Closing Tax Loopholes

PREVENT COMPANIES FROM SPLITTING FOREIGN TAX CREDITS FROM INCOME - The foreign tax credit is designed to prevent double taxation (i.e., full taxation by both a foreign country and by the United States) of income earned abroad. However, companies have devised transactions that essentially shift the burden of the foreign income tax onto the Federal government. These transactions enable companies to operate offshore with essentially little or no tax liability to either the U.S. or the foreign government.

This abuse of the foreign tax credit encourages companies to move jobs offshore to avoid U.S. taxation.

The bill would prevent utilization of foreign tax credits unless the income on which the foreign income tax was paid is repatriated to the U.S. It does this by:

- Preventing the splitting of the taxes from the income that was subject to the tax, and;
- denying the foreign tax credit for taxes imposed on income that will never be subject to U.S. tax (asset acquisitions treated as stock purchases for foreign law)
- preventing inappropriate use of tax treaties to claim foreign tax credits on U.S. – sourced income
- preventing the manipulation of an anti-abuse rule (sec. 956) to increase foreign tax credits
- preventing the use of redemptions to avoid U.S. taxation
- preventing the manipulation of interest allocation rules to increase foreign tax credits

CLOSING INDIVIDUAL AND BUSINESS LOOPHOLES

TAXATION OF CARRIED INTEREST –The bill would prevent investment fund managers from paying taxes at capital gains rates on investment management services income received as carried interest in an investment fund. To the extent that carried interest reflects a return on invested capital, the bill would continue to tax carried interest at capital gain tax rates. However, to the extent that carried interest does not reflect a return on invested capital, the bill would require investment fund managers to treat seventy-five percent (75%) of the remaining carried interest as ordinary income. A transition rule would apply prior to January 1, 2013.

PREVENT AVOIDANCE OF MEDICARE TAX BY PROFESSIONALS INCORPORATING AS S-CORPS - Some service professionals (lawyers and lobbyists) have been avoiding Medicare and Social Security taxes by routing their self-employment income through an S corporation. These taxpayers then pay themselves a nominal salary and take the position that the remaining earnings are exempt from employment taxes. The bill would address this abuse in situations where (1) an S corporation is engaged in a professional service business that is principally based on the reputation and skill of 3 or fewer individuals or (2) an S corporation that is a partner in a professional service business. The bill would also clarify that individuals that are engaged in professional service businesses are unable to avoid employment taxes by routing their earnings through a limited liability corporation or a limited partnership.