of 10%, 25% and 35%
      - Income threshold for the 35% bracket would mirror that of the current 39.6% bracket.
      - Income brackets indexed to "chained CPI" instead of CPI
    - Special rate structure for dividends and capital gains replaced with an above the line deduction equal to 40% of net capital gains and qualified dividends.
    - Qualified domestic manufacturing income subject to a top rate of 25%.
    - Phaseouts still in play.
    - JCT estimates a 10-year cost of $498.7 billion

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Chairman Camp's Tax Proposal

- Changes to the EITC
  - Proposal would make creditable only employment related taxes paid by or on behalf of the taxpayer.
  - Various thresholds in place to claim this refundable credit.
  - JCT estimates a 10-year net reduction to outlays (spending) of $218 billion.

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Chairman Camp's Tax Proposal

- Repeal of the "personal exemption"
  - Benefits for taxpayer and spouse "consolidated" into the larger standard deduction
  - Benefits for taxpayer dependents consolidated into expanded child and dependent tax credit.
  - JCT estimates net increase in revenue of $731 billion

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Chairman Camp's Tax Proposal

- Education Tax Benefits
  - Currently there are over 15 different education-related tax benefits.
  - The current four higher education tax credits would be consolidated into one "American Opportunity Tax Credit".
  - Hope Scholarship Credit, Lifetime Learning Credit and tuition deduction would be repealed.
  - Change in ordering rules for Pell Grants
  - JCT estimates a net cost of $9 billion

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Chairman Camp's Tax Proposal

- Education Tax Changes
  - Repeal of deduction of interest on student loans, which is currently an above the line deduction.
  - Repeal of exclusion of income from US savings bonds used to pay higher education expenses.
  - Repeal of exclusion for discharge of student loan indebtedness.
  - Repeal of exclusion for qualified tuition reductions

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Chairman Camp's Tax Proposal

- Changes to individual tax credits and incentives
  - Repeal of credit for residential energy efficient property ($2.8 billion in revenue)
  - Repeal of credit for qualified electric vehicles (no impact)
  - Changes to recognition of gain from sale of principal residence.
    - Must occupy residence for 5 of prior 8 years as principal residence for exclusion of gain.
    - Gain exclusion phased out for income over $500,000

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Chairman Camp's Tax Proposal

- Changes to individual tax credits and incentives
  - Deduction of mortgage interest limited to indebtedness of $500,000
  - Changes to deduction of charitable contributions
  - Repeal of deduction of state and local taxes
  - Repeal of deduction for medical expenses
  - Termination of deduction and exclusion for contributions to medical savings accounts

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Chairman Camp's Tax Proposal

- Changes to individual tax credits and incentives
  - Repeal of 2% floor on certain deductions
  - Repeal of limitations/phaseout of itemized deductions
  - Consistency in definition of "self employment" income
    - S Corporation shareholders subject to SECA on distributive share

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Chairman Camp's Tax Proposal

- Changes to individual tax credits and incentives
  - Repeal of income limitation on contribution to Roth IRAs and no further contributions to traditional IRAs permitted ($17.9 billion in revenue)
  - Repeal of individual and corporate AMT (1,442 billion cost)

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Chairman Camp's Tax Proposal

- Business Tax Reform
  - 25% flat corporate tax rate phased in to full effect in 2019 ($680.3 billion cost)
  - Repeal of MACRS depreciation scheme
    - Move to scheme more consistent with ADS straightline depreciation
    - Repeal of bonus depreciation
    - Repeal of special depreciation provisions for Indian Reservation property
    - Increase to revenue of $269 billion

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Chairman Camp's Tax Proposal

- Business Tax Reform
  - NOL carryover or carryback limited to 90% of taxpayer income. ($70.5 billion in revenue)
  - Required amortization of "R&D" expenditures that are currently deductible under Section 174 ($192.6 billion in revenue)
  - 50% of advertising expenses required to be amortized over 10-years. ($169 billion in revenue)
  - Section 179 limitations increased to $250k deductible with phaseout beginning at $800k in capital investment. (Cost of $54.9 billion)

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Chairman Camp's Tax Proposal

- Business Tax Reform
  - 20-year amortization period for goodwill and other "Section 197" intangibles. ($13 billion in revenue)
  - Repeal of Section 199 deduction for domestic manufacturing activities. ($115 billion in revenue)
  - Repeal of percentage depletion. ($5.3 billion in revenue)
  - Repeal of like-kind-exchanges

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Chairman Camp's Tax Proposal

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- Business Tax Reform
  - Research credit modified and made permanent
    - Makes the alternative simplified credit method permanent at 15% of qualified expenditures exceeding the base.
    - Repeal of the 280C election
    - $34.1 billion cost

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Chairman Camp's Tax Proposal

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- Business Tax Reform
  - Repeal of WOTC (no impact)
  - Cash method available to all companies with gross receipts under $10 million ($23.6 billion in revenue)
  - Limitation of use of Completed Contract Method for long-term projects ($6.5 billion in revenue)
  - Repeal of LIFO
    - LIFO reserve included in taxable income over 4-years
    - Closely held entities (100 or fewer shareholders) only taxed at 7% on LIFO reserve recognition
    - $79.1 billion in revenue

