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Resetting the Code: Tax Reform and the Politics of Debt and Deficits

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Agenda

- Fall Legislative Agenda
- Divided Government and the Politics of the 112th Congress
- The Fiscal Challenges Ahead
- Is the Supercommittee the Cure?
- Tax as a Solution? The Prospects for Tax Reform
- Breakout Session: The Case for International Tax Reform
 - First Steps: Camp Territorial Draft
 - Incremental Reform: International Revenue Offset Risks
- Lessons from 1986?
- Anticipating Tax Reform
- Election 2012 Preview

Fall Legislative Agenda

- Tax legislative package possible before year-end
 - Could move with CR – December 16 deadline
- Possible items included in year-end tax package
 - Extension of current law payroll tax relief
 - Unemployment insurance benefits
 - Medicare “doc fix”
- Disagreement over how to offset minimum \$110 billion cost
 - Democrats propose 3.25% surtax on millionaires
 - Republicans propose continuing salary freeze on federal employees
- What happens to extenders and AMT patch?
 - Likely retroactive extension in late 2012

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3% government contractor withholding

- President Obama signed into law November 21 legislation (P.L. 112-56) that repeals the 3% withholding requirement
 - Clarifies that current-law 100 percent levy on payments to tax-delinquent federal contractors applies to payments for “property, goods, or services”
 - Requires Treasury Secretary and OMB Director to submit a study within 12 months on ways to reduce the outstanding tax owed by federal contractors
 - Provides tax incentives to employers who hire unemployed veterans
- Repeal follows delay in implementation date enacted in American Recovery and Reinvestment Act of 2009 (ARRA)
 - Repealed after criticisms from businesses and government agencies regarding implementation costs and increased burdens on compliance

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Divided Government and the Politics of the 112th Congress

“There is a lot of evidence...that the American people...have believed for decades now that divided government may work better than unified government.”
- President William J. Clinton (Nov. 9, 1994)

Politics of Divided Government

- Republican controlled House
- Filibuster creates de facto Republican control of Senate
- WH may look for alternative routes to pursuing policy preferences, but has not been aggressive in this space yet
 - Regulation
 - Examination
- What's today's date?
 - Washington focused on Nov. 6, 2012

Does Divided Government = Gridlock?

- Fundamental tension of the legislative process
- Significant non-crisis legislation is enacted through either
 - Incremental bipartisan progress
 - OR
 - Sweeping partisan change (usually w vehicle of reconciliation)
- This is particularly true of fundamental reform and deficit reduction initiatives only question is, is it:
 - **1986?** The passage of the once unimaginable
 - **1995?** Devolution into gridlock
 - **1997?** Bipartisan passage of significant deficit reduction legislation w tax as a “side car”

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Iceberg (err) Fiscal Challenges Ahead!

“I am not worried about the national deficit. It is big enough to take care of itself” – Ronald Reagan

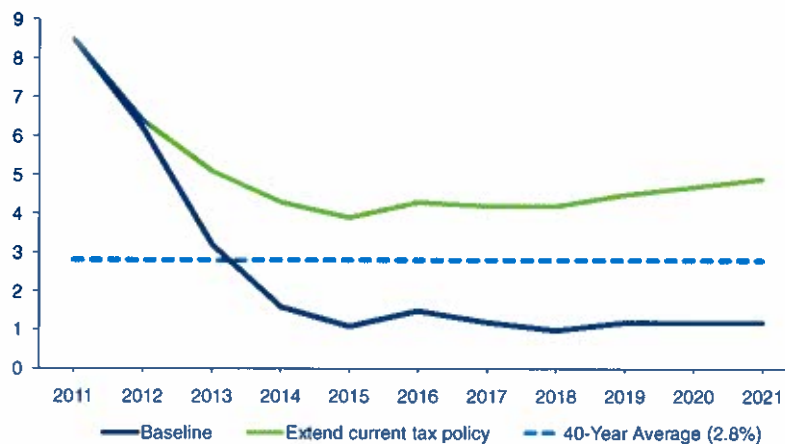
Fiscal challenges ahead

- Unsustainable gap between federal tax revenues and spending if current policies continue
- Unavoidable demographic shifts will strain Social Security and Medicare
- Debt servicing costs will increase sharply if large annual deficits continue to add to publicly held debt and are particularly vulnerable to fluctuations in interest rates

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Projected federal deficits (as a percentage of GDP)

