TRUMP, LEGISLATION AND TAXES

How the Expected Tax Reform May Impact Global Organisations

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FEDERAL TAX REFORM

Domestic Agenda and Legislative Process

Todd Simmens

PRESIDENT DONALD TRUMP'S DOMESTIC TAX PRIORITIES

Businesses

- Lower corporate rate to 15% (from 35) for C corporations
- 15% rate for income from passthroughs and sole proprietors (reporting on 1040).

Individuals

- Consolidate current rates of 10, 15, 25, 28, 33, 25, and 39.6… to 12, 25, and 33
- Eliminate 3.8% surtax on capital gains, investment income for higher incomes
- Repeal the estate tax
- Eliminate the alternative minimum tax (AMT).

Administration

- Cut IRS budget by approximately 14% to help offset $54 billion increase in defence funding.

THE REPUBLICAN BLUEPRINT – DOMESTIC PRIORITIES

Businesses

- Lower corporate rate to 20%
- Eliminate some ‘special interest deductions and credits,’ such as sec. 199
- Repeals corporate Alternative Minimum Tax
- Allows Net Operating Losses (‘NOLs’) to be carried forward indefinitely (no carry back) with adjustments for inflation; NOL carryforwards limited to 90% of net taxable income for such year
- Allows businesses to immediately write off the full cost of new investments (both tangible and intangible) in the first year
- Only allows interest expense to be deducted to the extent of interest income; remaining net interest expense would be carried forward indefinitely to offset future net interest income
- Provides for a business credit to encourage research and development
- Preserves the last-in-first-out method of inventory accounting
- Eliminates nearly all other credits/deductions.

THE REPUBLICAN BLUEPRINT – DOMESTIC PRIORITIES

Individuals

- Consolidate rates to 12, 25, and 33
- Passthrough and sole proprietorship income taxed at 25%
- Deduct half of net capital gains, dividends, interest
- 3.8% surtax gone
- AMT repealed
- Eliminate many deductions, credits to pay for changes
- Repeal estate, gift, and generation-skipping transfer taxes (subtitle B of the Code)

FEDERAL TAX LEGISLATIVE PROCESS – WHO'S INVOLVED?

- "All Bills for raising Revenue shall originate in the House of Representatives; but the Senate may propose or concur with Amendments as on other Bills." U.S. Const. Art. 1, Sec. 7.1. Formally, tax legislation must originate in the House of Representatives; it must take action before the Senate
- Individual members of the House or Senate may prepare a proposed law, or 'bill'
- The House Committee on Ways and Means and Senate Committee on Finance are each responsible for considering tax legislation. Proposals are 'marked up' by a committee
- Staff from the (Congressional) Joint Committee on Taxation and U.S. Treasury Department generally assist in analysing policy changes. The Joint Committee on Taxation is the official scorekeeper.
  - Legislation counsel from both the House and Senate assist with drafting bill language
  - Ways and Means and Finance generally prepare 'committee reports' to describe marked up bills
  - The Joint Committee on Taxation generally prepares a 'blue book' explanation of legislation after it is enacted
- Conference Committees are chosen to reconcile House and Senate bills when they are different. A conference report is generally prepared describing the agreed-to bill
- The President/Treasury Department generally issues its suggested legislative changes ('revenue proposals') near the start of the calendar year. These can often become part of the legislative discussion.

FEDERAL TAX REFORM

International

Joe Calianno

GOP HOUSE BLUEPRINT

- Identifies several problems with the United States current tax system, including the high corporate tax rate that has led to a number of 'inversions'
- U.S.-based multinational companies hold more than $2 trillion in capital overseas
- Contrasts U.S. tax system with the U.S. major trading partners
  - U.S. tax system
    - Worldwide tax system (e.g., taxes the earnings of foreign subsidiaries when those earnings are repatriated or taxed under certain anti-deferral rules, such as the 'subpart F' rules)
    - Foreign tax credit primary mechanism for alleviating U.S. tax on such earnings
  - Major trading partners
    - Most have adopted territorial tax systems.

GOP HOUSE BLUEPRINT'S PLAN TO ADDRESS GLOBAL COMPETITIVENESS

Some of the Important Corporate/International Aspects of the Blueprint:

- Reduce the corporate tax rate to 20%
- Switch from a worldwide tax system to a territorial system and scale back 'subpart F' rules
- Implement 'border adjustments'.

