Tax & Investment in the US

Fourth quarter 2014

Key tax developments for global companies operating in the US

Highlights

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

- *Mike Danilack joins PwC*
- *Paying Taxes 2015: Key aspects of the US tax system*
- *Captive insurance: Recent favorable US Tax Court decision*
- *Share-based compensation: understanding the tax accounting*

Mike Danilack joins PwC

PwC is pleased to announce that Mike Danilack, who served until recently as US Internal Revenue Service (IRS) Deputy Commissioner (International), joined the firm December 1 as a Principal in our Washington, DC office.

While at the IRS, Mike had oversight of all international tax matters in the IRS's Large Business and International Division (LB&I), including serving as the US Competent Authority.

Mike's work for PwC's will focus on competent authority/MAP matters, advance pricing agreements, the IRS Transfer Pricing Operations group, and tax audits and disputes. Mike is available to provide his insights through his years of IRS service to US inbound companies. He can be reached at +1 (202) 414-4504 or mike.danilack@us.pwc.com.

Paying Taxes 2015: Key aspects of the US tax system

Paying Taxes 2015 is the only piece of research that measures the ease of paying taxes across 189 economies — including the US — by assessing the time required for a case study company to: prepare, file, and pay its taxes, the number of taxes that it has to pay, the method of that payment, and the total tax liability as a percentage of its commercial profits.

Release of *Paying Taxes 2015* comes at a pivotal time for tax policy. Globalization, technological change, shifting demographic patterns, and the persistent challenges that continue around climate change and the environment are just some of the global trends that have a significant impact on fiscal policy and the associated tax systems. Against this backdrop, this year the Organisation for Economic Co-operation and Development (OECD) put forward proposals for changing the international tax rules to modernize them for today's globalized business.

Alongside all of these circumstances, however, there are two simple, mutually supportive objectives for governments:

- ensure that there are sufficient public revenues for the future, to lay a foundation for sustained improvements in productivity
- incentivize investment and economic growth.

Tax & Investment in the US

The results of the *Paying Taxes 2015* survey illustrate successful tax reforms and reform challenges and also provide a platform for government and business to engage in constructive discussion of tax reform across a broader range of issues.

The objectives of the study are to:

- compare tax systems on a like-for-like basis
- facilitate the benchmarking of tax systems within relevant economic and geographical groupings, which provides an opportunity to learn from peer group economies
- analyze data and identify good tax practices and reforms
- generate robust tax data on 189 economies around the world, including how they have changed, which can be used to inform tax policy decisions.

Paying Taxes 2015 includes many insights, including those regarding the US tax system, that will be of interest to companies that invest or plan to invest in the US.

US efforts to reduce tax compliance burden hampered by mounting complexity and resource scarcity

The Internal Revenue Service (IRS) wants to make it easier for US taxpayers to pay their proper federal tax liability and achieve greater tax compliance. In recent years, the government has increased its focus on formal initiatives to reduce the tax compliance burden. As a result, the IRS has made successful strides streamlining and increasing the efficiency of specific areas within its compliance program, resulting in benefits not only for taxpayers, but for the IRS as well — a win-win for both parties.

One might assume that under the *Paying Taxes* study, the time to comply for the United States would show a steady decline over the past several years due to these initiatives. However, this year's survey shows this as 175 hours. While this is lower than the world average (264), the OECD average (185), the G8 average (192), and the region average (213), it is the same as the previous two years and down only slightly from 187 hours for the four years before that.

So why doesn't the US ranking show improvement over this period? Unfortunately, no one factor can explain this stagnation. In fact, the IRS continues to face numerous obstacles that are hampering these welcomed efforts for taxpayers.

A primary challenge is that the complexity surrounding tax compliance in the United States has been mounting for decades. Another hurdle is that US lawmakers have continued to reduce the agency's budget and resources while at the same time adding new requirements.

The former is not necessarily the case with the actual process of submitting a tax return, but rather with what information is reported on it. A telling statistic is that between 2000 and 2010, the IRS was tasked with implementing over 4,000 tax code changes enacted by the US Congress. Sometimes contributing to this complexity is the fact that the US Treasury Department has added numerous sets of regulations and other guidance that taxpayers must understand and act on.

How the IRS is easing taxpayer burden

The IRS has streamlined specific compliance processes within various stages of the tax compliance cycle — pre-filing, filing, audits, and disputes.