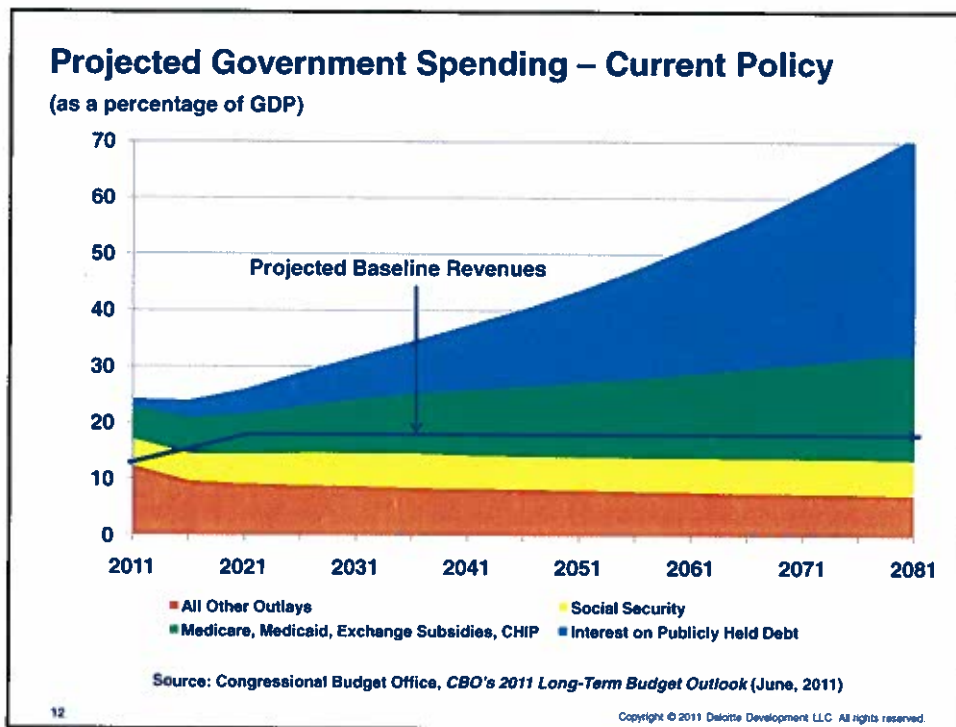
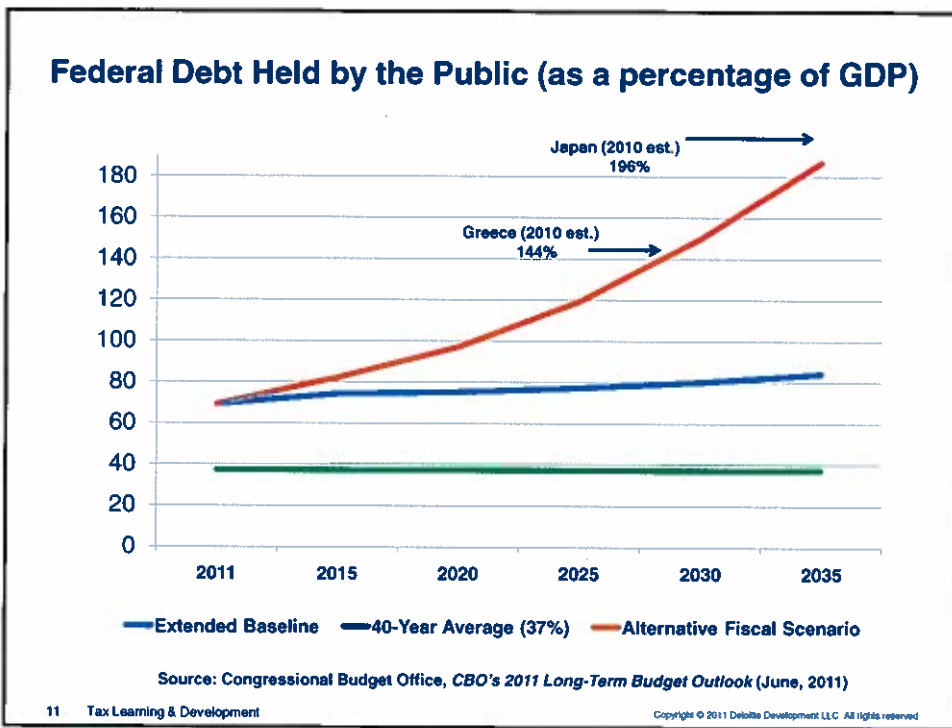


Source: Deloitte calculation from CBO, *The Budget and Economic Outlook: An Update* (August 2011)

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Major deficit reduction proposals FY2020 goals

	Spending	Revenue	Deficit
Current CBO baseline	23.7%	20.6%**	-3.1%
Bipartisan Policy Center	23.0%	21.4%	-1.6%
President's FY2012 budget*	23.0%	19.9%	-3.1%
Ryan's <i>Path to Prosperity</i>	19.9%	18.2%	-1.8%***
President's Commission	21.8%	20.6%	-1.2%
Republican Balanced Budget Amendment	18.0%	18.0%	0%

* President's FY 2012 budget does not purport to be a long-term deficit reduction plan
 ** Assumes all expiring provisions are allowed to lapse
 *** Difference due to rounding

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Can the Supercommittee Cure What Ails Us?

