



Wolters Kluwer



# GLOBAL TAX WEEKLY

## a closer look

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**SUBJECTS** TRANSFER PRICING INTELLECTUAL PROPERTY VAT, GST AND SALES TAX CORPORATE TAXATION INDIVIDUAL TAXATION REAL ESTATE AND PROPERTY TAXES INTERNATIONAL FISCAL GOVERNANCE BUDGETS COMPLIANCE OFFSHORE

**SECTORS** MANUFACTURING RETAIL/WHOLESALE INSURANCE BANKS/FINANCIAL INSTITUTIONS RESTAURANTS/FOOD SERVICE CONSTRUCTION AEROSPACE ENERGY AUTOMOTIVE MINING AND MINERALS ENTERTAINMENT AND MEDIA OIL AND GAS

**COUNTRIES AND REGIONS** EUROPE AUSTRIA BELGIUM BULGARIA CYPRUS CZECH REPUBLIC DENMARK ESTONIA FINLAND FRANCE GERMANY GREECE HUNGARY IRELAND ITALY LATVIA LITHUANIA LUXEMBOURG MALTA NETHERLANDS POLAND PORTUGAL ROMANIA SLOVAKIA SLOVENIA SPAIN SWEDEN SWITZERLAND UNITED KINGDOM EMERGING MARKETS ARGENTINA BRAZIL CHILE CHINA INDIA ISRAEL MEXICO RUSSIA SOUTH AFRICA SOUTH KOREA TAIWAN VIETNAM CENTRAL AND EASTERN EUROPE ARMENIA AZERBAIJAN BOSNIA CROATIA FAROE ISLANDS GEORGIA KAZAKHSTAN MONTENEGRO NORWAY SERBIA TURKEY UKRAINE UZBEKISTAN ASIA-PAC AUSTRALIA BANGLADESH BRUNEI HONG KONG INDONESIA JAPAN MALAYSIA NEW ZEALAND PAKISTAN PHILIPPINES SINGAPORE THAILAND AMERICAS BOLIVIA CANADA COLOMBIA COSTA RICA ECUADOR EL SALVADOR GUATEMALA PANAMA PERU PUERTO RICO URUGUAY UNITED STATES VENEZUELA MIDDLE EAST ALGERIA BAHRAIN BOTSWANA DUBAI EGYPT ETHIOPIA EQUATORIAL GUINEA IRAQ KUWAIT MOROCCO NIGERIA OMAN QATAR SAUDI ARABIA TUNISIA LOW-TAX JURISDICTIONS ANDORRA ARUBA BAHAMAS BARBADOS BELIZE BERMUDA BRITISH VIRGIN ISLANDS CAYMAN ISLANDS COOK ISLANDS CURACAO GIBRALTAR GUERNSEY ISLE OF MAN JERSEY LABUAN LIECHTENSTEIN MAURITIUS MONACO TURKS AND CAICOS ISLANDS VANUATU

## What's That Thumping? The Repatriation Boogeyman Is Back!

by Ian Boccaccio, Principal and Practice Leader, Michael Minihan, Principal, Ryan



The February 2017 iteration of this article stated the premise that the Repatriation Boogeyman was coming;<sup>1</sup> he was a demon to keep you awake at night, worrying that your under-loved Earnings and Profits (E&P) and Tax Pools were in need of immediate attention. Did you get that work done? Did you get up the next morning and start calculating?

Whether you performed or upgraded pool calculations in the last few months, it is imperative to not fall into the trap of thinking that your calculations are "good enough." That thumping you hear? It is the signal of impending legislative change, which will require you to get past "good enough," and get into the realms of "minimized," "supportable," and even "perfect," when describing E&P attributes. In addition, it is important to expand the thought process around other international attributes, and tackle any open opportunities with Foreign Tax Credits as soon as possible.

Legislative change felt imminent in February, with several thought leadership pieces widely disseminated by both the Trump Administration and the Republican controlled House of Representatives. With Republican control of Congress and the White House, it seemed, fleetingly, that anything was possible!

And then ... health care repeal failed; one of the major platforms of Republican sweeps last November had met a humiliating public demise. It leaves us to ponder whether tax reform is now *more* or *less* likely, but we would argue that it is now *more* likely.

Considered in the context of campaign messages, the repeal of health care was *not* the desire of a large contingent of the Washington electorate. The same cannot be said for tax reform, as most politicians campaigning for Federal office during the years 2014–2016 (including Hillary

Clinton) included tax reform among their goals. For this reason alone, tax reform stands a better chance for success than health care repeal. More fundamentally though, Washington's Republican majority needs a win – not wants, *needs*. Another defeat of a major platform initiative would be politically devastating. For these reasons, we believe that a tax reform bill is *more* likely now than ever.

