

## Obama's 2011 Budget: Check-the-Box off the Table; Subpart F Expanded

February 2, 2010

On February 1, the Treasury Department released the *General Explanations of the Administration's Fiscal Year 2011 Revenue Proposals* (2011 Green Book), which includes the Obama administration's plans to significantly reform the U.S. international tax system. The revenue provisions in the new budget alter previous proposals in at least two important aspects: the 2011 budget does not include the previously proposed limitations on "check-the-box" elections but replaces them with a dramatic expansion of the subpart F antideferral rules. The check-the-box proposals appeared to be the more tolerable of the two, as various planning techniques were available to mitigate their effect. Given the change in Washington's make-up following the election of Senator Scott Brown (R-Mass.) and the upcoming mid-term elections, it is questionable whether Congress currently has the appetite for what would constitute a sweeping overhaul of the subpart F antideferral policy and a major tax increase for a significant portion of the Fortune 500.

The revenue provisions set forth in the 2011 Green Book would treat the "excessive return" earned by a controlled foreign corporation "subject to a low effective tax rate in circumstances that evidence excessive income shifting" in connection with an intangible transferred by a related United States person as subpart F income. The 2011 Green Book does not provide any further explanation of this provision, but it appears to have its genesis in various statistical studies that Congress and the Treasury believe indicate that taxpayers are shifting excessive income to low-tax jurisdictions in spite of the existing transfer pricing rules.<sup>1</sup>

The new proposal could have a devastating impact on most cost-sharing structures and other transfers of intangible property, as it is a safe bet that Congress and taxpayers will take radically different views as to what constitutes an "excessive" return. This proposal suggests that the Obama administration (and the IRS) apparently believe that the government is unable to properly value intangible property under the existing transfer pricing rules, including the "commensurate with income" standard, and must resort to circumstantial evidence of income shifting.

It is further unclear why such income shifting, if it exists, should be addressed under subpart F. The unsupported shifting of income (or deductions, credits) is exactly what Section 482 was intended to

---

<sup>1</sup> Joint Committee on Taxation, "Revenue Provisions Related to Taxation of Cross-Border Income, Investment in President's Fiscal Year 2010 Budget Proposal," (September 14, 2009).

address and is not the intended purview of subpart F. Including an “excessive return” under subpart F appears to be a messy solution to a perceived intercompany pricing issue.

The latest proposal comes on the heels of the Obama administration’s withdrawal of its previous plan, in the face of vocal criticism and intensive lobbying efforts from the business community, to limit the ability of taxpayers to utilize “check the box” entity classification regulations. While the withdrawal of these rules is welcome, it remains to be seen if the replacement will be viewed more favorably. It has been reported that the new proposal was introduced by the administration based on input from businesses, but the scope of the proposed changes and their anticipated impact make it a virtual certainty that such proposal will only heighten anxiety and result in enhanced criticism from the business community.<sup>2</sup>

Although the proposal does not define any terms or offer any additional guidance as to the scope of its application, it is clear that the administration intends for this proposal to be a significant measure to prevent the shifting of income offshore by U.S. taxpayers. The revenue estimates contained in the 2011 Green Book project that the proposal would generate approximately \$15 billion from Fiscal Year 2011 through Fiscal Year 2020. That \$15 billion estimate is in all likelihood a vast understatement of the impact it would have.

There are various other provisions set forth in the President’s 2011 Budget proposal that impact international transactions. Those proposals are discussed in the Treasury Departments 2011 Green Book, a copy of which can be accessed via the following link: <http://www.treas.gov/offices/tax-policy/library/greenbk10.pdf>.

If you have any questions or would like more information on any of the issues discussed in this LawFlash, please contact any of the following Morgan Lewis attorneys:

**Palo Alto**

Barton W.S. Bassett	650.843.7567	<a href="mailto:bbassett@morganlewis.com">bbassett@morganlewis.com</a>
---------------------	--------------	--

**San Francisco**

Neal A. Gordon	415.442.1229	<a href="mailto:ngordon@morganlewis.com">ngordon@morganlewis.com</a>
Craig E. Barrere	415.442.1322	<a href="mailto:cbarrere@morganlewis.com">cbarrere@morganlewis.com</a>

**Washington, D.C.**

Gary B. Wilcox	202.739.5509	<a href="mailto:gwilcox@morganlewis.com">gwilcox@morganlewis.com</a>
----------------	--------------	--

**About Morgan, Lewis & Bockius LLP**

With 22 offices in the United States, Europe, and Asia, Morgan Lewis provides comprehensive transactional, litigation, labor and employment, and intellectual property legal services to clients of all sizes—from global Fortune 100 companies to just-conceived startups—across all major industries. Our international team of attorneys, patent agents, employee benefits advisors, regulatory scientists, and other specialists—more than 3,000 professionals total—serves clients from locations in Beijing, Boston, Brussels, Chicago, Dallas, Frankfurt, Harrisburg, Houston, Irvine, London, Los Angeles, Miami, Minneapolis, New York, Palo Alto, Paris, Philadelphia, Pittsburgh, Princeton, San Francisco, Tokyo,

---

<sup>2</sup> Bloomberg L.P., “Obama Budget Seeks \$1.9 Trillion Tax Rise on Richest, Business,” (February 2, 2010).

and Washington, D.C. For more information about Morgan Lewis or its practices, please visit us online at [www.morganlewis.com](http://www.morganlewis.com).

### **IRS Circular 230 Disclosure**

To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. federal tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein. For information about why we are required to include this legend in emails, please see <http://www.morganlewis.com/circular230>.

This LawFlash is provided as a general informational service to clients and friends of Morgan, Lewis & Bockius LLP. It should not be construed as, and does not constitute, legal advice on any specific matter, nor does this message create an attorney-client relationship. These materials may be considered **Attorney Advertising** in some states.  
Please note that the prior results discussed in the material do not guarantee similar outcomes.

**© 2010 Morgan, Lewis & Bockius LLP. All Rights Reserved.**