"The less people know about how sausages and laws are made, the better they will sleep at night"
 -Otto Von Bismarck (attributed)

Budget Control Act of 2011

- Created the bipartisan, bicameral Joint Select Committee on Deficit Reduction (i.e., the “supercommittee”)
- 12-member supercommittee tasked with recommending an additional deficit reduction package of \$1.2 - \$1.5 trillion over 10 years
- Enforced by “trigger” which cuts spending \$1.2 trillion if supercommittee deadlocks or Congress fails to enact supercommittee’s recommendations
- Budget Control Act may trade a debt limit crisis today for a debt limit *and* tax crisis later
 - The Act ensures the debt limit is sufficiently raised to carry the government until the end of 2012
 - Expiring after 2012: Current tax rates on individual income, capital gains, and dividends; current estate tax exemption and top rate; AMT patch
 - Effective in 2013: Taxes on upper-income taxpayers enacted as part of healthcare reform, including the 3.8% Medicare surtax on investment income and .9% increase in the employee portion of the Medicare HI tax

President’s Tax Reform and Deficit Reduction Plan

Principles for tax reform

- Lower tax rates
- Cut “inefficient and unfair tax breaks”
- Cut the deficit
- Increase job creation and growth in the U.S.
- Observe the “Buffett rule”

Recommendations to the “supercommittee” for deficit reduction taken largely from previous budgets

- Allow 2001/2003 tax cuts to expire for upper income taxpayers
- Limitation on itemized deductions as well as certain exclusions
- International changes (discussed later)
- Carried interest
- Repeal of LIFO/LCM
- Fossil fuel tax provisions
- Corporate aircraft

Super Committee "Offers"

	Democrats	Republicans
Receipts		
Revenue	1,300	
Co-pays & fees		400
Dynamic scoring		200
"Chained" CPI		40
Healthcare	575	600
Other Mandatory	250	400
Discretionary		
Defense	200	
Non-defense	200	250
Total before interest savings	2,525	1,890

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Can the Supercommittee Agree?

Yes	No
The President & Speaker will cut a deal	Leaders cannot deliver their partisans
Failure is not an option	Compromise on principle is not an option
It only takes a  e	No one is walking the plank alone
Members need agreement for 2012	Members need to stand pat for 2012
A good deal will be harder in 2013	A good deal will be easier in 2013
The triggers will force an agreement	Triggers have no real affect until 2013
Committee & deadline will force a	Committees and deadlines routinely

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The Prospects for Tax Reform

“A tax loophole is something that benefits the other guy. If it benefits you, it is **tax reform.**” - Russell B. Long

Reforming the Current Tax System

- **Individuals**

- Increase rates (top earners)
- Improve taxpayer compliance (individuals)
- Reduce complexity (for some)
- Eliminate significant tax expenditures (broaden the base)
- Eliminate special treatment for capital gains and dividends
- An additional consumption tax (VAT, gas, carbon, sweetened and alcoholic beverages) ?

- **Corporate**

- Broad consensus for lowering the rate
- Pressure to “pay for” reduced rates
- Eliminate significant tax expenditures
- Worldwide vs. Territorial

Taxwriting committee hearings

- Both Taxwriting Committees have held a number of hearings during the first half of 2011, and these are expected to continue throughout the remainder of the year
- Hearings to date have focused primarily on corporate and international tax rather than individual tax issues
- Common themes in CEO/CFO testimony suggest some business community consensus around
 - Target corporate rate 23-25% (note that's well below the 26-28% achievable through elimination of corporate tax expenditures)
 - Willingness to trade most (if not all) current corporate tax expenditures in exchange for buying down the corporate rate
 - Although growing defense of 199 and R&D
 - Transition to territorial regime

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Tax Expenditures

- What is a tax expenditure?
 - “revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability”
- Or, more simply,*
- Almost anything on your tax return that you like*

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Largest Corporate Tax Expenditures

Expenditure	JCT Revenue Estimates over 10 yrs. (\$ billions)
MACRS	\$506.8
Expensing of R&E expenditures	\$152.2
Deduction for income attributable to domestic production activities	\$127.0
Inventory methods and valuation: LIFO & LCM	\$65.6
Credit for low income housing	\$33.0
Deferral of gain on like-kind exchanges	\$16.0
Completed contract rules method	\$13.9
Energy related expenditures	<u>\$12.3</u>
Subtotal	\$926.8
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Five Fundamental Questions for Policymakers as they Confront Tax Reform

Tax Reform & Deficit Reduction Together?

- Revenue neutral similar to 1986?
 - Distribution of tax burdens for individuals largely unchanged

OR

- Raise additional revenue to reduce the deficit?
 - Consequences for tax decisions

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Corporate & Individual Tax Reform Together?

- Consensus begins and end with sense that corporate rate should come down
- WH wants stand alone corporate tax reform, but Congress looking to broaden to include individuals
- Factors that make corporate-only approach difficult
 - Significant business activity is taxed at individual level through pass-through entities and sole proprietorships
 - Tax benefits enjoyed by both corporate and individuals could be affected
 - Corporate-only leaves uncertainty for individual tax

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What approach should govern reform?

