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# Tax Reform Policy, Process, Prospects and Planning:

What's next? How can you prepare?

18 July 2017

# Agenda

- Tax Reform Process & Proposals
- Tax Reform Observations
- Deloitte Approach

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# Tax Reform Process & Proposals

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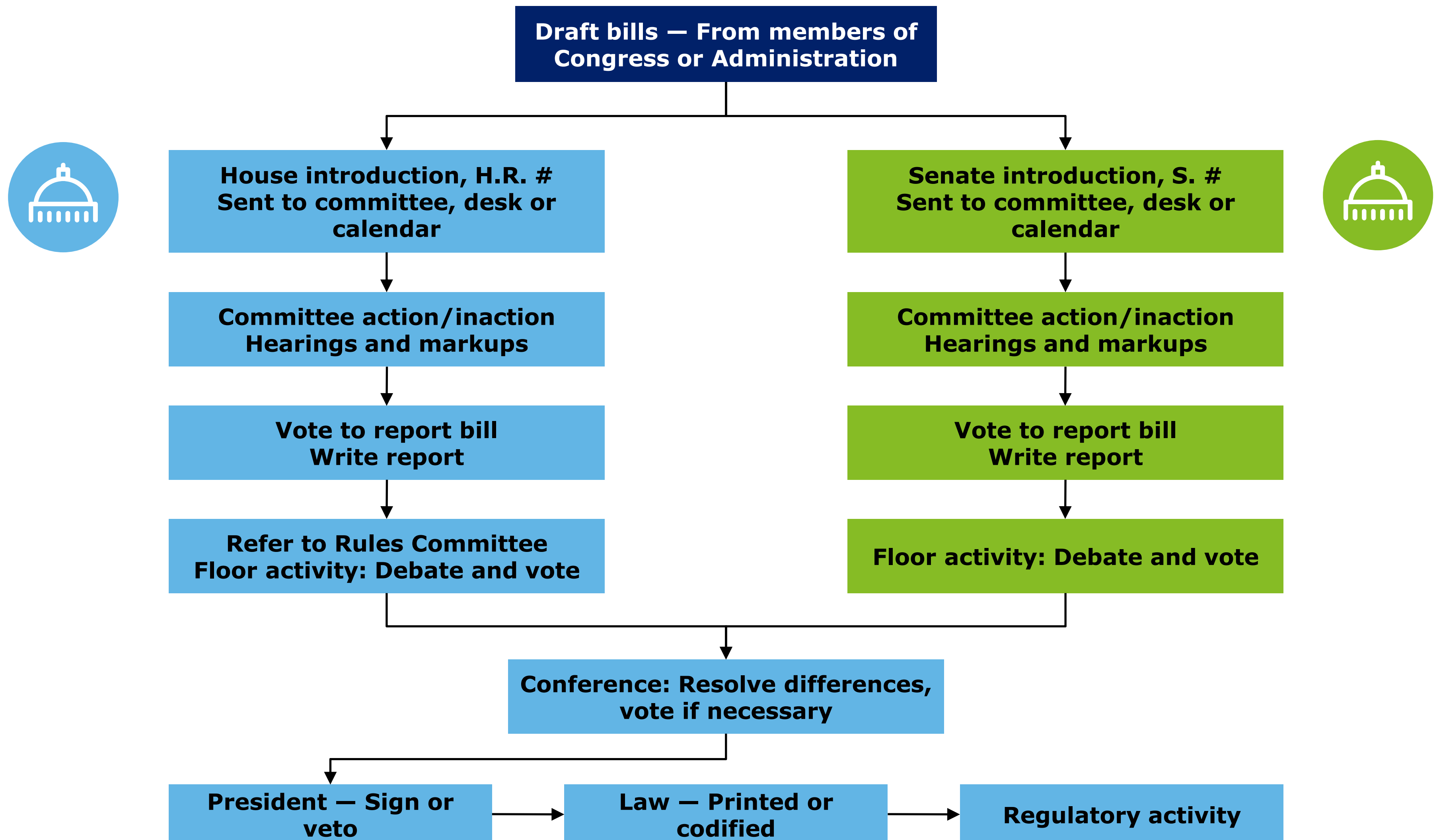
# The Legislative Process

