Tax & Investment in the US

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Key tax developments for global companies operating in the US

Recent legislative proposals can impact US inbound companies

House Ways and Means Committee Chairman Dave Camp (R-MI) released the 'Tax Reform Act of 2014,' a discussion draft for comprehensive tax reform of the Internal Revenue Code (the Camp discussion draft) which would lower the corporate tax rate from 35% to 25% and includes several international tax proposals on February 26, 2014.

The Obama Administration released its fiscal year 2015 (FY 2015 budget) proposals in the Treasury Green Book which also includes several international tax proposals on March 4, 2014. The Administration's FY 2015 budget contains several international tax proposals from prior years, but also contains new proposals that could have significant impact for US inbound companies.

Some of the more noteworthy proposals include new restrictions on US interest deductibility, as well as new restrictions on deducting interest and royalties in certain types of hybrid arrangements. Although tax reform is unlikely this year or next, US inbound companies are encouraged to consider the impact of the inbound proposals in both the Camp discussion draft and the President's FY 2015 budget due to the potential for these proposals to be picked up as revenue raisers in other bills.

US interest deductibility

Camp: The Camp discussion draft proposes to tighten the Section 163(j) interest deduction limitation to 40% of a corporation's adjusted taxable income (ATI), compared to the 50% of ATI limitation under current law.

Furthermore, excess limitation from tax years beginning after December 31, 2014, may not be carried forward. The proposed change to a 40% of ATI limitation under Section 163(j) will further limit interest deductions of US inbound companies.

Administration Budget: The Administration's FY 2015 budget proposal would introduce a new approach for restricting interest deductions of US inbound companies. Under the proposal, a member of a group that prepares consolidated group financial statements under US or international financial reporting standards would generally limit its US interest expense deduction to the member's interest

Highlights

What tax issues are potentially affecting companies investing in the USA today?

- *Recent legislative proposals can impact US inbound companies*
- *2014 insourcing survey reflects confidence of insourcing CFOs; work still needed*
- *OFII suggests changes to OECD discussion draft on BEPS Action 6*
- *OFII comments on OECD's efforts to neutralize the effects of hybrid mismatch arrangements*

income plus a proportionate share of the group's net interest expense computed under US tax principles. A member's proportionate share of the group's net interest expense would be determined based on the member's proportionate share of the group's earnings (computed by adding back net interest expense, taxes, depreciation, and amortization) reflected in the group's financial statements.

If a member fails to substantiate the member's proportionate share of the group's net interest expense, or if it so elects, the member's interest deduction would be limited to 10% of its ATI (as determined under Section 163(j)). Under the proposal, disallowed interest can be carried forward indefinitely and any excess limitation for a tax year can be carried forward to the three subsequent tax years. A member of a financial reporting group that is subject to the proposal would be exempt from the application of Section 163(j).

Observation: The Administration's FY 2015 budget proposal introduces a new, complex and far reaching approach to deny interest deductions of US inbound companies. The proposal essentially applies a proportionate worldwide leverage test to determine US interest deductibility.

Hybrid arrangements

Administration Budget*:* The Administration's FY 2015 budget proposal includes a provision that would deny deductions for interest and royalty payments made to related parties under certain circumstances involving hybrid arrangements. Hybrid arrangements are described as including use of hybrid entities, hybrid instruments, and hybrid transfers (such as a sales-repurchase or 'repo' transaction, in which the parties take inconsistent positions in respect of the ownership of the same property).

The proposal includes a regulatory delegation to the Secretary to issue regulations to:

1) deny deductions from certain conduit arrangements that involve a hybrid arrangement between at least two of the parties to the arrangement
2) deny interest or royalty deductions arising from certain hybrid arrangements involving unrelated parties in appropriate circumstances, such as structured transactions
3) deny all or a portion of a deduction claimed with respect to an interest or royalty payment that, as a result of the hybrid arrangement, is subject to inclusion in the recipient's jurisdiction pursuant to a preferential regime that has the effect of reducing the generally applicable statutory rate by at least 25 %.

Other items addressed include:

- anti-inversion rules and corporate residency
- reinsurance
- limitation on treaty benefits
- investments in US real property
- foreign person's sale of partnership interests
- expansion of FATCA reporting
- passenger cruise income.

For more information, *read PwC's Tax Insights, Impact of recent legislative proposals on US inbound companies.*

2014 insourcing survey reflects confidence of insourcing CFOs; work still needed

The Organization for International Investment (OFII) and PwC are proud to present the 2014 Insourcing Survey. The survey provides keen insights from 101 US Chief Financial Officers (CFOs) at insourcing companies, firms that operate in the United States and are headquartered overseas.

These are the individuals who help determine where their company locates or expands operations. The survey gauges how the United States is perceived as a location for foreign investment as compared to other nations.

