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Practice Update

International Tax Impact of American Taxpayer Relief Act

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On January 1, 2013, the Senate passed the American Taxpayer Relief Act, H.R. 8 (the "Bill"), by a vote of 89 to 8. Later that same day, the House of Representatives approved the Bill by a vote of 257 to 167. On January 2, 2012, the Bill was signed into law by President Barack Obama. To view the text of the bill click here. The Bill has a number of international tax implications, as are highlighted herein.

First, the Bill permanently extends the benefits provided by the Jobs and Growth Tax Relief Reconciliation Act of 2003. This Act allows companies in certain foreign jurisdictions to be treated as "Qualified Foreign Corporations" ("QFCs") and allows for dividends received from QFCs by U.S. persons to be taxed at long term capital gain rates and not ordinary income tax rates, which is typical. Pursuant to the Bill, the long term capital gain rates will be raised from 15% for those taxpayers earning income in excess of $400,000 (individuals), $425,000 (heads of households), and $450,000 (married filing jointly) to 20%. Taxpayers below the 25% income tax bracket will continue to be taxed at zero percent and those in the middle income tax bracket will continue to be taxed at 15%. This

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permanent extension provides for significant income tax planning alternatives and options.

Another aspect of the Bill with international tax implications is the one-year extension of the look-through treatment of payments between related controlled foreign corporations ("CFCs") under the foreign personal holding company rules. The extension allows the tax deferral of certain payments, such as interest, dividends, rents, and royalties, between CFCs and applies until January 1, 2014. As a result, CFCs will be able to continue transferring certain payments between one another without triggering current year U.S. income tax.

The Bill also extends through 2013 the subpart F exception for active financing income. This provision allows a U.S. parent of a foreign subsidiary engaged in a banking, financing, or similar business to defer tax on such subsidiary's earnings if the subsidiary is predominantly engaged in such business and conducts substantial activity with respect to such business. To qualify, the subsidiary must pass an entity level income test to demonstrate that the income is active, not passive, income.

Finally, the Bill permanently applies a 20% withholding tax to gains on the disposition of U.S. real property interests by partnerships, trusts, or estates that are passed through to partners or beneficiaries that are foreign persons under the Foreign Investment in Real Property Tax Act.

Also of note, the Bill made permanent the gift and estate tax exclusion amount at $5 million, which can also play a big part in international tax planning. The Bill also made permanent the portability provision, which allows a surviving spouse to elect to use any unused portion of the deceased spouse's exemption amount.

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