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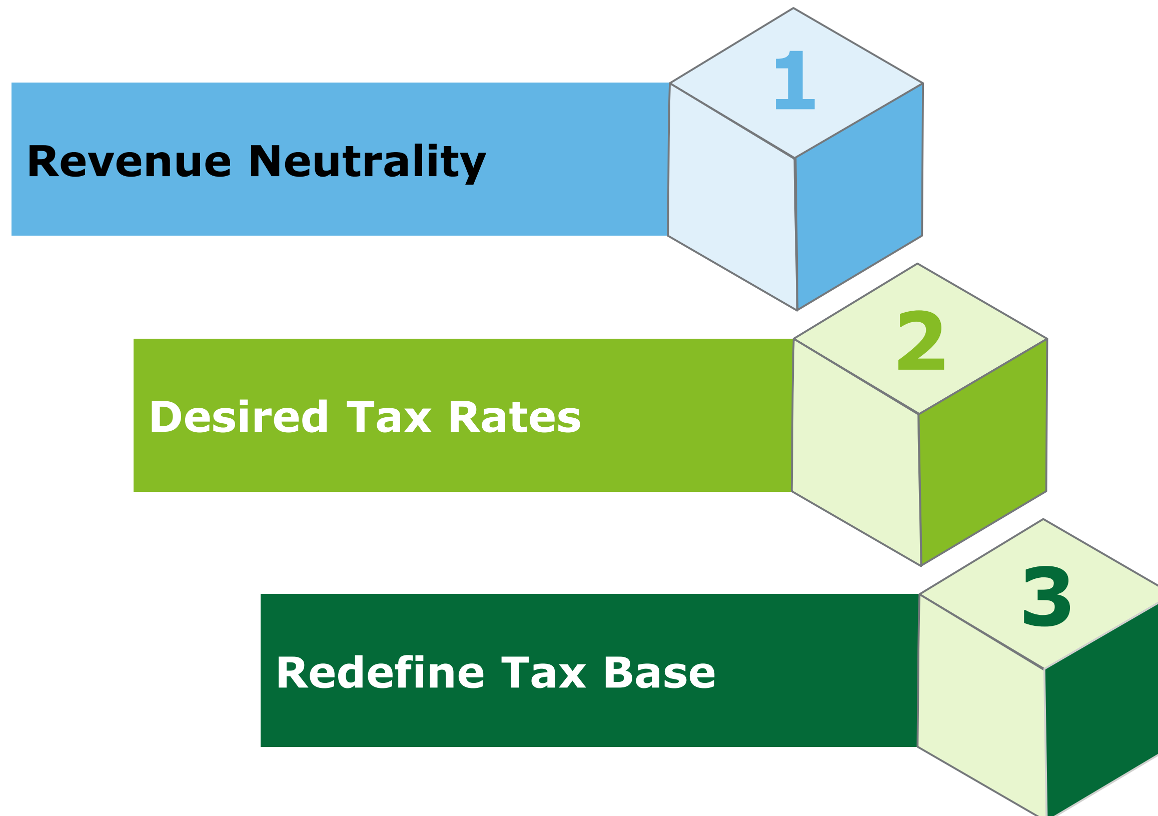
# Three Basic Building Blocks

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# Comparing business tax proposals

| | President's tax plan | House GOP blueprint | H.R. 1 (2014 Camp plan) |
|---|---|---|---|
| **Corporate rate** | 15% | 20% | 25% (phased in over 5 years) |
| **Pass-through rate** | 15%, but unclear to which entities and income it applies/other restrictions | 25% | Taxed at individual rate |
| **Expensing/ depreciation** | Not addressed | Full expensing in year one of all assets, tangible and intangible, other than land | Phase in repeal of MACRS |
| **Interest deduction** | Not addressed | No current deduction for net interest expense (disallowed deductions may be carried forward indefinitely) | • Modified section 163(j) and implements new thin cap rules<br>• Section 163(j) interest deduction limit for adjusted taxable income reduced from 50% to 40% |

