

Tax & Investment in the USA

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Key tax developments for global companies operating in the US

Outlook optimistic for US tax reform, but details remain unclear

Highlights

- *Outlook optimistic for US tax reform, but details remain unclear*
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It is no longer news that there is real potential to move tax reform forward after years of discussion ending in ultimate disappointment. The combination of Republican majorities in both the House and the Senate, coupled with a Republican president, significantly increases the prospects for comprehensive tax reform this year. President Trump has been outspoken that action in this space is one of his top priorities and Congressional Republicans have endorsed this view, emphasizing that tax reform is essential to their pro-growth agenda.

However, the details of what changes could be coming – and when new rules would be made effective – remain to be worked out during the legislative process, which will require reconciling different approaches likely to be taken by the House and the Senate. In PwC's [2017 Tax Policy Outlook](#), our legislative specialists in Washington dissect the many considerations to be analyzed in assessing the potential timeline, process, and outcome of the tax reform debate. From the perspective of investors into the US, a number of areas are worthy of highlighting in a more detailed way, even as the broader debate is being watched closely.

Financing costs

One critical issue in any tax policy debate is the treatment of financing costs, as this is an important driver of the cost of capital and return on investment with respect to the investment of business operations within the US. This is particularly true now as the profile of interest deductibility recently has been high in the minds of businesses and policymakers alike, resulting in changes at the regulatory level (see below for an update on the Section 385 Regulations) and much discussion in the legislative debate.

The focus on financing costs, coupled with a need to identify 'base broadeners' to incorporate in an overall tax reform package, makes it likely that tax reform proposals ultimately will include some changes in this area, particularly focused on deductibility of interest expense. The form of such a change could range from provisions targeted just at inbound investors to a broader restriction for all businesses based on thin capitalization or other mechanisms. As a reference, both President Trump's tax reform proposal and the June 2016 House Republican Tax Reform 'Blueprint' (discussed in more detail below) include significant changes, each of which could result in complete loss of any deduction from the taxable income calculation for interest expense.

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For investors into the US, this space needs to be watched closely, and any changes in the deductibility of interest should be modelled against the other changes in any tax reform package to assess the overall impact to business operations and the return on US investment.

Repatriation

Not all US businesses of non-US investors in turn own businesses outside of the US (commonly referred to as a 'sandwich structure'). However, it is not uncommon, especially in situations where the US business has been brought into the global group through acquisition and the non-US businesses have come along with the acquisition. When that structure exists, all the issues associated with ownership of non-US businesses arise, including the US tax treatment of foreign earnings.

Like financing cost changes, it also appears quite likely any tax reform package will include changes related to accumulated earnings outside the US, as well as potential changes in the US taxation of future earnings. The repatriation aspect of any changes in particular could result in a material cash tax charge at inception of a new regime. For example, President Trump's tax reform plan includes a 10% deemed repatriation tax, while the House Republican Blueprint includes a 8.75% tax for accumulated foreign earnings held in cash and 3.5% on other accumulated earnings. At the same time, despite this potential cash tax cost, this could simplify access to both prior-year and future earnings and cash underneath the US for the foreign parented global group.

Rate

Ultimately the prize in tax reform is, of course, the rate. With the US corporate tax rate still at 150% of the average for the top rate in OECD member countries, alignment to global norms will be a goal of any tax reform proposals. With proposed rates of anywhere between 15% and 25%, the extent of the benefit for all US businesses could vary dramatically. In addition to weighing the benefit of any rate reduction against base broadening and other changes – as will be the case for all US businesses – investors into the US also will want to model the impact of the rate reduction in their global tax position as part of the modified rate mix, including that of the parent company location, the impact on financial statement reporting, and the assessment of investment location choices.

A deeper look at the House Republican Tax Reform Blueprint

While it may seem that it is but one of several potential frameworks for building consensus on a tax reform package, there are two reasons to take a more in-depth look at the 2016 House Republican Blueprint. First, it is the likely starting point for drafting legislation in the House Ways and Means Committee, which is critical to the path forward of any legislative package. Second, the business tax proposals in the Blueprint would radically change the way the US taxes business-operations moving toward a destination-based cash-flow consumption tax, which would be dramatic in its effect and implications.

Again, a detailed analysis has been developed by PwC's legislative specialists in Washington and can

be found at: [House Republican Blueprint: A destination based cash-flow tax](#). While the discussion above applies to the Blueprint in terms of analysis of the changes in the corporate tax rate (20%), treatment of financing costs (a complete elimination of the deduction for interest expense), and repatriation of foreign earnings, we consider below several of the other critical aspects of the Blueprint as they will impact investors into the US.

