US tax reform – A closer look at the Tax Cuts and Jobs Act (HR1)

By Scott Slater
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The recent U.S. tax reform effort culminated with the enactment of the Tax Cuts and Jobs Act ("HR1") in December 2017. HR1's underlying principles include the simplification of the U.S. tax code for individuals and making U.S.-based businesses more competitive in the global market by lowering the corporate tax rate and moving to a 'territorial' tax system.

HR1 includes significant changes to the manner in which the U.S. taxes international business. The change from a global tax system to a territorial tax system requires a 'cleanse' of the historic global system via the 'toll tax' which triggers a deemed repatriation of all untaxed foreign earnings for certain U.S. owners of applicable foreign corporations. The toll charge carries a reduced tax rate from the historic 35% corporate rate (and post-2017 corporate rate of 21%) and can be paid over a number of years beginning in 2017; however, these untaxed earnings were often indefinitely reinvested in the foreign country and thus would not have been subject to U.S. tax until repatriated.

HR1 introduced the Base Erosion and Anti-Abuse Tax (or "BEAT") which targets U.S. tax base eroding payments to non-U.S. affiliates with a minimum tax. Another new tax enacted by HR1, the Global Intangible Low-Tax Income ("GILTI") tax, operates similar to the Subpart F income regime and has a significant impact to U.S.-owned foreign entities with limited to no trade or business assets.

Additionally, HR1 includes changes to the historic Controlled Foreign Corporation ("CFC") and Passive Foreign Investment Company ("PFIC") rules which cast a wider net over U.S. owned foreign corporations. The CFC rules have evolved with a change to the definition of U.S. shareholder from a 10% or more 'voting power' owner to a 10% or more 'vote or value' owner. The PFIC rules, as they relate to a non-U.S. insurance company, now include a 'bright line' test for being available to avail itself of the 'active insurance exception' to the PFIC rules.

In light of the aforementioned changes, a number of structures commonly seen in the Caribbean will need to be re-examined; particularly those with U.S. ownership or affiliates. U.S. owners of Caribbean entities will need to determine if they are subject to the toll tax on any untaxed earnings within the Caribbean entities. Payments from U.S. affiliates to entities domiciled in the Caribbean which hold intellectual property ("IP") including patents, trademarks, etc. or provide reinsurance to the U.S. entities may now be subject to the BEAT.

Additionally, such Caribbean entities which are U.S. owned may cause the U.S. shareholders to be subject to the GILTI tax. The use of 'voter cutback' rules or the issuance of non-voting preference shares which historically limited a U.S. person's voting power in a foreign entity no longer mitigates the risk of the foreign entity being a CFC. Additionally, U.S.-owned foreign insurance companies prevalent in Bermuda, Barbados, Turks & Caicos and the Cayman Islands will now be subject to new rules and may be treated as PFICs under HR1.

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The takeaway

Caribbean industries will need to remind the public why their jurisdiction was sought after in the first place. Possibly, it is the clarity in the regulations, lower cost of capital, the history of that sector in the region, or the vast amount of local financial services available in the Caribbean. Whichever is the primary benefit in your country will not have changed due to the above new U.S. tax law.

Let's talk

For additional details on how HR1 may affect your business, please contact:

Tax services partner, PwC Bermuda

Scott Slater

Email: scott.slater@bm.pwc.com

+1 441 299 7178