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# Comparing business tax proposals

| | President's tax plan | House GOP blueprint | H.R. 1 (2014 Camp plan) |
|---|---|---|---|
| **Corporate AMT** | No proposal | Repeal | Repeal with 50% refund of AMT credit carryforward for three years with full refundability in year four |
| **§199 Deduction** | Implicit repeal | Repeal | Repeal (over 2 yrs) |
| **Net Operating Losses** | No proposal | • Eliminate NOL carryback<br>• Permit indefinite carryforward with amount "increased by an interest factor"<br>• Limit current deduction to 90% of taxable income | • Eliminate NOL carryback<br>• Limit current deduction to 90% of taxable income |
| **Misc. Revenue Raisers** | Not addressed | Eliminate most business tax expenditures other than R&D credit and LIFO | • Repeal of LIFO and LCM<br>• Amortize §174 expenditures over 5 yrs<br>• Amortize advertising expenditures over 10 yrs<br>• Extend §197 intangibles amortization to 20 yrs<br>• Repeal entertainment expense deduction<br>• Repeal like-kind exchanges<br>• Repeal income exclusion for non-shareholder capital contributions |

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# Comparing business tax proposals

| | President's tax plan | House GOP blueprint | H.R. 1 (2014 Camp plan) |
|---|---|---|---|
| **International regime** | Move to territorial | • Move to territorial (via 100% dividend exemption)<br>• Eliminate most subpart F rules; retain foreign personal holding company rules | • Provides US corp shareholders 95% dividends received deduction for foreign source dividends received from 10%+ owned foreign corporation<br>• 15% minimum worldwide effective rate on foreign base company intangible income<br>• 12.5% minimum worldwide effective rate on foreign base company sales income |
| **Deemed repatriation** | Rate not specified | Differential rates for cash (8.75%) and noncash (3.5%) assets, payable over 8 years at taxpayer's election | Differential rates for cash (8.75%) and noncash (3.5%) assets, payable over 8 years (no interest charge; FTCs and NOLs may offset tax) |
| **Border-adjusted tax base** | Not addressed | Tax imposed on imports, but not exports (similar concept to other countries' credit-invoice VATs) | No proposal |

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# Tax Reform Observations

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# Tax reform: opportunities and challenges

## Opportunities

- There is general agreement by both political parties on the need to lower the corporate tax rate and reform international tax rules
- The sense of urgency related to BEPS, increased foreign acquisitions of US-based companies, and EU state-aid actions is increasing
- Significant tax reform work already done with discussion drafts released by Camp, Baucus and Wyden as well as the House GOP blueprint
- Dynamic scoring may make it easier to achieve deficit-neutral tax reform
- Attempt by White House and House/Senate Republicans to present a unified approach to tax reform may help move process forward in the fall

## Challenges

- Tax reform is always easier said than done. The actual task of paring back popular credits and deductions offers ample opportunities for well-organized opposition to arise
- Who is “driving the train” on tax reform?
- President Trump and Speaker Ryan may have very different visions of how to move forward on taxes (“relief” v. “reform”)
- 2018 elections limit the window to achieve tax reform

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# Tax reform through reconciliation—is it really an option?

**Arguments for using reconciliation**

- Cannot be filibustered, meaning it can pass the Senate with just 51 votes (or 50 plus the tie-breaking vote of the Vice President)
- Democrats may demand concessions on key issues (overall cost, estate tax, marginal rates, distribution of tax burden, etc.) that some Republicans may find unacceptable

**Arguments against using reconciliation**

- Procedural rules can have major substantive impacts by preventing inclusion of provisions that:
  - Have no budgetary or have budget effects that are "merely incidental"
  - Increase the deficit outside the budget window

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# The 2017 legislative calendar and potential tax reform timeline

| | JUL | AUG | SEPT | OCT | NOV | DEC |
|---|---|---|---|---|---|---|
| | 1 week District work period | 5 week summer recess | 1 week District work period | 1 week District work period | 1 week District work period | Target Adjournment 12/15 |
| **Must Pass** | BY SEPT 30<br>• Pass FY18 spending bills… or shut down part of the gov't<br>• Reauthorize FAA<br>• Raise or suspend federal debt ceiling?<br>• Extend Children's Health Insurance Program<br>• Senate continues processing Trump's nominees | | | | | |
| **ACA Repeal/Replace** | Repeal through F17 budget reconciliation process | | | | | |
| **House** | Pass FY18 budget resolution including reconciliation instructions; start tax reform hearings; negotiations with Senate and White House continue | | House Ways & Means vote | Full House vote | | |
| **Senate** | Pass FY18 budget resolution including reconciliation instructions; negotiations with House and White House continue | | | Senate Finance vote | Full Senate vote | |