- Reform that lowers rates and broadens the base
 - Generally maintains same level of revenue collection as share of GDP
 - Generally maintains existing distribution of tax burden across income categories

- Fundamental areas of disagreement
 - How much tax should be collected
 - Who should bear what share of the burden

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Corporate rate

- Competitiveness concerns have driven reform plans:
 - Rangel 2007: 30.5 percent rate
 - Bowles-Simpson 2010: top rate not to exceed 29 percent
 - Wyden-Gregg 2010: 24 percent
 - Ryan 2010: abolish corporate income tax and replace with 8.5 percent business consumption tax
 - WH reportedly to introduce proposal with rate in high 20s

- \$120 billion for every percentage point decrease in corporate rate
- Lowering corporate rate and eliminating tax expenditures could **raise** the effective tax rate for some corporate taxpayers

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Tax Rates and Reform

Proposal	Expenditures repealed	Corporate rate	Individual rate
Rangel (2007)	Selected corporate	30.5%	High-income surtax
Bowles-Simpson "Zero Plan"	All corporate and individual	26%	23%
Bowles-Simpson "Modified Zero Plan"	All corporate and many individual	28%	28%
Wyden-Coats	Selected individual and corporate	24%	35%
Domenici-Rivlin <small>Tax Learning & Development</small>	Targeted corporate and individual rates	27%	27%

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Should Worldwide Income be Taxed?

- Chile, Ireland, Mexico, Poland, South Korea, and United States only remaining OECD countries with worldwide systems
- Together with high statutory rate perceived as a drag on competitiveness of U.S. based multinationals
- Bowles-Simpson echoed 2005 Fiscal Commission and recommended adoption of territorial system as part of corporate tax reform proposal
- Revenue implications highly dependent on system design
 - 2005 JCT estimated that transitioning to a territorial system would actually raise \$50 billion/10 years

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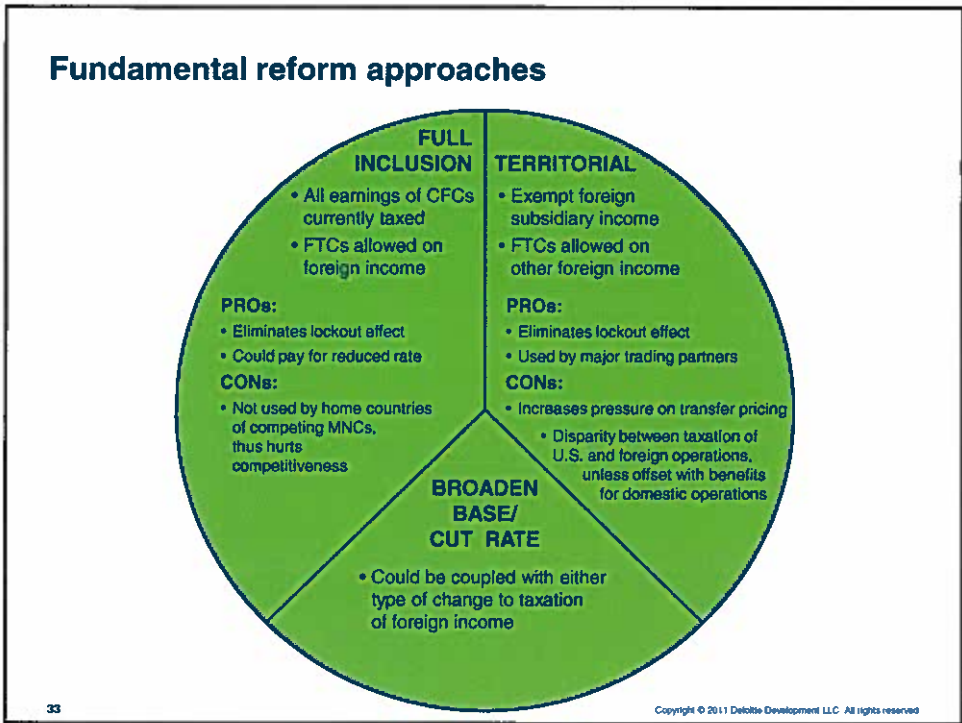
Breakout: The Case for International Tax Reform

“Don’t tax you, don’t tax me; tax the fellow behind the tree.” - Russell B. Long

2 Approaches to International Tax Reform

- Fundamental Reform
 - Exemption system
 - Full inclusion
 - Broaden base and cut rate
- Incremental Reforms
 - Foreign tax credit proposals
 - Deferral-related proposals
 - Transfer Pricing-related proposals
 - Entity classification proposals
 - Corporate residence proposals

Both types of reform will have a fundamental impact on your Company's tax position and your go forward global tax strategy



