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H.R. 5328: International Tax Competitiveness Act of 2010

On May 18, Ways and Means Committee member Lloyd Doggett introduced H.R. 5328, the “International Tax Competitiveness Act of 2010” (the “Bill”).

HR 5328 includes many provisions previously included in proposed legislation that ultimately did not pass the Congress. Doggett was one of the sponsors of the Stop Tax Haven Abuse Act and, although that law was not passed, much of it was incorporated in the Foreign Account Tax Compliance Act provisions of the Hiring Incentives to Restore Employment (HIRE) Act, which imposed a new system of withholding on payments made to non-U.S. persons.

Other provisions of the Stop Tax Haven Abuse Act have been picked up in the Bill. The main focus of the Bill is to prevent U.S.-managed foreign corporations from avoiding U.S. taxes by tightening the corporate residency rules so that a foreign corporation would be considered a domestic corporation under certain circumstances. The Bill would treat foreign corporations that are “managed and controlled” primarily in the United States as domestic corporations, if such corporations have (directly or indirectly) more than \$50 million in gross assets at any time during the current or preceding taxable year or the stock of the corporation is regularly traded on an established securities market. Assets held by a controlled foreign corporation (CFC) member of a U.S.-affiliated group that has substantial active trade or business assets used in the United States are excluded.

A corporation would be considered “managed and controlled” primarily in the United States if substantially all of the corporation’s executive officers and senior management, who exercise day-to-day responsibility for making decisions involving strategic, financial and operational policies of the corporation, are located primarily in the United States. The Bill would treat certain individuals, who are not executive officers or senior management of the corporation but who nonetheless exercise similar day-to day responsibilities, as executive officers or senior management for purposes of the test. A corporation will also be treated as “managed and controlled” in the United States if its assets (direct or indirectly held) include assets primarily managed on behalf of investors, and if the investment decisions are made in the United States. Additional parameters regarding when the management and control of a corporation occurs primarily in the United States would be provided in regulations.

Previous attempts to pass provisions like the above-mentioned have met resistance from major business organizations, and from Republicans in general. The provision swaps the “place-of-organization test” currently used to determine the country of corporate

Jack Cummings
Editor

*The Atlantic Building
950 F Street, NW
Washington, DC 20004-1404
202.756.3300
Fax: 202.756.3333*

www.alston.com

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International Tax Group

Sam K. Kaywood, Jr.
Co-Chair
404.881.7481

Edward Tanenbaum
Co-Chair
212.210.9425

John F. Baron
704.444.1434

Henry J. Birnkrant
202.756.3319

Robert T. Cole
202.756.3306

Phillip C. Cook
404.881.7491

James E. Croker, Jr.
202.756.3309

Jasper L. Cummings, Jr.
919.862.2302

Tim L. Fallaw
404.881.7836

Terence J. Greene
404.881.7493

Brian D. Harvel
404.881.4491

Michelle M. Henkel
404.881.7633

L. Andrew Immerman
404.881.7532

Brian E. Lebowitz
202.756.3394

Clay A. Littlefield
704.444.1440

Tola Ozim
212.210.9533

Vivek Patel
404.881.7686

Timothy J. Peadar
404.881.7475

Matthew A. Stevens
202.756.3553

Gerald V. Thomas II
404.881.4716

Charles W. Wheeler
202.756.3308

residency with a test of whether the “management and control” of a company is primarily in the United States. As a result, the provision threatens to redefine some historically foreign-based companies as U.S. corporations for tax purposes, thus bringing them into the U.S. taxing jurisdiction. Although this provision represents a significant change in U.S. domestic law, the concept itself is not unfamiliar to U.S. taxpayers, as many foreign countries and our treaties use “place of management” of a company to determine residency.

The Bill also contains the following additional revenue raisers.

1. The §954(c)(6) look-through rule for royalties received from related-party controlled foreign corporations (CFC) would be repealed. Thus, any royalty payments from a related-party CFC (including disregarded entities) would no longer benefit from the exclusion under §954(c)(6) from treatment as foreign personal holding company income (an element of Subpart F income). The Bill also addresses the issue of income shifting from IP migration offshore that was identified in President Obama’s budget, by treating the use of intangible property that is made available by a U.S. person to a related CFC and that contributes to the production of personal property as a sale of such personal property to a related party (thus creating foreign base company sales income—another element of Subpart F income).
2. The “80/20” rule, under which interest and dividends paid by a U.S. corporation to foreign shareholders (and interest paid by resident alien individuals) is free of U.S. withholding tax if at least 80 percent of the gross income of the U.S. payor is foreign source income, would be repealed.
3. The “boot within gain rule” of section 356(a) would be modified so that money and property received by the taxpayer will be treated as a dividend to the extent of the fair market value equal to the amount of the money and property received, and not just limited to the gain recognized in a tax-free reorganization. Thus, such dividends made in connection with a tax-free reorganization would be subject to either income or withholding tax.

For more information, please contact Tola Ozim at 212.210.9533 or Edward Tanenbaum at 212.210.9425.

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