

US Tax Reform – Business Tax Proposals

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US Tax Reform Proposals

- House Republican Tax Reform Blueprint (HRTRB) released in June 2016
 - Most detailed of the current proposals
- President-elect Trump Tax Reform Plans
 - Trump's tax reform proposals have undergone refinements during the campaign but not as detailed as HRTRB
- Senate Republican Tax Reform Plans
 - Have not yet released their tax reform plans

US Tax Reform Prospects

- Combination of Trump Administration and Republican control of Congress have greatly increased prospects for tax reform in 2017
- Trump and Republican Leaders in Senate and House all say they want to cut taxes for Individuals and lower rates for Businesses to make U.S. companies more competitive with international rivals
- HRTRB and Trump tax reform proposals represent most significant reform of US tax system in 30 years (last major reform was 1986)
- As with any fundamental changes to tax system, Transition Rules will be critical

US Tax Reform - Legislative Considerations

- Trump and House - Would like to move quickly
- Senate – Advocating slower and bipartisan approach
 - Key issue is whether bipartisan (i.e., Democratic) support can be generated to avoid use of special budget rules known as “Budget Reconciliation” to pass it.
 - Advantage of Budget Reconciliation is that it only requires a simple majority in the Senate (avoids Democratic party filibuster in Senate).
 - Disadvantage is that long-term revenue provisions (such as tax cuts) that impact the deficit must expire at end of the budget window, usually a ten-year period.

US Tax Reform – HRTRB and Trump Plans

Major Elements

- Individual Tax
- Estate & Generation-Skipping Transfer Taxes
- Business – In General
- Business – With International Operations

HRTRB – General Business Tax Reform Highlights

- Lower Corporate Tax Rate with Maximum Rate of 35% to a Flat Rate of 20%.
- Allow Businesses to Fully and Immediately Expense Cost of Investments in Tangible Property (such as Equipment and Buildings) and Intangible Assets (such as Intellectual Property).
- Allow Businesses to Deduct Interest Expense against Interest Income. Excess Net Interest Expense can be Carried Forward Indefinitely against Future Interest Income (May Require Special Rules for Financial Services Companies).
- Allow NOLs to C/F Indefinitely with Inflation Factor Adjustment. No NOL C/B and 90% Annual Limitation on NOL C/F Utilization.
- Eliminates Various Special-Interest Deductions and Credits. R&D Credit Would Remain.

HRTRB – International Business Tax Reform Highlights

- Shift US from Worldwide to Territorial Tax System. Would Provide 100% Exemption for Active Business Income.
- Would Repeal Current “Subpart F” Regime for Foreign Base Company Income and Retain Foreign Personal Holding Company Income. (i.e., Active vs. Passive Income).
- Would Impose One-Time Tax on Accumulated Foreign Earnings. Follows Prior W&M Chairman Camp Proposals.
 - 8.75% Tax on Accumulated Foreign Earnings Held in Cash or Cash Equivalents
 - 3.5% Tax on All Other Accumulated Foreign Earnings
 - Tax Paid Over Eight-Year Period
- Would Shift US to a Destination or Consumption-Based System for Taxing Business Income Through Border Adjustments for Imports & Exports. Aim of this Consumption-Based Tax Approach is to (1) Spur US Manufacturing and (2) Counter Imbalance of Competing Against Countries Using VAT Systems.

Trump – General Tax Reform Highlights

- Lower Corporate Tax Rate from Maximum Rate of 35% to a Flat Rate of 15%.
- Companies Engaged in Manufacturing in the US Could Choose (Elect) Between Full Expensing of Capital Investments and the Deductibility of Interest Paid.
- Most Corporate Tax Expenditures Would be Eliminated. Eliminates Domestic Production Activities Deduction (§199 Deduction). R&D Credit Would be Retained.

Trump – International Business Tax Reform Highlights

- Appears to Support Shifting US from Worldwide to Territorial Tax System.
- Would Impose One-Time Tax on Accumulated Foreign Earnings at 10% Rate Payable Over Ten-Year Period.
- Has Not Taken a Position on the Controversial Proposal to Tax Imports under the HRTRB Consumption-Based Tax Systems with Border Adjustments. However, Trump has Campaigned Against US-Based Companies that Manufacture Goods Outside the US and Import Such Goods Back into the US.

US Business Tax Reform

HRTRB and Trump Proposals Differ in Certain Key Respects But Have Common Themes

- Significant Reduction in Corporate Tax Rate
- Ability to Deduct Capital Expenses Immediately
- Disallowance of Interest Deductions
- One-Time Tax on Accumulated Foreign Earnings

US Tax Reform – International Business Operations

HRTRB Proposal to Shift US to a Consumption-Based System for Taxing Business Income

- Faces Strong Opposition by Import-Dependent Businesses
 - Key Element of the HRTRB Business Tax Proposals
 - Estimated to Raise \$1 Trillion in Revenues and Helps Pay for the Tax Cuts in the HRTRB
 - Without this Revenue, Republicans Would Either Have to Reduce the Size of the Tax Rate Cuts or Increase the Deficit.
- Also Raises Threshold Question on Whether the HRTRB Proposal Replaces Current Income Tax With a Consumption Tax
 - WTO Compliance Concerns (Direct vs. Indirect Tax)
 - US Tax Treaty Concerns (Apply to Income Taxes Not Consumption Taxes)

US Tax Reform – Global Restructuring Needed?

Desired Location of Operations and Corporate Earnings

- Will Proposals Impact Foreign Tax Minimization Structures?
 - Already Under Pressure from OECD BEPS
 - Weigh Reduced Tax Savings vs. Maintaining Operational/Substance Costs
- Will Proposals Spur Increase in US Manufacturing?
 - Lower Business Tax Rates & Immediate Expensing for Capital Investments
 - Impacts on Existing Supply Chain Structures
- Will Proposal for Consumption-Based Tax System with Border Adjustments Survive?
 - Need for Transition Period

US Tax Reform – Global Restructuring Needed?

Need to Rethink Capital Structures

- Quantify Impact of Non-Deductible Interest in US
- Planning to Maximize Global Interest Deductions
 - OECD BEPS Interest Deduction Limitations (Action 4)
 - Foreign Country Thin Cap Limits
- Planning to Maximize US Interest Income Offsets
 - US-Based Global Treasury Centers
 - Intragroup Financing

US Tax Reform – Global Restructuring Needed?

IP Structures and R&D/Innovation Tax Incentives

- How Do Proposals Impact Location of R&D Activities and IP Holding Locations?
 - Immediate Expensing for Intangible Assets Acquisitions
 - Lower Business Tax Rate with R&D Credit Retained
 - Impact of US Border Adjustments on Cross-Border Licensing Flows
- Single v. Multiple Locations for DEMPE Functions and Related Substance

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