TP WEEK

US tax reform bill takes aim at IP and TP planning

House Republicans have unveiled the Tax Cuts and Jobs Act, outlining a comprehensive overhaul of the US's tax code. The act will probably still get more than just a few little tweaks before being passed into law, but it is very likely to have an impact on multinationals' transfer pricing planning and decisions on where to house IP.

November 03, 2017

Related to Analysis , News & US

The **Tax Cuts and Jobs Act** published on Thursday confirms plans to cut the US corporate tax rate from 35% to 20% and the change to a territorial-type tax system. The act introduces repatriation of offshore earnings with a rate of 12% for accumulated earnings held in cash or cash equivalents and 5% for other earnings, and proposes a 25% maximum tax rate on pass-through business income, such as limited liability company income.

With the new 25% maximum tax rate on pass-through business income, and the associated anti-abuse rules, the act looks to curb the ability to stash profits in low-tax jurisdictions if there is no substance. Alongside BEPS, this should lead to greater substance-based planning, Mike Heimert, global head of transfer pricing at Duff & Phelps, told *TP Week*. However, this will not eliminate transfer pricing issues altogether, said Stuart Gibson, counsel at law firm Schiff Hardin.

Passing grade

However, the act is less than likely to complete the legislative process in its current form, and is widely seen as an opening bid rather than a final proposal.

"My initial thought is that some of the details will require changes in order for the Republicans to get enough votes to pass the tax reform bill. Corporate tax relief is a welcome sight, but it still remains to be seen if they can get enough votes to pass tax reform from a worldwide tax system to a territorial tax system," Patrick Bagarozza, Americas head of tax at Swiss chemicals and biotechnology company Lonza Group, told *TP Week*.

As the bill stands, there are several proposed changes to transfer pricing as the government tries to curb base erosion and profit shifting. Some provisions bring changes to intellectual property (IP) and many companies are likely to start hedging their bets and look at other options for where to house their IP.

According to policy highlights published by the Committee on Ways and Means, to curb base erosion by MNEs shifting IP and risks to low-tax jurisdictions, the bill's section 4301 proposes to eliminate "tax incentives for companies to locate IP, risks, and related manufacturing jobs overseas" by taxing US companies on 50% of their foreign subsidiaries' low-taxed excess returns.

The Joint Committee on Taxation (JCT) estimates that this measure would contribute some $77 billion between 2018 and 2027.

"Some companies may forego their cost-sharing arrangements or look to move their IP into different jurisdictions," said Heimert. "The US [corporate tax] rate will drop to 20%, while also imposing a tax for 'high return amounts' of controlled foreign companies, [and] the tax benefit US companies can obtain by shifting intangibles to low tax jurisdictions is now significantly reduced. Coupled with the DEMPE requirements being imposed by many countries on the heels of BEPS, which raises the cost and risk of maintaining entities that principally possess only intangible property, it means that many companies, particularly small and mid-sized multinationals, will see the cost of defending their structures and complying with tightened rules outweighing the potential tax benefits, and they will reevaluate where they want their IP to reside."

"For instance, they may choose to keep their IP in the US and receive royalties from the non-US use of the IP, or have their IP outside the US housed in countries where the multinational already possesses, or plans to develop, substantive activities."

Heimert also said the excise tax, which places a 20% tax on payments from US companies to related entities in certain situations including royalty payments and cost of goods-sold payments, might have far-reaching ramifications for intercompany transactions.

Falling out of favour

The act also takes aim at debt creation and corporate tax inversions, "reinforcing the the arm's-length standard by removing the incentive to artificially inflate outbound related-party payments".

The act seeks to axe "existing tax incentives to import interest deductions into the US tax base by limiting those deductions to the US share of global interest expense".

Limitations in deductibility of related-party interest for corporations are proposed at 30% of EBITDA.

A lot of current transactional flows will be reconsidered to take advantage of the lower US tax rates, particularly among mid-sized multinationals that will look to recharacterise certain transactions and shifting risk profiles within inter-company transactions, Heimert told *TP Week*.

$1.5 trillion limit

The bill can increase the federal deficit over 10 years by $1.5 trillion and still comply with the budget resolution passed by Congress earlier in October.

Gibson told *TP Week* that some of the machinations in the bill, particularly in the timing of effective dates, are driven by the need to stay within the $1.5 trillion figure.

“Whether these items will be made permanent at some points in the future, will generate uncertainty as businesses make strategic decisions for the short and long term,” Gibson said. “Because of the $1.5 trillion limit, the bill eliminates many relatively small tax breaks that affect both businesses and their employees. While they may not garner a lot of headlines, they will profoundly affect millions of taxpayers. This bill has the potential to affect every corner of the US economy and every US taxpayer. It is important to pay attention, particularly to the details.”

However, multinationals still have time to prepare while the bill goes through various stages. 50 votes are needed to pass the bill in the Senate.

“Recent history suggests that the first version of legislation is always the most ambitious version. And that ambition is diminished as the bill makes its way through each stage of the legislative process. So the next question is how much of today’s proposal can stick,” John Gimigliano, KPMG principal, told *TP Week*.

Lena Angvik

RELATED ARTICLES

The BAT is caged – what’s next for US tax reform?
August 1, 2017

US MNEs eye planned tax break on repatriated foreign profits
November 15, 2016

Sanders wants tax avoiders to feel the Bern
March 14, 2017

Double Irish is on borrowed time
October 17, 2014

EC slaps Amazon with €250 million state aid bill
October 4, 2017