

# The impact of global tax trends

## Outlook for corporate tax reform

US multinationals are likely to see significant changes in the taxation of income earned by their foreign subsidiaries. How significant? As nearly half the income of US multinationals is earned by their foreign subsidiaries, the proposed changes are likely to increase the tax burden of these US companies.

The proposals would impact US companies' ability to defer US tax on foreign earnings that the companies continue to reinvest in those foreign operations, by deferring certain deductions and diluting the credit for foreign taxes paid.

These proposed changes in US tax law would be in contrast to the trends seen in most other developed industrial nations. Our major trading partners, including most Organization for Economic Cooperation and Development member countries, largely exempt foreign earnings from tax even when they are distributed to the parent company. The United States needs to be sensitive to the tax burdens borne by US companies compared to their foreign competitors, and the possible challenges the proposals would create for US companies competing in global markets.

No legislative action has been taken at the time of this writing on these international revenue-raising tax proposals, although some are predicting that changes to US international tax rules will be considered in 2010 as part of a broader tax reform debate. As part of this broader reform, Congress also might seek to address the high US statutory corporate tax rate—which is the second highest among OECD countries.

At President Obama's request, former Federal Reserve Chairman Paul Volcker is heading a tax reform task force to consider ways to simplify the tax code, close tax "loopholes," and reduce tax evasion and corporate "welfare." Certain of the policy options it recommends could be considered by the administration for inclusion in the president's fiscal year 2011 budget, which will be submitted to Congress in early February 2010.

The current political and economic environment could increase the risk that Congress will consider enacting corporate revenue-raising proposals to pay for its social and economic priorities. It is expected that policymakers will continue to look toward international taxation as one area for potential revenue increases.

### Directors' actions

- Discuss with management the potential effects of the tax proposals on the company's competitiveness and financial performance, including the possible impact on the company's tax rate and plans to repatriate cash from foreign operations.
- Consider the extent to which management should engage with key policymakers to share perspectives on the business effects of the proposed legislation.

## Increased coordination by tax authorities

Tax authorities in the United States and other countries around the world are sharing information with one another to enhance the effectiveness of their examinations of multinational companies.

Historically, tax authorities have used "exchange of information" agreements to combat tax evasion and potentially abusive tax transactions. More recently, they are expanding their cooperation to share best practices and observations on a range of cross-border tax enforcement issues. They now have multilateral agreements under which participating countries can conduct simultaneous examinations to facilitate addressing issues of common interest.

This increased cooperation and communication among tax authorities comes at a time when governments around the world, facing fiscal constraints, need to increase revenue. Aggressive tax compliance efforts may be an attractive option to raise revenue.

### Directors' action

Discuss with management how it is addressing increased coordination by tax authorities, including whether management:

- Is evaluating the global risks inherent in cross-border transactions and transfer pricing arrangements, and is prepared to respond to challenges from tax authorities.
- Has a process in place to ensure the information shared with tax authorities in each country is consistent. This is particularly important given how tax authorities are exchanging information.
- Is considering working with tax authorities to obtain advance rulings on tax issues in what could be an increasingly contentious environment.

## The focus on directors and tax

Internal Revenue Service Commissioner Shulman addressed the National Association of Corporate Directors' Corporate Governance Conference in the fall of 2009. He expressed the view that directors should play a role in overseeing business tax risks and tax strategies and described the types of information they should receive to enable them to effectively monitor tax risk. The speech further indicated that other countries have also begun to emphasize the importance of board involvement in company tax matters.

### **Directors' action**

Understand the significant tax issues and complex tax structures being used, and discuss how management is addressing them.

The current political and economic environment could increase the risk that Congress will consider enacting corporate revenue-raising proposals to pay for its social and economic priorities.