CTJ

Citizens for Tax Justice

December 13, 2007 Contact: Bob McIntyre (202) 299-1066 x22

Senate Must Choose EITHER Offshore Tax Avoidance Schemes for Wealthy Elite OR AMT Relief for 23 Million Taxpayers

On Wednesday, December 12, the U.S. House of Representatives passed a bill, H.R. 4351, that would extend the exemptions that keep the Alternative Minimum Tax (AMT) from affecting most Americans and would replace the $53 billion in revenue that the AMT would otherwise collect. The revenue would be replaced partly by restricting offshore tax avoidance schemes by wealthy individuals. Another provision that would help replace the AMT revenue would delay the implementation of an unnecessary tax break for multinational businesses which hasn't even gone into effect yet.

Dropped from this bill is a provision that would end the tax subsidy for "carried interest," a type of compensation paid to wealthy fund managers. Carried interest is currently taxed at a special, low rate of15 percent rate, lower than the tax rate paid by many middle-class families. Last week, Republicans in the Senate blocked a similar House-passed bill that would have ended this tax subsidy because they were committed to defending this break for millionaire fund managers. So, in the spirit of compromise, the House passed H.R. 4351 on Wednesday without the carried interest provision.

Incredibly, some members of the Senate are insisting that they will block this new bill even though it lacks the "controversial" carried interest provision. They seem to believe that H.R. 4351 includes "tax increases" that will hurt the economy. By this logic, the economy literally depends on the ability of rich individuals to avoid taxes by using offshore shell companies. Also by this logic, the economy depends on a tax break for multinational companies that has not even gone into effect yet.

The following is a description of the provisions in H.R. 4351 that would replace the AMT revenue.

Closing a loophole for offshore deferred compensation schemes by private equity fund managers

Ten-year revenue gain: +$23.7 billion

The tax code allows employees to defer paying taxes on money that they or their employers put into "qualified" retirement savings plans, such as 401(k)'s, until they take money out during retirement. But contributions to such "qualified" plans are limited to no more than $30,000 a year depending on the type of plan. That's the sort of plan most Americans can get — if they're lucky. Highly-paid corporate executives, however, often get to go a giant step farther. They can set up "non-qualified" deferred compensation plans, which are not taxable to the executives until they take the money out, but which are not deductible by companies until then either. Currently, there is no limit on how much money executives can defer taxes on through these plans. But the corporations who pay them also have to defer the deduction they take for whatever they pay into the deferred compensation plan, so in theory there is only a small loss to the Treasury (and to the rest of the taxpayers).

But private equity fund managers have managed to create an approach to deferred compensation that goes even farther, and does impose a substantial cost on the rest of the taxpayers. Private equity fund managers often have an "unqualified" plan into which is paid an unlimited amount of deferred compensation. But they arrange the payments to be technically made by an offshore corporation in a tax haven country that has no corporate tax, or a very low one, so the loss of the deduction is not an issue. Of course, this is done with paper transactions. No one is actually working in the tax haven country, so this is really just a scheme to increase the amount of deferred compensation that can be paid to these already highly-compensated fund managers without being taxed right away.

H.R. 4351 would close this tax-avoidance scheme by requiring fund managers using these schemes to pay taxes on the earnings of their deferred compensation plans as it accrues.

Delay the 2004 change in international interest allocation rules
Ten-year revenue gain: +$26.2 billion

Suppose a multinational corporation borrows money and uses it to support its foreign operations, such as by building a plant in a foreign country. In such cases, the interest paid on the loan ought to be treated as a foreign expense, and should not be deducted from U.S. taxable income.

For many years, however, our tax rules have let multinationals take U.S. tax deductions for some of their interest expenses that are really foreign. Very recently, in 2004, Congress actually expanded this loophole, a change that is scheduled to take effect starting in 2009.[1]

H.R. 4351 would delay the implementation of this loophole expansion until after 2017. This will give Congress plenty of time to consider fuller reform of the rules in this area.

[1] Corporate lobbyists have argued that the U.S. should allow companies this tax break because in some cases foreign countries won't let them deduct the interest. But that's a problem that the companies have with foreign tax systems, not with the U.S. And why do we want to subsidize offshore operations, anyway?

Clarify and strengthen the "economic substance" doctrine
Ten-year revenue gain: +$4 billion

The "economic substance" doctrine is a somewhat murky court-made rule that disallows tax benefits from transactions entered into only to avoid taxes. H.R. 4351 would require at least a "substantial" non-tax-avoidance purpose for a transaction to generate tax benefits. A stronger rule, requiring that the primary purpose of the transaction is not tax avoidance would be much better, but the change is a step in the right direction.

Provisions Related to Penalties
Ten-year revenue gain: +$1.7 billion

The Myth of the "Unintended" AMT Revenue

Republican congressional leaders are committed to blocking any bill that pays for AMT relief. They claim that Congress should eliminate the AMT without paying for it because no one ever intended to collect the AMT's revenues. But that's not true.

When George W. Bush proposed his tax cut plan, he and his tax advisors were well aware that, since the AMT is an alternative tax, lowering the regular tax rates without adjusting the AMT would push tens of millions of people into the AMT. But they needed the added AMT revenues to significantly reduce the projected cost of Bush's tax cut program. In fact, Bush's chief economic advisor was adamant that Bush's plan contemplated a huge increase in the AMT.

"President Bush and his allies in Congress created most of the AMT problem," said CTJ director Robert S. McIntyre. "Now, they're given a chance to correct their mistake, but instead they've chosen to protect a wealthy elite avoiding taxes through foreign shell companies and a tax break for multinational businesses that hasn't even gone into effect yet. This type of obstructionism really is an insult to the taxpayers."