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# India Impact

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# Impact on India’s inbound business through US

- US Tax reforms similar to India tax policy changes – reduction in corporate tax rate and reduction in certain allowable expenditure
- US’s proposed territorial taxation system clubbed with the India’s reduction in corporate tax may encourage US held companies to set up their business locally in India.
- With the proposed exemption/partial exemption in case of receipt of dividend, US subsidiaries in India can repatriate surplus to US by paying 20 per cent dividend distribution tax in India with no further tax in US.
- Dividend received is proposed to be exempt subject to conditions satisfied. Accordingly, US Companies already having subsidiaries in India may defer their plan to declare/pay dividend.
- US entities having presence in India may defer revenue recognition in US to post reform period to take benefit of territorial taxation system.
- Loan given by Indian subsidiary to US parent treated as deemed dividend in past may be set off against dividend declared in light of proposal limiting interest expense allowability and India TP Regulations (including secondary adjustments).

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# Impact on India’s outbound business to US

- The proposed border tax and immigration issues clubbed with the reduction in tax rate and territorial taxation system may encourage Indian companies to set up business locally in US.
  - Attention will have to given to both, reforms which lower the tax base and reforms which increase tax base.
- Funds can be repatriated to India with overall tax as low as 17 per cent.
  - This dividend received from the US entity would also result in reduction of dividend distribution tax in the hands of the India shareholder company declaring dividend in the same financial year.
- Loan given by India Holding Company to US subsidiary may be repaid in light of reform with respect to limitations on interest expense allowability and India TP Regulations (including secondary adjustments).

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# Deloitte Approach

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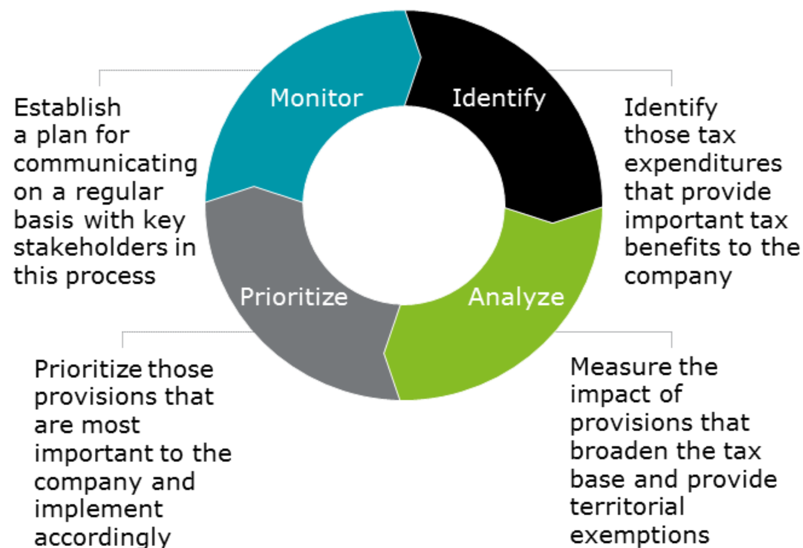
# Tax reform readiness – navigating the uncertainty

## Tax reform readiness

Navigating the uncertainty

With the possibility of tax reform on the horizon, companies will need to accurately analyze and assess the potential impact of the anticipated tax proposals.




| Uncertainty around tax reform may lead to inaction, however, there is … | Therefore, US companies may wish to consider … |
|---|---|
| **Common ground:** Identified proposals* include transition tax and headline rate reduction | Mitigating transition tax and deferring earnings to post-transition period |
| **Time value of money:** US tax attributes are worth more today than they will be tomorrow (and may expire with tax reform) | Utilizing/monetizing existing tax attributes (including unrecognized attributes) |
| **A window of opportunity:** through tax reform implementation to pursue current year benefits that may perpetuate | Exploring considerations for permanent tax savings through accounting method changes |

* President Trump, House GOP and Camp proposals

As tax reform proposals undoubtedly evolve throughout 2017, it will be important to have an **agile approach** to analyzing the tax effects of new proposals on business operations.