Camp Discussion Draft Overview

Proposal	Description
95% DRD	<ul style="list-style-type: none"> Generally provides U.S. corporate shareholders a 95% DRD for foreign source dividends received from CFCs Foreign branches and electing 10/50 companies deemed CFCs Generally, 1.25% U.S. rate on qualifying dividends
FTC	<ul style="list-style-type: none"> §§902 and 909 repealed §960 retained in modified form (no FTC baskets; modified deductions)
Subpart F	<ul style="list-style-type: none"> Retains and expands existing rules. <i>See next slide</i> §§956, 959, and 961 repealed Repatriated subpart F income generally subject to 26.25% U.S. rate
Interest Deductions	<ul style="list-style-type: none"> Corporate U.S. shareholders of a WW affiliated group must reduce interest deductions by the lesser of: (i) relative leverage test or (ii)

Camp Discussion Draft: Subpart F

Proposal	Description
Option A	<ul style="list-style-type: none"> Obama Administration's proposal to tax currently "excess returns" associated with transfers of intangibles offshore
Option B	<ul style="list-style-type: none"> Adds a new category of subpart F income called "low-taxed subpart F income," which would be <i>any income</i> of a CFC unless it is derived in the CFC's home country, or is subject to a foreign effective tax rate exceeding 10%
Option C	<ul style="list-style-type: none"> Bitter: Creates new category of subpart F income for "foreign base company intangible income" (FBCII) subject to a 13.5% or lower ETR on income "properly attributable" to IP. Sweet: Deduction equal to sum of 40% of the "foreign intangible income" of the U.S. shareholder, and 40% of the lesser of (a) FBCII inclusion of its CFCs or (b) CFCs' foreign intangible income

Camp Discussion Draft: Interest Deduction

Proposal	Description
Interest Deductions	<ul style="list-style-type: none"> General: Corporate U.S. shareholders of a WW affiliated group must reduce interest deductions by the lesser of (i) relative leverage test or (ii) percentage-of-adjusted-taxable-income test. Relative leverage test: percentage which (i) the excess of U.S. affiliated group's debt-to-equity ratio bears to the worldwide affiliated group's debt-to-equity ratio, bears to (ii) worldwide affiliated group's debt-to-equity ratio Percentage-of adjusted-taxable-income test: domestic corporation's net interest expense in excess of [?] percentage of its adjusted taxable income. <ul style="list-style-type: none"> Unspecified percentage – however, §163(j) is 50%; Obama Administration proposal would reduce to 25% Coordination with §163(j): No double disallowance under both provisions Carryforward of deductions: Indefinite carryforward of disallowed deductions (possible book impact)

Comparing Camp to UK & Japan Exemption Regimes

Proposal / Regime	Transition	Dividends Exempt	Branch Exemption	Deductions Limited	CFC Rules Expanded
Camp	Deemed Distribution historic E&P; generally 5.25% U.S. rate	✓ 95% exempt	✓ Deemed to be CFCs	✓ US v. WW debt to equity or thin cap	✓ Expanded
UK	Dividend of historic earnings qualified for dividend exemption if paid on or after July 1, 2009 and certain conditions were satisfied	✓ 100% exempt	✓ 100% exemption of both profits and losses if election is made (subject to anti-avoidance).	✓ Interest deductible subject to: • World-wide debt cap • Transfer pricing/thin cap (no safe harbor ratios) • Anti-arbitrage • Unallowable purpose	✗ UK CFC legislation is being loosened with a number of exemptions to make the UK more attractive as a holding jurisdiction (particularly for financing activities or IP).
Japan	Dividend of historic earnings	✓ 95% exempt	✗	✓ Thin cap safe harbor: 3:1	✓ Even if active

Territoriality – Potential Transition Issues

- Income tax treaties
 - Existing U.S. treaties based on current worldwide system
 - Would likely require renegotiation of double tax articles in existing treaties and possibly other provisions
- Pre-effective date E&P
 - Taxation of dividends sourced from pre-effective date E&P
 - Gain in CFC stock that is attributable to pre-effective dates earnings
 - Approaches include:
 - Maintain existing rules, i.e. deferral, for pre-effective date earnings;
 - Exempt all pre-effective date earnings; or
 - Tax all pre-effective date earnings – at reduced rates (cf. §965) or regular rates?

Full Inclusion Approach?

- Earnings of CFCs would be subject to immediate U.S. tax, without regard to whether such earnings are repatriated
- A similar approach has been proposed several times, for example:
 - President Kennedy in 1961, subpart F was enacted instead limiting current taxation to 'mobile' income
 - The Senate version of the Tax Reduction Act of 1975
 - Congressmen Rostenkowski and Gradison in 1992
 - Senators Wyden, Coats, and Begich in 2011 (the "Bipartisan Tax Fairness and Simplification Act of in 2011," S. 727)
- Would eliminate the so-called "lock-out effect" of present law
- Full inclusion is not the approach used by any other major (or minor?) country

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Broaden the Income Tax Base and Cut the Rate

- Couple a series of incremental reforms that broaden tax base with a tax rate reduction
- What is the right rate?
 - If rate too high, United States is uncompetitive as an investment location
 - If corporate rate too low relative to individual rate, may induce individuals to shift income into corporations
- Raisers discussed
 - Repeal §199 deduction
 - Repeal LIFO inventory accounting
 - Deny business meals deduction
 - Eliminate R&E credit
 - Repeal low-income housing credit

