Tax Reform Planning for Multinational Corporations

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Andersen Tax can help multinational corporations prepare for tax reform.

With the recent introduction of tax legislation in Congress, efforts by President Donald Trump and the Republicans to reform the Internal Revenue Code (the Code) are well underway. The Republicans' stated goal is to enact tax reform before the end of 2017. Based on the proposed tax law changes, we recommend that businesses take proactive measures now to plan for the changes that are likely to occur if tax reform efforts are successful. In order to engage in proactive planning for tax reform, U.S.-based multinational corporations (MNCs) have a unique set of considerations. Not only do MNCs need to consider tax planning around domestic proposals, including a potential reduction in the top corporate income tax rate from 35%, interest expense limitations, expensing of capital expenditures and other changes, proposed changes to U.S. federal international tax laws could result in a radical shift in how U.S. corporations are taxed with respect to activities and investments outside of the U.S.

Current Status - Worldwide Taxation

Based on the proposed tax law changes, we recommend that businesses take action now.

Domestic corporations are currently taxed on a worldwide basis with deferral of taxation on earnings of certain foreign subsidiaries until such earnings are repatriated via dividends, or when the foreign subsidiaries trigger certain anti-deferral provisions—i.e., via rules pertaining to controlled foreign corporations (CFCs) or passive foreign investment companies (PFICs). Upon actual or deemed repatriation of foreign earnings, double taxation is mitigated to an extent under the foreign tax credit (FTC) system. Over the years, the CFC and PFIC anti-deferral regimes have generated a large volume of complex statutes, regulations, administrative rulings and court decisions. The rules around the FTC have similarly expanded to impose significant complexity and limitation of the ability of many taxpayers to claim a credit and avoid double taxation when earnings are ultimately taxed in the U.S. Thus, the CFC, PFIC, FTC and other related rules represent a complex system of tax rules that U.S.-based MNCs must navigate through a significant investment of time and resources on international tax planning. The present system has also been viewed as encouraging U.S. companies to move their tax residency offshore through inversion transactions and discouraging investment in the U.S. economy.

Proposed Transition to Territorial Taxation and Mandatory Deemed Repatriation

Current proposals by the House Committee on Ways and Means and the Senate Finance Committee to reform the U.S. federal international tax rules include provisions to establish an exemption system for the foreign-source portion of dividends received from certain foreign corporations by U.S. shareholders that are domestic corporations that meet certain conditions. In order to transition to the exemption system, both the House and Senate proposals also include a mandatory deemed repatriation tax based on certain currently deferred earnings and profits (E&P) that would apply to any U.S. shareholder of a foreign corporation that satisfies

certain conditions. The effective tax rate on the mandatory deemed repatriation of foreign earnings would differ based on the amount of earnings invested in cash and liquid property vs. other assets.

The House and Senate proposals include other significant changes for multinational businesses going forward, including: (a) additional limitations on interest expense deductions; (b) proposals designed to ensure a global minimum tax on certain foreign earnings; (c) revisions to existing subpart F and FTC provisions; (d) changes to sourcing rules; (e) rules pertaining to transfers of intangibles; (f) rules addressing hybrid payments; (g) additional rules to prevent base erosion; and (h) several other rules and changes. While some similarities exist between the House and Senate plans, certain proposals in the respective plans for international businesses differ significantly. As the process continues to unfold, these proposed changes could be modified or replaced, or other proposed changes could be introduced.

Implications of the Transition

Because the current system of taxation for U.S.-based MNCs differs dramatically from the new system being proposed, taxpayers stand to benefit significantly through proper planning. Due to the compressed time frame involved in the process, taxpayers need to be prepared to act quickly and should begin the planning process immediately. For instance, if tax reform as proposed is enacted during 2017, calendar year groups will be required to analyze and apply the complex mandatory deemed repatriation rules in order to compute their 2017 financial statement tax provisions. Many financial statement issuers will need to begin the process of computing relevant tax attributes and modeling computations as soon as possible in order to prepare. There may also be cases where planning opportunities exist with respect to the transition to the new system that could occur at the beginning of 2018. Finally, beyond the transition, if enacted, the various new prospective changes referenced above will inevitably require more in-depth analysis over time and potential changes to supply chain, entity organization, and financing structures.