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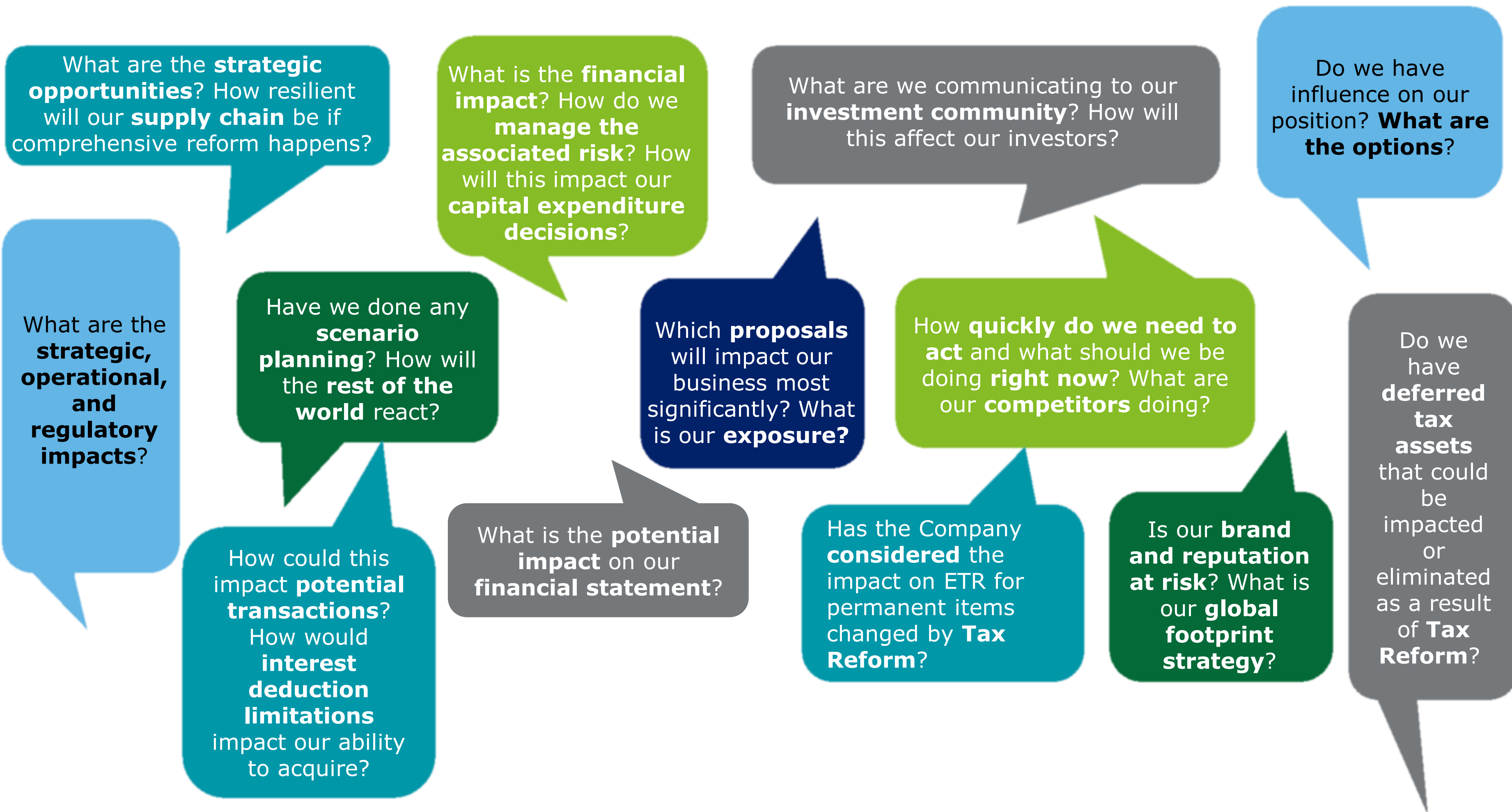
# Top considerations on the impact of Tax Reform