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Incremental Reform Proposals: Revenue Raiser Risk

- The President's latest Tax Reform and Deficit Reduction plan includes a number of controversial international tax reform proposals from previous proposals, including:
 - Single pool of foreign tax credits
 - Deferral of interest expense where foreign income remains offshore
 - Excess returns from transfers of IP
 - Definition of intangible under section 367(d) "clarified"
 - Section 907 and dual capacity taxpayer modifications
- While the President's overall package has been met with significant Republican opposition to date
 - Always a risk that individual provisions could still be passed
 - Post-election Congress may feel differently

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Significant Recent Foreign Tax Credit Proposals

- Pooling proposal
 - President Tax Reform and Deficit Reduction plan appears to be identical to FY2010-12 administration budget proposal:
 - Deemed paid credit allowed with respect to pool of foreign taxes paid by foreign subsidiaries in same ratio as all distributed foreign E&P of foreign subsidiaries bears to total E&P of all foreign subsidiaries
 - 2007 Rangel bill
 - Administration's proposal modeled after Rangel bill, with some modifications
 - Query:
 - Is the role of the foreign tax credit to allow for double taxation unless all foreign earnings are repatriated?
 - Is "averaging" desirable?
 - Does this proposal address averaging?

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Other Foreign Tax Credit Proposals

- Per country or geographic region
 - Foreign tax credit limitation determined on a per country or regional basis
 - What would the proposal achieve?
 - Reduce ability to average
 - Raise significant issues regarding complexity, particularly as multinationals increase their footprint
- High and low tax FTC limitation “baskets”
 - Could be a “high-tax kick-out” *from* the general basket
 - Less complex than per country with similar limitations on averaging

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Deferral-Related Proposals

- Amendments to scope of deferral – see transfer pricing discussion
- Deferral of deductions
 - President’s Tax Reform and Deficit Reduction plan appears to be identical to FY2010-12 administration budget proposal:
 - Defer certain deductions of U.S. persons allocated and apportioned to foreign source income in proportion to the proportion of such income not subject to U.S. taxation
 - 2007 Rangel bill
 - Generally similar to administration budgets
 - Deduction proposal may actually increase the disincentive to repatriate foreign earnings
 - Competitiveness
 - Complexity

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Transfer Pricing-Related Proposals

- Excess returns for transfers of IP
 - President’s Tax Reform and Deficit Reduction plan appears to be identical to FY2010-12 administration budgets
 - FY2011&12 Administration Budget Subpart F proposal
 - Expands definition of subpart F income to include income after certain IP transfers – see next set of slides
 - Arm’s-length principle
 - JCT suggestions relating to use of comparables and cost sharing arrangements
 - Recommendations for increased reporting
 - Apportionment
- “Clarification” of definition of intangible
 - President ‘s Tax Reform and Deficit Reduction Appears to be identical to FY2010-12 administration budget
 - FY2010-12 Administration Budget §§367(d)/482 proposal
 - “Clarifies” definition of intangibles to include workforce in place, goodwill, and going concern value; would provide additional rules regarding valuation of intangibles

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Excess return proposal comparison FY2011 and 12

	FY2011 Budget Proposal	FY2012 Budget Proposal
Affected Taxpayers	U.S. person who transfers an intangible from the U.S. to a related CFC that is subject to a low foreign ETR in circumstances that evidence excessive income shifting	U.S. person who transfers (directly or indirectly) an intangible from the U.S. to a related CFC
Covered Transfers	Unspecified	Sales, leases, licenses or any shared risk or development agreement (including a CSA)
Amount of Subpart F Income	<ul style="list-style-type: none"> – An amount equal to the “excess return” – Gov’t indicated informally that, for revenue estimate purposes, a return of more than 30% is an “excess return” 	<ul style="list-style-type: none"> – Excess of gross income from transactions connected with or benefiting from the covered intangible over the costs (excluding interest and taxes) properly allocated and apportioned to this income increased by a percentage mark-up – Gov’t indicated informally that the relevant “percentage markup” could be 50%