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Chairman Camp's Tax Proposal

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- Business Tax Reform
  - Repeal of “lower of cost or market” inventory method. ($3.8 billion in revenue)
  - Reduced (5-year) period for S Corp recognition of built in gains made permanent. (cost of $3 billion)
  - Repeal of partnership technical termination rules. ($.5 billion in revenue)
  - “Carried interest” income treated as ordinary income. ($3.1 billion in revenue)

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Chairman Camp's Tax Proposal

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- Business Tax Reform
  - TEFRA and ELP audit rules repealed and streamlined into single partnership level audit. ($13.4 billion in revenue)
  - Professional sports leagues (NFL, NBA, etc.) lose tax exempt status. ($.1 billion in revenue)
  - Changes to tax return due dates
    - Partnership or S corporation required to file by 3/15
    - C corporation required to file by 4/15
      - Automatic 6-month extension for C corporations
  - Repeal of medical device excise tax

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CURRENT STATUS OF TAX EXTENDERS

Tax Extenders

- House tax extenders package
  - On April 29, 2014, House Ways and Means approved six separate extender bills to permanently extend certain provisions of the code that expired as of 12/31/13.
  - None of the bills contain revenue offsets.
  - Democrats do not appear willing to accept any extender legislation that lacks revenue offsets to help pay for making permanent these tax provisions.

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Tax Extenders

- H.R. 4429
  - Permanent Active Financing Exception Act of 2014
    - Makes permanent the subpart F foreign personal holding company income exemption for income that is derived in the active conduct of a banking, financing, or similar business, as a securities dealer, or in the insurance business.
    - Cost of $59 billion

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Tax Extenders

- H.R. 4438
  - American Research and Competitiveness Act of 2014
    - Enhances and makes permanent the R&D tax credit
    - Only of the six extender bills to receive Democrat support
    - Cost of $156 billion

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Tax Extenders

- H.R. 4453
  - Permenent S Corporation Built-in Gains Recognition Period Act of 2014
    - Permanently reduces from 10 to 5 years the period during which the built-in gains of and S corportion are subject to tax.
    - Cost of $1.5 billion

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Tax Extenders

- H.R. 4457
  - America's Small Business Tax Relief Act of 2014
    - Makes permanent the following limitations for current expensing of certain capital purchases
      - Up to $500,000 may be expensed
      - Amount of expense allowed phased out if total capital expenditures exceed $2 million.
    - Inflation adjusted limitations
    - Cost of $73 billion

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Tax Extenders

- H.R. 4464
  - Permanent CFC Look-Through Act of 2014
    - Makes permanent the tax rule exempting dividends, interest, rents, and royalties received or accrued from certain controlled foreign corporations by a related entity from treatment as foreign holding company income (thus permitting tax deferral of such income).
    - Cost of $20 billion

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Tax Extenders

- On April 3, 2014, the Senate Finance Committee approved legislation to temporarily extend certain provisions that expired at the end of 2013 or are set to expire at the end of 2014.
- Expiring Provisions Improvement Reform and Efficiency (EXPIRE) Act
- Senate would prefer to wait on comprehensive tax reform until after the mid-term elections.

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Tax Extenders

- EXPIRE Act provisions
  - Deduction for expenses of elementary and secondary school teachers (cost of $430 million)
  - Exclusion of mortgage debt forgiveness (cost of $5.4 billion)
  - Deduction for state and local general sales tax (cost of $6.5 billion)
  - Extension of R&D tax credit (allows certain startups to claim credits against employment taxes). (cost of $16 billion)

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Tax Extenders

- EXPIRE Act provisions
  - Work Opportunity Tax Credit extended through 2015 (cost of $3.2 billion)
  - Extension of 15-year straight-line cost recovery for certain leasehold improvements (cost of $4.8 billion)
  - Extension of 50% bonus depreciation for assets placed in service before 1/1/16, or certain long-term projects placed in service before 1/1/17 (cost of $2.9 billion)

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Tax Extenders

- EXPIRE Act provisions
  - Extension of the $500,000 / $2 million thresholds for Section 179 expensing (cost of $3.2 billion)
  - Extension of the exception under subpart F for active financing income (cost of $10.4 billion)
  - Look-through treatment of payments between related CFC's under the foreign personal holding company rules (cost of $2.5 billion)
  - Reduction in S corporation recognition period to 5-years for sales occurring in 2014 and 2015 (cost of $232 million)

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Tax Extenders

- EXPIRE Act provisions
  - American Somoa economic development credit extended through 2015 (cost of $29 million)
  - Three year depreciation period for certain racing horses (cost of $9 million)
  - Seven year depreciation period for certain motorsports arena property (cost of $71 million)
  - Extension of various renewable energy and efficiency provisions.

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Tax Extenders

- EXPIRE Act revenue raisers
  - Child tax credit diligence requirements (revenue of $43 million)
  - Levy of up to 100% on tax delinquent Medicare service providers (revenue of $818 million)
  - IRS to enter into qualified tax collection contracts (revenue of $2.4 billion)
  - Indexing tax penalties to inflation (revenue of $115 million)

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QUESTIONS