Strategy for International Tax Reform Planning

We suggest U.S.-based MNCs take the following steps to prepare for a potential shift in the overall tax system:

1. Identify and Evaluate Attributes

As mentioned above, the proposed tax law changes include a mandatory deemed repatriation tax. The immediate taxation is proposed at different rates for earnings held in illiquid assets versus earnings held in cash or cash equivalents with the option to pay the tax liability over several years. In order to evaluate the impact of this mandatory repatriation, taxpayers will need to have up-to-date computations of various attributes, such as accumulated E&P, net operating losses (NOLs), unutilized foreign tax credit carryovers, overall foreign losses (OFLs), overall domestic losses (ODLs), previously taxed E&P (PTI), unrealized foreign currency gain/loss, and foreign tax pools of certain foreign subsidiaries. Thus, if taxpayers have not already established or updated E&P analyses for their foreign subsidiaries, they are advised to begin this process as soon as possible.

Andersen Tax can assist with computation of tax attributes that might not have been updated for a number of years or were never computed. For instance, if a corporation has never claimed an FTC in the past, but has foreign subsidiaries with deferred earnings, the taxpayer may have never computed their OFL, E&P, foreign tax pools, basis, or other attributes, all of which might be critical in computing the effect of the proposed mandatory deemed repatriation.

2. Dynamic Modeling to Support Analysis

The details included in the proposals for the mandatory deemed repatriation tax are complex. Once the basic attributes are determined, these complex rules must be applied in order to evaluate the taxpayer's position. Therefore, in order to develop a strategy to plan for tax reform, taxpayers must carefully analyze the proposed rules and model the effects of mandatory deemed repatriation. This modeling should be dynamic in order to accommodate variables in the computations or elections that can affect relevant attributes, as well as to be responsive to potential amendments and other prospective information about tax reform.

Andersen Tax can assist clients with establishing baseline and dynamic models to compute the effects of proposed mandatory deemed repatriation and support further analysis and planning in connection with an international tax planning strategy. Such a model should be established and updated as attributes are computed and the details of proposed tax reform evolve.

3. Attribute Planning

Once the status of attributes has been identified and a dynamic model has been constructed for the baseline mandatory deemed repatriation, more proactive alternatives can be assessed. For instance, with E&P calculations established, taxpayers may find that planning opportunities exist to increase or decrease accumulated E&P through either automatic or advance consent accounting method changes. This may result from finding that foreign subsidiaries have been using impermissible methods of accounting for U.S. federal tax purposes. Tax accounting for some items may also be elective depending on the circumstances. Examples of foreign subsidiary tax accounting items that may provide accounting method adoption or change opportunities include self-insured medical claims, UNICAP, software costs, R&D expenditures, tangible property costs, bad debts, inventory valuation, prepaid expenses, advance payments and various other items. Some taxpayers may find that reducing E&P through accounting method changes that accelerate deductions or defer revenue recognition provide a beneficial result. Opportunities may also exist to proactively change other attributes depending on the outcome of initial analysis. For example, taxpayers who have previously elected to deduct foreign taxes rather than claim a foreign tax credit may be able to increase available foreign tax credit carryovers by filing amended returns to claim the foreign tax credit in lieu of the deduction for foreign taxes.

Andersen Tax can assist with identifying these planning opportunities and in taking necessary actions, such as analyzing accounting method alternatives for E&P computation, preparation and filing of accounting method change applications, amended tax returns and other actions.

4. Prospective Planning

After the transition to the proposed exemption system and mandatory deemed repatriation have been addressed, the next step is to consider the effects of the various other proposed U.S. federal international tax law changes on the MNC's financing structure and supply chain. Once the effect of the proposed tax law changes have been evaluated via attribute analysis and modeling, many taxpayers may consider alternatives to optimize their group structures and transaction flows. As always, any contemplated internal restructuring transactions must be grounded upon strategic business concerns such as supply chain impacts and local tax and legal implications that typically must be approached on a more comprehensive basis.

Andersen Tax can assist clients with evaluating the tax effects of their global group structures in light of changes to the tax laws and develop continuing strategies to optimize entity structures, supply chain transaction flows, financing, and more.

The Takeaway

In recent years, the pace of change for international tax laws around the world has increased dramatically. A few examples are the Organisation for Economic Co-operation and Development (OECD) studies on base erosion and profit shifting (BEPS) and corresponding responses by taxing authorities in local countries; European Commission directives; uncertainty around Brexit, and various other constantly changing tax regimes. These recent developments mean that many taxpayers are already evaluating changes to their group structures. The prospect of U.S. tax reform will present additional facets to this process. International tax specialists at Andersen Tax are prepared to assist clients with establishing and executing a strategy to address this constantly changing cross-border tax landscape.

For further information please contact your Andersen Tax advisor.

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