While the benefit of these initiatives depends on the specific taxpayer's circumstances, they generally help taxpayers reduce compliance burdens by providing real-time information through online channels. These initiatives have enabled greater up-front certainty by facilitating early communication with the IRS to reduce risk. Initiatives to leverage technology for the filing of returns have had a tremendous impact, while other efforts have led to more consistency with respect to audits and quicker resolutions of disputes.

For more information, read *Paying Taxes 2015: The US at a glance*, or the entire *Paying Taxes 2015* report.

Captive insurance: recent favorable US Tax Court decision

The growing trend in commercial insurance markets for increasing premiums and deductibles has created tremendous opportunities for the use of captive insurance programs by US inbound companies.

As a result, many US inbounds may have established or are considering establishing captive insurance programs to self-insure risks, including those risks that are not otherwise covered through commercial insurance.

A fully utilized captive insurance program may allow an organization to reduce its overall insurance costs, centralize its risk management function, and improve its overall operating efficiency. A captive insurance program also may help US inbounds achieve significant tax benefits.

Favorable Tax Court decision

The US Tax Court recently issued a taxpayer-favorable decision regarding captive insurance.

In a memorandum opinion, the US Tax Court in *Securitas v. Commissioner*, T.C. Memo 2014-225 (October 29, 2014) held that payments made to a brother-sister insurance company were properly deductible as insurance premiums. This decision follows the full Tax Court's opinion earlier this year in *Rent-A-Center v. Commissioner*, 142 T.C. 1 (January 14, 2014), in which the court similarly ruled that premiums paid by a parent company to a subsidiary insurance company on behalf of other wholly owned subsidiaries were properly deductible as insurance premiums. The favorable *Securitas* opinion provides additional support for existing captive insurance arrangements and calls in to question the status of Revenue Rulings 2005-40 and 2002-90, including whether the IRS will continue to assert the positions taken in those rulings.

On balance, the *Securitas* memorandum opinion, although accorded less precedential weight than a full Tax Court opinion, is a favorable development for companies with captive insurance programs or that are considering them in several respects. For example, the opinion appears to confirm the conclusion that risk shifting can be achieved despite a small number of policyholders as long as there are sufficient risks for the law of large numbers to apply. In addition, under appropriate circumstances, risk may be shifted to an affiliate insurer that is the beneficiary of a parental guaranty.

Companies that are under IRS examination or in appeals on their captive insurance programs also may find their positions are stronger as a result of the *Securitas* opinion.

Taxpayers should note that *Securitas* could affect companies that applied a parental guaranty to avoid insurance company status for federal income tax purposes.

For more information, read *Securitas Holdings, Inc. v. Commissioner: Tax Court allows deduction for premiums paid to a captive insurance company*.

Share-based compensation: understanding the tax accounting

As US inbounds and other multinational companies (MNCs) seek to incentivize high performance among employees, the popularity of share-based compensation and equity incentive plans continues to increase. Mobility of global workforces and evolving global tax and regulatory compliance requirements raise significant challenges in administering global equity incentive plans. In addition, tax accounting for equity incentive plans remains a complex area for many MNCs due to the uniqueness of the accounting principles coupled with diverse local territory tax laws.

Many questions often must be addressed in the process of accounting for the tax consequences of these arrangements. For example:

- Should a deferred tax asset related to share-based compensation be recorded?
- If so, how should it be measured?
- To what extent are tax benefits recorded in tax expense versus equity?
- Should the deferred tax asset be adjusted for expected forfeitures?
- Will financial reporting under US Generally Accepted Accounting Principles (US GAAP), International Financial Reporting Standards (IFRS), or local GAAP lead to differing results?

To assist MNCs with addressing these questions, PwC provides a refresher of the tax accounting guidance for share-based compensation under US GAAP and IFRS and highlight similarities and differences between the two accounting standards.

For more information, read *Share-based compensation: understanding the tax accounting*.

Let's talk

For a deeper discussion, please contact:

Joel Walters

US Inbound Tax Leader
+1 (202) 414-4323
joel.walters@us.pwc.com

Mike Danilack

1 (202) 414-4504
mike.danilack@us.pwc.com

Anthony DiGilio

Captive Insurance
+ 1 (703) 918-4812
anthony.digilio@us.pwc.com

Edward Abahoonie

US Tax Accounting Services Technical Leader
+1 (973) 236 4448
edward.abahoonie@us.pwc.com