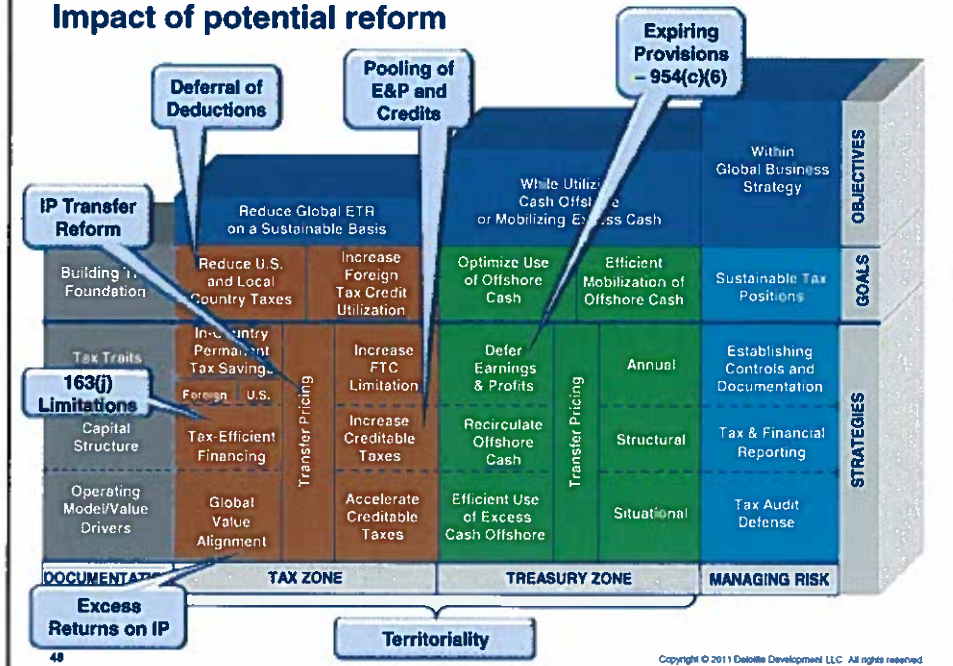
Additional Congress-Driven Proposals

- Change rules for determining U.S. residency of a corporation
 - JCT Proposal
 - Residence of a publicly-traded foreign entity would be made based on its primary place of management and control (if that is different from its place of incorporation)
 - Levin/Doggett bill
 - Any foreign corporation primarily managed and controlled within the United States will be treated as an U.S. corporation for tax purposes, unless both (i) it is not traded on an established securities exchange and (ii) gross assets (including assets under management for investors) are less than \$50 million
 - Provision generally does not apply to a CFC if 80% of its vote and value is directly or indirectly owned by a U.S. corporation that has substantial assets held for use in the active conduct of a trade or business in the U.S.
 - Similar to a provision co-sponsored in 2007 by then-Senator Obama
- Place of shareholder residence
 - What are the proposals intended to achieve?
 - Administrability
 - Similarities/Differences to regimes of other countries

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Impact of potential reform



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Lessons from 1986?

“The first American Revolution was sparked by an unshakable conviction -- taxation without representation is tyranny. Two centuries later, a second American revolution for hope and opportunity is gathering force again -- a peaceful revolution, but born of popular resentment against a tax system that is unwise, unwanted, and unfair.” – President Ronald Regan, May 28, 1985

The 1986 environment

An election battle and promise

Strong White House/Exec Branch leadership

Despite divided party control, strong bi-partisan actors and Congressional leadership

-- Rostenkowski, Packwood, Bradley, Dole, et al.

Lengthy debate and complex process

- January 1984 Pres. Regan calls for Tax Reform in SOTU address
- October 1986, Tax Reform Act signed into law
- Treasury I and II total some 1000 pages of reform options and technical analysis

Consensus on form of tax (lower rate/broad based income tax)

Consensus on revenue neutrality (last minute shift in burden to corporate taxes)

Current environment?

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Transition Relief (or not)

- Transition relief reduces revenue in early years
- When rates are at stake, transition can be harsh
- 1986 Act examples:
 - Haircut on Investment credit carryforwards
 - Corporate installment sale income triggered and spread over 4 years
 - Capital gains taxed at new rates when recognized
 - Kiddie tax applied to previously transferred assets

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Anticipating Reform

“ I was seldom able to see an opportunity until it ceased to be one.” – Mark Twain

Tax Reform Observations

- Tax reform debate will continue but action unlikely before the election
 - Watch for:
 - WH corporate tax reform whitepaper
 - Additional drafts from Camp on Corp and Indiv reform
- A top corporate rate in the 25-28 percent range
 - Buy down w repeal of expenditures doesn't get you all the way to 25, alternative revenue source?
- On Territorial, beware of what you ask for, design makes a huge difference

What Can Taxpayers Do?

- Stay connected to Washington
 - Discussion of tax and spending policies will likely create “winners” and “losers,” review relationship of tax with government affairs
- Balance Statement impact
 - Deferred tax assets & Liabilities?
 - Accumulated foreign income
- Income Statement impact
 - One-time effect
 - Ongoing tax liabilities
- View tax reform efforts as three phases
 - Current environment
 - Transition phase
 - Post-reform

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Current Environment

- Business
 - Maintain tax planning effort
 - Model alternative tax scenarios
 - Analyze risk and contingency plan
 - Strengthen forecasting, analytics, and modeling capability
- Owners (shareholders)
 - Develop investor communication plan
 - Analyze and communicate financial statement impact of tax reform
- Employees
 - Review recruitment and retention policies
 - Consider tax and compensation strategies for execs/employees
- Products and services
 - Review tax reform impact on product and service offerings

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Transition Phase

- **Business**
 - Utilize benefits available prior to law change
 - Manage timing of tax items to utilize advantages available when rates change
 - Consider opportunities or strategic acquisitions
- **Owners (shareholders)**
 - Communicate impact of tax and spending changes to investors
- **Employees**
 - Revise compensation and benefit programs
 - Educate employees on impact of tax changes to business
- **Products and services**
 - Withdraw products and service offerings no longer effective under new law