## Questions the board and C-suite are asking

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# We recommend a simple roadmap for companies to proactively navigate the journey and better prepare for upcoming tax reform

**Assess baseline situation**
- Initiate dialogue with key executives on change imperative
- Develop a strong understanding of planned initiatives that may be impacted
- Establish baseline state and key applicable considerations

**Define scenarios and associated impact**
- Set up a dynamic model with the key inputs identified
- Model multiple scenarios and quantify impact
- Identify potential corporate rate reduction and E&P/FTC considerations

**Validate assumptions**
- Validate key assumptions with stakeholders
- Refine the model and pressure test the assumptions / outputs generated
- Prepare a deliverable outlining the initial design of a readiness plan for consideration

**Implement action plan**
- Proactively implement changes to align with tax and business strategy
- Manage change throughout the organization

A prepared organization ready to use Tax reform to their advantage

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# How are we assisting our clients?

- Deloitte can assist with tax reform readiness by **tailoring a broad-based approach** to address our Clients' tax planning objectives. This may include:
  - Analyzing Clients' current tax position
  - Assisting Clients in modeling anticipated effects of tax reform at federal, international, and state level;
  - Reviewing global mobility policies and talent strategy in light of potentially reduced tax rates and potential changes in US policy around offshore manufacturing and augmented border entry efforts;
  - Helping to identify and model potential tax planning considerations, both immediate and longer-term, under various proposals; and
  - Assisting Clients to prioritize implementation plans
- To get started, Deloitte may perform an **initial assessment phase**, in which we will:
  - Gather some preliminary information from management;
  - Establish Clients' (and its shareholders') key tax planning objectives around reform;
  - Perform an initial impact analysis;
  - Identify potential corporate rate reduction considerations that can be implemented on the 2016 return; and
  - Prepare a deliverable outlining the initial design of a readiness plan for further consideration

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# Immediate Tax Reform Planning Considerations

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# Rate Reduction Planning – Permanent Cash Savings

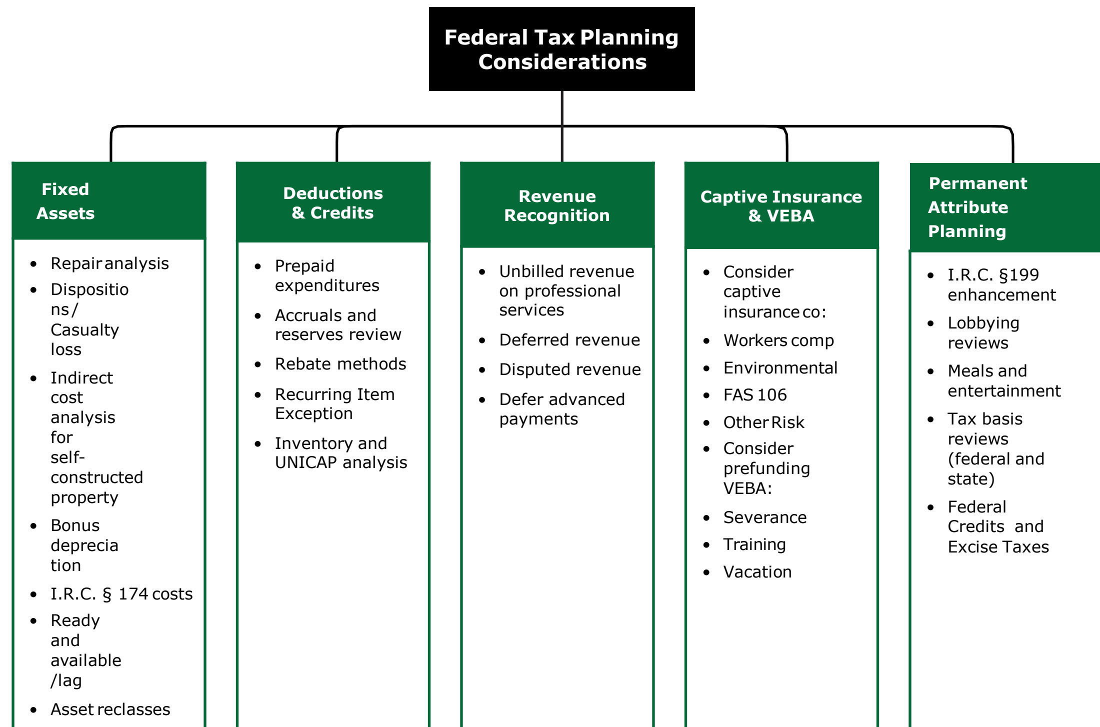
## Tax Reform Proposals Include a Reduction in Corporate Rates Between 10 – 20%

