

International Tax: U.S. Legislative Update

October 6, 2008

A number of important provisions impacting international transactions are included in H.R. 1424 (the Bill), which President Bush signed into law on October 3, 2008. The Bill was approved by the Senate on October 1, 2008, and then by the House of Representatives on October 3, 2008. The Bill contains three distinct subdivisions:

- The Emergency Economic Stabilization Act of 2008
- The Energy Improvement and Extension Act of 2008 (the Energy Act)
- The Tax Extenders and Alternative Minimum Tax Relief Act of 2008 (the Extenders Act)

Several provisions within these subdivisions specifically relate to international tax. Notably absent from the Bill is any provision further postponing implementation of the worldwide interest allocation election beyond the deferred date already established under the Housing and Economic Recovery Act of 2008. Most importantly for corporate taxpayers focused on outbound transactions, the Bill contains a number of extenders that relate to provisions of existing law currently scheduled to sunset. Set out below are some significant elements of the Bill relating to international tax:

- **Extension of Look-Through Rule for Related CFCs.** As was widely expected, section 954(c)(6) of the Internal Revenue Code (the Code) has been extended for one additional year. Accordingly, for taxable years beginning before January 1, 2010, a CFC's receipt of interest, dividends, rents, or royalties from a related CFC generally may avoid characterization as subpart F income, provided certain conditions are satisfied. At the very least, this extension will allow taxpayers additional time to plan and implement efficient post-sunset cash management structures. *See* section 304 of the Extenders Act.
- **Extension of Active Financing Income Exception.** The new law contains a one-year extension of the active financing income exception found at section 954(h) of the Code, continuing a legislative trend to which taxpayers have become accustomed over the years. Thus, for instance, income of certain CFCs from an active banking or financing business generally will continue to be excluded from the definition of subpart F income, at least in respect of tax years beginning before January 1, 2010. *See* section 303 of the Extenders Act.
- **Collapse of the FTC Treatment of FOGEI and FORI.** The separate treatment of FOGEI (Foreign Oil and Gas Extraction Income) and FORI (Foreign Oil Related Income) is eliminated for tax years beginning after December 31, 2008. This combination rule was introduced as a revenue raiser. As a result, FORI will be swept into the FOGEI limitation, which generally causes non-U.S. taxes paid in excess of a formulaic amount to be neither creditable nor deductible. *See* section 402 of the Energy Act.
- **American Samoa and Puerto Rico.** Certain existing Code provisions that promote production activity in American Samoa and Puerto Rico were revived and extended for two additional years. For certain domestic corporations operating in American Samoa, the post-section 936 possessions tax credit (i.e., a credit that offsets U.S. tax liability on income earned in the territory) is extended to cover all tax years beginning before January 1, 2010. It previously was available only in respect of tax years beginning before January 1, 2008.

Similarly, U.S. taxpayers with income attributable to domestic production activities in Puerto Rico may continue to treat Puerto Rico as part of the United States for purposes of claiming the section 199 deduction for tax years beginning before January 1, 2010. *See* sections 309 and 312 of the Extenders Act.

- **Deferred Compensation Paid by Certain Tax-Indifferent Parties.** The Bill adds new section 457A to the Code, which taxes on a current basis an individual's deferred compensation received from a tax-indifferent entity (e.g., a non-U.S. corporation). The provision is an obvious revenue raiser, and is effective for services performed after December 31, 2008. This provision is targeted at private investment pool managers who receive deferred compensation from offshore tax-haven entities, but could in certain fact patterns have broader application. *See* section 801 of the Extenders Act.
- **Retroactive FIRPTA Exception for RICs.** Through December 31, 2009, distributions by a RIC to non-U.S. persons with respect to any class of stock traded on an established U.S. securities market will not be treated as FIRPTA gain (and thus not subject to withholding), provided the non-U.S. person owns 5% or less of such class of stock. This provision originally expired as of December 31, 2007, but was revived with retroactive effect and extended through the date indicated above. *See* section 206 of the Extenders Act.

A more lengthy discussion of these provisions is available via our *International Tax Update* circular. If you have any questions or would like clarification of any provision, please do not hesitate to contact any of the following Morgan Lewis attorneys:

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