Post-Reform (the new normal)

- **Business**
 - Implement information systems and reporting requirements
 - Review and realign choice of entity structure and investment choices
- **Owners (shareholders)**
 - Review and revise investment portfolio
- **Employees**
 - Implement redesigned compensation and benefit programs
- **Products & services**
 - Introduce new products and services
 - Focus on new or expanded markets

Election 2012 Preview

November 2012 election: Battle for control of Congress

Senate:

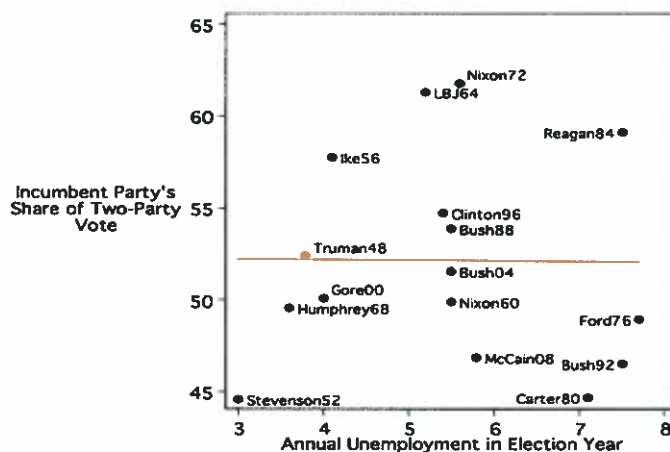
- Democrats defending 23 seats (2 of which are Independents) to Republicans' 10 seats
- 8 senators have announced retirement so far

House:

- 17 Democrats and 7 Republicans will retire or seek higher office
- All seats up for re-election

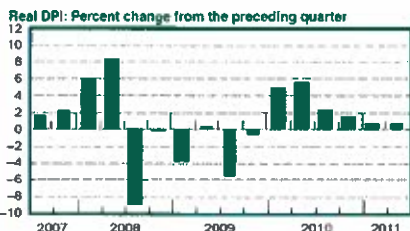
Presidential Vote and Unemployment

Average national unemployment rate in 2011 = 9.1%



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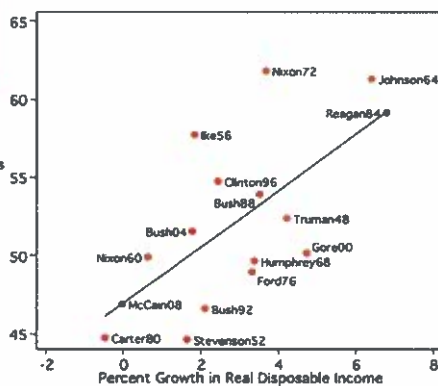
Presidential Vote and the Economy



U.S. Bureau of Economic Analysis

2nd Quarter 2011 % Growth in RDI = 0.7%

Incumbent Party's Share of Two-Party Vote



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GOP 2012 primary battle: Tax issues

- During summer debate, all GOP candidates unanimously rejected a hypothetical deficit reduction plan with a 10:1 ratio of spending cuts to tax increases
- Details beginning to emerge about certain candidates' tax plans; appears to be common ground on:
 - Individual rates at or below current levels
 - Zero rate on cap gains, dividends, and interest income depending on income threshold
 - 25% top corporate rate or lower
 - Elimination of select or all corporate tax expenditures
 - Support for transition to territorial regime

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Former Gov. Mitt Romney

- Make permanent 2001 and 2003 tax cuts (35 percent top individual income tax rate)
- Eliminate tax on capital gains and dividends for individual taxpayers with AGI below \$200,000 (15% for all other taxpayers)
- Reduce corporate tax rate to 25 percent (eliminate unspecified tax expenditures)
- Repeal the estate tax
- Transition to a territorial tax system
- Repeal the Patient Protection and Affordable Care Act (PPACA) (repeal tax increases)

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Former Speaker Newt Gingrich

- Make permanent 2001 and 2003 tax cuts (35 percent top individual) but allow an optional 15 percent flat tax rate
- Eliminate tax on capital gains for individuals
- Repeal the estate tax
- Reduce the top corporate tax rate to 12.5 percent
- Move to a territorial tax system
- Repeal PPACA; Sarbanes-Oxley

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Gov. Rick Perry

- Optional 20% individual flat tax (option to retain current tax code; one-time election cannot be reversed)
 - Would retain mortgage interest, state and local sales tax, and charitable contribution deductions (eliminate all other expenditures for flat tax)
- Eliminate taxes on capital gains and dividends
- 20% top corporate tax rate (retain R&D tax credit, 100% expensing, eliminate all other expenditures)
- One-time 5.25% repatriation tax holiday
- Repeal PPACA, Dodd-Frank, Sarbanes-Oxley

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