What insourcing CFOs had to say

- Insourcing CFOs have growing confidence in the US economy.
- More confidence means more investment and employment.
- US manufacturing and exports are on the rise.
- Emerging markets are viewed as the top location for new investment.
- Among advanced economies, America offers a better business environment.
- Corporate tax rate is the top tax policy impacting CFO investment decisions.
- Ensuring fair treatment of insourcing companies is critical.

How the US can attract more global investment

Insourcing CFOs rank: 1) the tax system, 2) the regulatory system, and 3) a skilled workforce, as the 'most important issue areas' where the United States can improve to increase global investment.

States can also act to draw investment

Beyond economic and tax incentives, CFOs say 'state corporate tax policy aligning with international norms (i.e., federal tax treaties)' is an important consideration when evaluating states as locations for new investment.

Once a company has located in a state, connecting businesses with new local customers is the most important service a state can offer to ensure insourcing companies grow and expand employment in the state.

More than half of the CFOs identified educational priorities as the most important service a state can provide to encourage greater investment and growth.

For more information, *read the full findings of the Insourcing Survey 2014.*

OFII suggests changes to OECD discussion draft on BEPS Action 6

The Organization for International Investment (OFII) is keenly aware of the complex issues raised by the OECD's Discussion Draft on BEPS Action 6 (discussion draft). But while OFII and its member companies support and commend the OECD's endeavor to combat treaty abuse, it believes that certain proposals recommended in the discussion draft would penalize enterprises engaging in legitimate business transactions and would inhibit cross-border investment.

OFII has urged the adoption of certain changes to the discussion draft, specifically, it recommends:

- **inclusion of a derivatives benefits test:** it would provide a basis for treaty entitlement for customary multi-tiered business structures where no treaty shopping concerns exist.
- **modifications to certain entitlement to benefits (ETB) provisions to ensure they are narrowly focused on treaty abuses:** as currently drafted, OFII believes that the proposed ETB article would deny benefits to legitimate business structures and transactions as it does not represent the clear, objective requirements necessary for an LOB article to work effectively, and is overly restrictive and would limit access to the treaty by legitimate business enterprises undertaking customary cross-border business operations.
- **exclusion of a 'main purpose test':** the proposed subjective main purpose test is unnecessary to address treaty concerns, and undermines the clarity and predictability principles that are intended by a limitation on benefits article to facilitate cross-border trade and investment.

  Overall, OFII is concerned that the uncertain treatment fundamental business decisions would receive under the application of a main purpose test would undermine the function and purpose of tax treaties and urges the OECD to implement clear, objective rules to prevent treaty abuse and remove the main purpose test from the ETB article.

For more information, read the Organization for International Investment (OFII) Comment Letter on the OECD Discussion Draft on BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

OFII comments on OECD's efforts to neutralize the effects of hybrid mismatch arrangements

OFII notes that hybrid instruments and entities are a natural consequence of the interaction of each country's domestic rules and, as a result, are common in cross-border commerce, independent of tax motivations. It supports carefully crafted rules that prevent abuse of hybrid arrangements while ensuring that legitimate business activities and transactions carried out in the ordinary course of business are not impacted.

OFII agrees with the OECD's discussion draft that 'hybrid mismatch rules should not generally interfere with hybrid entities or instruments that produce outcomes that do not raise tax policy concerns,' however, it is concerned that certain recommendations in the draft would be at cross purposes with the stated goal, penalizing enterprises engaging in legitimate business transactions, resulting in double taxation and inhibiting cross-border investment. OFII believes the recommendations of the OECD should be limited to tax-motivated hybridity and avoid creating an environment that results in double taxation.

OFII makes numerous recommendations, including:

1) Rather than a top-down approach, adopt a bottom-up approach that would target transactions that raise genuine policy concerns and are engineered to shift profits offshore, while avoiding unnecessary uncertainty and administrative burdens for taxpayers and administrators.

2) Do not adopt a comprehensive hybrid rule in the imported mismatch proposal—a bilateral fashion is more effective.

3) Coordinate the work on BEPS Action 2 with other BEPS Action items on CFC, interest deductibility, and harmful tax practices.

4) To minimize the disruption to cross-border trade and commerce, exclude the arm's-length deductible payments incurred in the ordinary course of business for services or tangible property and payments in respect of financial obligations to a bank from the definition of deductible payment

5) Apply a threshold test before deductions are disallowed to minimize disruption to cross-border trade further

6) Restrict the scope of the discussion draft to transactions that involve hybridity.

For more information, read the Organization for International Investment (OFII) Comment Letter on the OECD Discussion Draft on BEPS Action 2: Neutralize the Effects of Hybrid Mismatch Arrangements.

Let's talk

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