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02 OPINION: U.S. TAX REFORM

In late 2017, the U.S. enacted the Tax Cuts and Jobs Act ("TCJA"), bringing legislative substance to President Donald Trump's campaign promise of tax reform. In my role as a technical tax professional, I am responsible for understanding, interpreting and applying the new law. TCJA presented a significant challenge, given the lack of legislative debate behind the new provisions, one that required considerable guesswork until the Treasury Department and Internal Revenue Service issued guidance; in fairness, they too had to scramble to implement the new provisions created by Congress.

As an interested observer of the legislative process that produced the TCJA, and as a U.S. taxpayer who must contend with the new tax law, I feel a high-level perspective of TCJA is useful to understand what the new law sought to achieve, and where we are 18 months later. Unfortunately, TCJA has a number of provisions that conflict with its intended outcomes, in addition to technical flaws embedded in the rushed legislation which, if not corrected, will continue or exacerbate problems of U.S. multinational companies competing in the global marketplace.

TCJA's provisions have been thoroughly addressed elsewhere and are not the focus of this discussion. The new law, to no one's surprise, achieved passage only as the result of considerable political maneuvering, concessions and compromises. Certainly, it would not be an understatement to describe TCJA as less than a carefully crafted, technically sound tax masterpiece. Admittedly, some progress was made to address some of the issues impacting the international tax areas targeted by the President and his Administration. TCJA sought to "level the playing field" for U.S. businesses through the reduction of the U.S. corporate tax rate and to attract new foreign investments. At the same time TCJA provided some incentives for U.S. companies to retain manufacturing operations and intellectual property in the U.S. The law also sought the return of the considerable offshore profits earned by U.S. companies' foreign subsidiaries and not repatriated due to the high tax cost that would have been incurred. Additionally, progress of sorts was made towards the widely proclaimed goal of moving the U.S. to a territorial taxing system. However, 18 months after being signed into law, the proclaimed successes of the legislation have fallen short of achieving the identified goals, and the successes claimed in the media.

Territorial Tax System

TCJA was marketed to an eager U.S. audience as moving the U.S to a territorial tax system which typically would have taxed only U.S. sourced income. However, with the imposition of the Global Intangible Low-Taxed Income ("GILTI") provisions, the U.S tax base expanded to include the foreign profits of foreign corporations controlled by U.S. shareholders. No longer could U.S. parent corporations create foreign "blocker" companies to provide tax deferral and efficient redeployment of their offshore profits. Companies with existing "blocker" structures must consider if the continued expense of maintaining the foreign corporations is justified. Moreover, structuring foreign operations to address the potential GILTI liability has proven challenging and expensive for affected U.S. taxpayers.

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Participation Exemption

Under TCJA's new Participation Exemption provisions, dividends received by U.S. corporate shareholders appear to enjoy a 100% dividends received deduction. While appearing to move the U.S. closer to the rest of the world, the GILTI provisions potentially make this benefit illusory, as the shareholder may have already been subjected to tax on the foreign subsidiary's profits. Additionally, as a direct offset to the Participation Exemption, TCJA mandated the repatriation of previously untaxed, accumulated foreign profits. These deemed repatriations were taxed at a lower tax rate, which increased U.S. tax revenues (some over an eight-year deferral period). However, while these "phantom" distributions were required, the actual repatriation of cash to the U.S. shareholders was not. The anticipated return of the offshore profits and investment into the U.S. economy has not reached anticipated levels. Cash that was distributed has not produced the expected level of capital spending. Distributions received by individual shareholders will have suffered a high individual rate of U.S. tax. Although elective treatment was available to obtain lower-taxed corporate treatment on the deemed repatriation, this upfront savings was reduced by a second level of tax on the actual cash distribution. The complexity of the new provisions and the alternative tax implications required costly professional advice to understand their options.

Leveling the Playing Field

The new 21% corporate tax rate brought the U.S. into the mid-range of global corporate rates, and the Foreign Derived Intangible Income ("FDII") tax deduction provides U.S companies with an additional benefit in competing with foreign-based competitors. However, it should be noted that the FDII deduction faces potential challenge by the World Trade Organization ("WTO"), and although the incentives for re-positioning manufacturing may prove beneficial in some respects, the cost of altering supply chain structures and operations may not be practical or economically feasible in the short-term. Further, certain TCJA provisions actually work counter to the intended return of the manufacturing operations to the U.S., by providing GILTI offsets for offshore infrastructure.

Summary

TCJA has required changes in operations and tax structures of multinational companies. The consequence of dealing with a tax reform bill that was designed for political expediency is that the outcomes from that law are more political in nature than the result of sound tax policy. Whether TCJA's changes produce actual tax benefits to U.S. businesses and foreign investors has yet to be concluded. Previous U.S. tax reform efforts have often been characterized as "full of sound and fury, signifying nothing." TCJA certainly created considerable noise, and the required responses to its provisions have perhaps signified "something." With the prospect of more tax "reform" following the 2020 election cycle, U.S. multinationals will need to balance responses to the TCJA provisions while anticipating the need to react yet again following a second round of tax legislation.