Destination-based taxation

The Blueprint proposes a destination-based tax meaning that the tax is imposed based on the place of consumption of the goods and services, rather than the source of income or the residence of the taxpayer. This is achieved through 'border adjustments' exempting gross receipts from exported goods and services while taxing goods and services imported into the US.

In a nutshell, therefore, it can be assumed that higher sales of goods and services by inbound companies into the US versus exports, will result in a greater tax burden and higher importation of input goods and services will have the same result. While not a universal certainty, it could be assumed that US businesses of foreign investors could find themselves in a position where they have less of their gross receipts from exports and use an increased percentage of inputs that are imported into the US. This could result in significant changes in the tax position of those businesses as compared to current law and a shift as well in relation to their US-owned competitors.

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Location of business activities

One implication of the Blueprint, if enacted in its current form, would be to encourage additional investment in the US through location of global business activities from manufacturing to intangible ownership within the US. Of course, this would be intended, as this is believed to drive up economic growth, jobs, and wages.

Global businesses that are parented outside the US are likely to have many commercial influences on the location of their business activities. Enactment of provisions such as these would require a reassessment of the tax implications of those choices. Tax, of course, is only one input into the decision-making process. In light of the other commercial drivers likely to be present in a non-US owned group, a careful review will be necessary to assess the best after-tax returns from business operations that can be located in the US or other jurisdictions.

Currency and price adjustments

Most academic economists believe that either prices or currency exchange rates will adjust to eliminate the impact of the border-adjustment tax treatment of goods and services. One concern that has been raised by businesses is that the adjustments may not be immediate or may not align exactly with the change in tax treatment resulting in lower after-tax profits for those negatively impacted by the border adjusted tax. The concern may be magnified for foreign-owned global groups, which have many cross-border pricing structures for their goods or services as well as complex

foreign currency positions. The analysis and the ultimate commercial impact will need to be evaluated, managed, and communicated within senior management and the external environment in an effective way.

CEOs assess engagement in policy debates

In [*US CEOs Battling Headwinds on Taxes, Regulation*](#), Rohit Kumar, PwC's Tax Policy Services Co-Leader, discusses the challenges faced by CEOs when engaging in the tax policy debate in Washington.

When thinking about this issue in the context of investors into the US, the challenges can seem more daunting. This is especially true in the current environment, where a misstep can result in attack in the traditional media or in social media. However, businesses owned by non-US investors, as well as the investors themselves, often can have a compelling case, especially when supported by a case for job creation. A clear story can be worth telling in Washington and can result both in being heard and in having an impact. At a minimum, serious consideration should be given to stepping forward either individually or together with like-positioned businesses.

Future of Section 385 regulations unclear

The road for the Section 385 regulations has been long and winding and may remain so for some period of time. When the proposed regulations were released in spring 2016 we viewed

them as “the most significant tax development for US inbound companies in the last 10 years.”

After considering nearly 200 comment letters on the proposed regulations, in October 2016, the IRS and US Treasury issued final regulations under Section 385. While the final regulations significantly limited the scope of the proposed regulations and provided several exceptions, the impact on financing of US subsidiaries of foreign-owned companies remained significant.

For further analysis see:

[Section 385 Regulations summary chart](#)

[IRS and Treasury release Section 385 Regulations](#)

[New Section 385 regulations significantly limit scope](#)

The outcome of the election, coupled with the renewed efforts around tax reform, have opened new possibilities for the future of these regulations. One possibility is for the Treasury, under its new leadership, to withdraw or modify the regulations pursuant to the procedural rules for making such changes, or otherwise to make administrative changes in enforcement of the regulations. Another possibility is for the Congressional Review Act (CRA) to be used, which allows Congress to overturn regulations with a simple majority vote.

It is unclear at this time what the future holds for the Section 385 regulations, so in the meantime preparations need to continue to achieve compliance. However, one eye should stay focused on the potential for some or even dramatic changes impacting the application or even existence of the regulations.

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Upcoming events

PwC's US Inbound Tax team hosts a series of events for tax professionals and CFOs, bringing together global companies investing in the United States and tax or business specialists to discuss the unique opportunities and challenges for companies.

To join any of our upcoming events or if you have any questions, please contact Liana Gravers or Jelena Budjevac of PwC's US Inbound Tax team and see the following:

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Schedule

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| 3/28 | Dallas, Texas
<i>Tax Roundtable with OFII</i> |
| 3/28 | Dallas, Texas
<i>CFO dinner with OFII</i> |
| 4/4 | Greensboro, North Carolina
<i>Tax Roundtable with OFII</i> |
| 4/19 | Florham Park, New Jersey
<i>Tax Roundtable with OFII</i> |
| 5/2 | Minneapolis, Minnesota
<i>Tax Roundtable</i> |
| 5/18 | Detroit, Michigan
<i>Tax Inbound Dinner</i> |
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Let's talk

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