

# Around the World

## *United States*

### **JCT Says Retroactive Effect of Proposal On Excess Returns Could Be Seen as Unfair**

**W**hile the proposal to tax excess returns from transfers of intangibles under the Obama administration's 2012 budget is narrower than the prior year's version in targeting the returns from a specific transaction rather than all those of the controlled foreign corporation, it has a retroactive effect that could be viewed as unfair, the Joint Committee on Taxation said June 14.

The JCT noted that unlike the prior year's proposal, the 2012 version specifies the types of activities that constitute a transfer of intangibles for purposes of computing Subpart F income under the proposal. But, the committee also pointed out that in contrast to the prior proposal, the current version relies not on the date of the transfer of intangible property, but rather on the date of the transactions that are connected with or benefit from a covered intangible. The current proposal applies to all such transactions occurring after Dec. 31, 2011.

A Treasury official in February said the government heard complaints that, under the 2011 proposal, a single transfer of intangibles would cause the excess returns provision to apply to all the assets of a controlled foreign corporation. The new proposal, by contrast, takes a transactional approach, with excess returns from the specific transaction treated as Subpart F income (19 *Transfer Pricing Report* 1099, 3/10/11).

The current excess returns proposal—one of two transfer pricing provisions in the administration's 2012 budget that also appeared in some form in the 2011 version—provided that if a U.S. person transfers an intangible from the United States to a related CFC, then certain excess income from transactions connected with or benefiting from the covered intangible are treated as Subpart F income if the income is subject to a low foreign effective tax rate. The current working definition of an excess return is a 50 percent return on operating costs for a particular intangible, and a low tax rate is being estimated under a sliding scale of between 5 percent and 15 percent. For a tax rate below 5 percent, 100 percent of the income at issue would be treated as Subpart F, and for tax rates above 15 percent, none of that income would be treated as Subpart F.

**Proposal to Limit Income Shifting.** A second transfer pricing proposal, designed to limit shifting of income through intangible property transfers, would change the definition of intangible property under Sections 367(d) and 482 to include workforce in place, goodwill, and going concern value. It also would allow the IRS to value a transfer of multiple intangibles on an aggregate basis when that treatment achieves a more reliable result. In addition, the proposal on income shifting would

allow the IRS, in valuing intangible property, to consider the prices or profits the controlled taxpayer could have realized by engaging in a realistic alternative to the transaction undertaken.

In its description of the second proposal, the JCT said questions have arisen about whether broader reform of the existing transfer pricing rules is necessary. The committee also said regarding the second proposal that “the appropriateness of respecting cost sharing arrangements among related parties could be explored.”

The JCT's description of both proposals appears in the Text section of this issue.

**Retroactive Effect.** Because intangible property often is made available to CFCs under agreements covering multiple years, the JCT said the excess returns proposal could apply to “transactions connected with or benefiting from” transfers made before its effective date.

“Some may argue that this provision has a retroactive effect related to such intangible transfers and connected transactions,” the JCT said. Noting that under present law, such transactions do not generate Subpart F income absent another applicable Subpart F provision, the committee said the provision “may be viewed as unfairly changing the rules of taxation for earnings that are properly allocable to the CFC” where a toll charge was previously paid following the original outbound transfer—or where an arm's-length royalty is paid. Payment of an arm's-length royalty would include circumstances where an advance pricing agreement was in place, or where a buy-in amount was settled with the Internal Revenue Service, the committee said.

However, the JCT noted that the provision will not change the transfer pricing rules or otherwise affect the allocation of income between the U.S. transferor and the related CFC. Rather, the committee said, the provision affects “only the ability to defer the CFC earnings in situations that some may view as aggressive income shifting to low-tax jurisdictions.”

**Respecting Cost Sharing.** In the committee's description of the proposal on limiting the shifting of income from intangible property transfers, it questioned the effectiveness of the existing cost sharing framework, saying that “the appropriateness of respecting cost sharing arrangements among related parties could be explored.”

The current cost sharing framework “may unintentionally encourage U.S.-based multinational groups to develop intangible property offshore and to shift the economic ownership of developed intangible property to CFCs by prescribing terms under which internal cost sharing arrangements will be respected despite the lack of any comparable arrangement among unrelated parties,” the committee said. It added that examining the extent to which the existing framework encourages outbound intangible property transfers “may lead to reconsideration of the merits of respecting cost sharing ar-

rangements and suggest a new, more limited framework.”

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