BORDER ADJUSTMENTS UNDER GOP HOUSE BLUEPRINT

- Destination-basis approach – the tax jurisdiction of income follows the location of consumption rather than the location of production
- Effectively exempt exports from U.S. tax while taxing imports
- Products, services and intangibles that are exported outside the United States will not be subject to U.S. tax regardless of where they are produced
- Products, services and intangibles that are imported into the United States will be subject to U.S. tax regardless of where they are produced
- Goal of border adjustments – eliminate the incentives to move or locate operations outside the United States, while allowing U.S. products, services, and intangibles to compete on a more equal footing in both the U.S. market and the global market
- WTO compliant?
  - GOP Blueprint states that: by moving "toward a consumption-based tax approach, in the form of a cash-flow focused approach for taxing business income," the Blueprint seeks to create the opportunity for the United States to "incorporate border adjustments in the new tax system consistent with the WTO rules regarding indirect taxes."
- Implications under existing U.S. tax treaties?
- Specific details needed on how border adjustments will operate in practice.

SHIFT FROM WORLDWIDE TAX REGIME TO A TERRITORIAL REGIME

- Replaces the existing worldwide tax system by allowing for a 100% exemption for dividends from foreign subsidiaries
- Transition rule for foreign earnings that have accumulated overseas under the old system
  - Accumulated foreign earnings will be subject to tax at 8.75% to the extent held in cash or cash equivalents and otherwise will be subject to tax at 3.5% (with companies able to pay the resulting tax liability over an eight-year period)
- Goal of moving to a territorial tax system is to eliminate the ‘lock-out effect’ of current law
- ‘Subpart F’ rules of the current international tax regime would be significantly streamlined and simplified
  - Only the foreign personal holding company rules, which were designed to counter the potential for truly passive income to be shifted to low-tax jurisdictions, will continue to play a role in addressing potential abuse

FEDERAL TAX REFORM

State Tax Impact and Uncertainties

Scott Smith

A FEDERAL REPUBLIC AND STATE INCOME TAXES

The Federal Government, the States, and States Income Taxes

- General rule: federal taxable income → state taxable income, as adjusted
- Unique State departures from federal rules, including international (unitary, economic nexus, apportionment, etc.)
- U.S. tax treaties generally do not apply to States.

How States Conform to the Internal Revenue Code

- ‘Rolling’ conformity – the IRC “as amended”
- Fixed-date conformity – the IRC “as in effect on…”
- Several state do not incorporate the IRC by reference, but still use federal taxable income as their ‘starting point’
- Other states conform only to specific IRC sections.

FEDERAL TAX REFORM – STATE IMPACT

Possible State Tax Reactions

- Common examples of current State non-conformity
  - IRC § 168(k) bonus depreciation
  - IRC § 179 expensing
  - IRC § 199 DPAD
  - Federal consolidated return regulations
  - NOL carryforwards and other limitations
- Given these examples, some states should be expected to limit or not conform to the full expensing regime of the 'Blueprint' and Trump proposals.

FEDERAL TAX REFORM – STATE IMPACT

Other State Considerations

- State corporate tax rates would become a higher proportion of the total US domestic rate
- States generally should be expected to conform to the elimination of the federal interest expense deduction and other base broadening measures
- States generally already have shorter NOL carryforward periods. What is likelihood of state carryforwards being extended?
- Will Federal Tax Reform encourage more states to abandon their income tax regimes for gross receipts taxes or other indirect tax regimes?

FEDERAL TAX REFORM - STATE IMPACT

‘Blueprint’s’ move to a ‘territorial’ international tax system

- Will/must states conform to a territorial system and 100% foreign DRD?
- What will impact be in water’s-edge unitary states?
- How will States treat any one-time repatriations of foreign earnings?

‘Blueprint’s’ Border-Adjustment Tax

- The method of the Federal adjustment could matter for state conformity
- Denial of a deduction from FTI for costs of imports?
- A deduction from FTI for exports has state sales factor consequences
- If the adjustment is a tax credit attributable to exports, a federal tax credit does not flow to a state’s tax return
- Export states v import states (winners/losers?)
- Comparable to Texas franchise tax (‘margin tax’).

TAX RISK MANAGEMENT

Todd Simmens

RISK MANAGEMENT CONSIDERATIONS

Uncertainty…

- …in making business decisions that impact tax
- …over facts of a transaction that impacts tax
- …in the laws and regulations that impact operations and planning.

Where Tax Risk Management matters

- Transactions and planning
- Business operations
- Tax compliance
- Professional responsibility and conduct
- Corporate citizenship and reputation.

RISK MANAGEMENT CONSIDERATIONS

Managing Tax Risk

- Limiting disputes with tax authorities
- Ensuring that tax has a seat at the table for business decisions, particularly in times of legislative uncertainty
- Assessing tax risk
- Adhering to tax risk management compliance practices.

Transactions and Planning

- How do uncertainties in the law and regulations impact the outcome of a transaction?
- How is the law being interpreted; are there outside advisors?
- Documentation of business purpose and economic substance.

FOR MORE INFORMATION:

www.bdo.co.uk