| Accounting Method Planning Implemented Prior to Rate Reform May Result in Permanent Rate Reduction for Taxpayers | | | |
|---|---|---|---|
| Current Gross DTA | Cash Tax Reduction if Deduct in 2017 at 35% Rate | Cash Tax Reduction if Deduct in 2018 at 25% Rate | Permanent Benefit of Accelerating Deduction into 2017 |
| $100,000,000 | $35,000,000 | $25,000,000 | $10,000,000 |

Generally, a taxpayer changing its method of accounting for an item of income or expense only shifts the recognition of such items between deferred and current tax expense. The change would typically produce cash tax savings but rarely creates a permanent tax benefit.

In taxable years bordering a change in federal corporate tax rates, however, taxpayers can capitalize on a permanent tax savings opportunity by decreasing current tax expense as much as possible in years where a decrease in rates is anticipated.

**Tax Reform has provided Companies with an opportunity to use accounting method changes which may result in cash tax savings as well as permanent rate savings.**

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# Level ETR Impact of U.S. Tax Reform

- Rate benefit resulting from accelerating deductions / deferring revenue may provide an **opportunity to execute transactions that generate a one-time tax cost but an on-going rate benefit**.
- I/C Transfer of assets from high tax-jurisdictions to low-tax jurisdictions:
  - For example, inbound groups with IP held in high-tax jurisdiction (e.g., Germany) should consider transferring such IP to a lower tax jurisdiction (considering all substance requirements) such as Ireland or UK.
  - Financial Statement Impact:
    - The sale of IP generates an immediate cash tax / financial statement cost
    - Financial statement cost from the sale of IP can be offset with deferred tax benefit, if any, resulting from the reversal of a net U.S. DTL.
    - Post-IP Transfer, **payment for the use of IP** from high-tax jurisdiction (e.g., Germany) to low-tax jurisdiction (e.g., Ireland/UK) **to give rise to an ETR benefit**.
- Evaluate existing FIN 48 reserves:
  - Revise analysis / opinion level on tax positions taken in the past
  - Revise calculations that had financial statement impact (e.g., distribution of E&P/utilization of foreign tax credits).

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# International Tax Reform Action Steps

## Planning for the Transition Tax

### Modeling of Various Scenarios

- Various Proposals
- Various Transition Years
- With and Without E&P Deficit Offset
- With and Without use of FTCs

### Change Year-End of CFCs

- May delay transition year for calendar year taxpayers
- Fiscal year taxpayers may already enjoy deferral
- Make year end change on 2016 tax return
- Consider filing of 2016 tax return prior to tax reform enacted

### CFC Earnings & Profits

- Utilization of E&P Deficits
- Identify Loss Assets owned by CFCs
- Restructuring Transactions to Impact E&P

### Defer Earnings & Profits / Accelerate Foreign Taxes

- Accounting Method Changes Impact Earnings
- Pending Foreign Tax Adjustments Affect Foreign Tax Pools
- Consider Accelerating Taxable Foreign Transactions

### Repatriate Cash and Excess Foreign Tax Credits

- Dividends Return of Basis

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# Appendix - Tax Reform Navigator

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# Appendix - Tax Reform Navigator

**Note:**

- Certain aspects of the Tax Reform Model may not be available for use on attest clients due to independence limitations.
- Hypothetical tax calculation only—the use of the Tax Reform Model is not a substitute for a full analysis of the potential tax and financial accounting consequences of any possible Proposal.

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