With the release of the GOP Framework (aka, the "Unified Framework for Fixing Our Broken Tax Code"), we have a new piece of thought leadership to guide the tax reform debate. Released on September 27, 2017, the GOP Framework presents broad guidelines for the tax writing committees of both the House and the Senate to follow in crafting reform legislation. Unburdened by details, the GOP Framework includes the following key components for international tax reform:

- Migration to a territorial tax system from the current worldwide system;
- Deemed repatriation of all foreign earnings that accumulated under the old tax regime;
  - Two-tier rate structure for taxation of these accumulated earnings, with a lower tax applicable to illiquid asset holdings, and a higher tax applicable to liquid asset holdings;
  - Payment of the applicable tax liability to be spread over multiple years.

In February, our article focused heavily on repatriation implications. That was our Boogeyman, and those issues remain relevant. Despite a paucity of detail, it is increasingly clear that E&P will be a marker for the base against which a split level of taxation will be applied. For this reason, "good enough" will not be good enough. The timing of your timing items will be relevant. The legitimate acceleration of deductible timing items will potentially create permanent tax benefits, and missing opportunities to reduce E&P pools or fix errors could mean those opportunities are lost forever.

From our February article, but still relevant, here are some of the key things our clients are evaluating for their foreign E&P:

#### 1. Revenue:

- Is E&P following GAAP recognition rules?
- Is E&P consistent with revenue recognition per the US tax return?
- Are there opportunities for changes in method?
- What revenue can be legitimately deferred?
- Has transfer pricing between the US and the foreign entities been evaluated to ensure the optimal point in acceptable ranges is being utilized?

## 2. Expenses:

- Have we legitimately maximized our deductions?
- Are there opportunities for changes in method?
- Have we looked at cost segregation opportunities for non-US projects?
- Are there acceleration opportunities that create legitimate E&P reductions, by mitigating the economic ability of the foreign entity to pay a dividend?
- Has the impact of non-functional currency items been properly considered in E&P?

## 3. Local Taxes:

- Have we adequately addressed accrued *versus* paid issues with respect to local taxes?
- Are there tax prepayment opportunities that create valuable E&P reductions, albeit at the expense of foreign tax credits for "voluntarily paid" taxes?
- Have the tax pools been adequately calculated and documented?

## 4. Attributes:

- What is the status of any Section 959 Previously Taxed E&P?
- Have deficits in E&P been optimally utilized within the non-US structure?

## 5. Accuracy:

- Have all permanent differences been captured?
- Are adjustments properly added or subtracted? In other words, are the signs correct?
- Have long-term timing items properly reversed?

As the thumping that is pending tax reform gets louder, many of our clients are preparing for the potential financial disclosure requirements around foreign earnings that have heretofore been exempted from incremental US tax provision as a result of APB 23. Many, many companies are in the process of preparing estimates, and a number of them are assuming the 8.75 percent/3.5 percent split rates that were contained in the House Blueprint for Tax Reform from June 2016. These split rates would apply to tax accumulated non-US earnings held in cash at 8.75 percent, and accumulated non-US earnings held in illiquid assets at 3.5 percent.

Some companies are now taking steps to ensure that their non-US operations have the minimum level of liquidity to try and lock in the lower rate on the deemed repatriation of existing foreign earnings. Defeating the whole purpose of repatriation legislation, obviously, this is resulting in the further investment of accumulated earnings *outside* the United States.

Without admitting defeat, some companies know they will not make the finish line if legislation is enacted before year end, and a provision needs to be created for the deferred tax liability associated with a tax on accumulated earnings. They have far too many non-US subsidiaries with far too much history to possibly complete this work in time for a proper 10-K release. Instead, these companies are working together with their external auditors to define the parameters of the estimate of this tax, with the understanding that adjustment will be needed as E&P studies reach completion.

Beyond E&P, many of our clients are now kept awake at night with worries about Foreign Tax Credit (FTC) utilization. The shift from a worldwide tax system to a territorial tax system will potentially reduce the opportunity to generate sufficient foreign source income that allows the utilization of previously limited FTCs. The framework is distinctly unclear on what happens to existing FTC assets, but it is entirely possible that they could vaporize, and become immediately worthless, or they may linger, dying a slow and painful death until the statute of limitations on their utilization expires, and they fall off because of a lack of available foreign source income. It is also possible that the deemed repatriation will generate foreign source income and an opportunity to use these previously unused credits. We just don't know, but these are often assets with enough value that their vaporization could make a Tax Director's career flash before their eyes.

We are helping our clients through difficult conversations with CFO's about what will happen if the laws are drafted one way or another, and consequently, what the impact will be for earnings in the year of enactment. "What if" scenarios rule our days until more guidance comes from Washington. This is a valuable exercise, irrespective of what legislation may or may not become reality. Our clients find that "what if" modeling typically leads to value creation through expedited FTC utilization.

House Speaker Paul Ryan has indicated that a draft tax reform bill could be released by the House before the end of October. If that happens, we would still be weeks, if not months away from enacted reform. While that may sound like a lot of time, many taxpayers can say with certainty that it is not.

If you haven't started yet on getting your international attributes in order, we strongly, strongly recommend that you start *now*. And remember, if you think you have done a good enough job, you probably haven't. There is some time left, but not much; the Boogeyman is almost here!

#### ENDNOTE

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<sup>1</sup> See *Global Tax Weekly*, No. 224, February 23, 2017.