



Wolters Kluwer



GLOBAL TAX WEEKLY

a closer look

ISSUE 224 | FEBRUARY 23, 2017

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

The Repatriation Boogeyman

by Michael Minihan
and Ian Boccaccio, Ryan

"What do you see when you're in the dark and the demons come?"



Infamous words, spoken by Clint Eastwood in the great classic "In the Line of Fire," resonate with me at times like this. A tsunami of change is coming. As it bears down on us, my fellow tax professionals, I ask: Have you done all that you can to prepare? What do you see when you're in the dark and the demons come?

In the international tax arena, the scariest demon that has been keeping us on our toes in this time of great tax uncertainty is foreign earnings. Foreign earnings, heretofore sheltered from true US tax analysis by the cloak of protection that is APB 23, are suddenly, seemingly, about to be extraordinarily relevant. Who can blame an overworked tax department for not putting resources into tax attributes that didn't matter for all of those years? That may have been the right move at the time, but now is the time to catch up; now is the time to slay that demon.

Tax reform feels as close to inevitable as it has ever been, and with a parched highway trust fund, yearning for the invigorating raindrops of a taxable repatriation, the time seems to be upon us to get our Earnings and Profits house in order. Two proposals currently warrant consideration: President Trump's 10 percent and the House Republican's blueprinted 8.75 percent / 3.5 percent. Under both proposals, taxpayers would be taxed on *all* of their previously untaxed foreign earnings, a sum currently estimated to be between two and three *trillion* dollars.

Trump's plan is more easily analyzed than the House Blueprint, if only because details are sparse. Guidance is limited to a 10 percent hypothetical tax rate on accumulated untaxed foreign earnings. In the absence of current guidance, we can look to the only previous instance of the tax "holiday" in recent history for possible details. The American Jobs Creation Act of 2004 is our model for this analysis. A "headline" tax rate of 5.25 percent was applied to applicable repatriations of

foreign earnings. In this case, the 5.25 percent represented the maximum incremental US tax rate to be applied to those earnings, after consideration of associated foreign tax credits.

The Trump proposal could work the same way, with just a quick substitution of 10 percent, for 5.25 percent. However, the fundamental difference would be in that this tax would be mandatory, applied to *all* untaxed foreign earnings, *vis-à-vis* the 2004 legislation, where the tax on repatriation was voluntary, and taxpayers made the decision as to the amount of earnings that they wished to repatriate. The concept of "all" *versus* "some" is important, and as we discuss later, should influence tax department behavior.

Conceptually similar to the Trump plan is the House Blueprint, in that taxpayers will be taxed on all untaxed foreign earnings. Divergence comes in two forms. First, the House Blueprint parallels foreign earnings with foreign cash. To the extent foreign cash is able to be repatriated, those earnings will carry a headline incremental US tax rate of 8.75 percent. To the extent the foreign entity does not have cash available for repatriation, those earnings will be taxed at a headline rate of 3.5 percent. In these cases, the second area of divergence applies: the payment plan. Where cash is not available for repatriation, the incremental US tax will be required to be paid over an eight-year period. The element of fairness in this plan, allowing a reduced rate of tax as well as deferral, seems unlikely to be part of any final legislation in its current form. It is an encouragement for taxpayers to actually make a non-US spend of any lingering cash balances to benefit from lower tax rates *and* further defer US tax.

If these proposals all seem favorable, why would a "tax holiday" keep you up at night? Why would any of this stir the demons?

Preparedness, it seems, is the ultimate demon. If you've ever calculated, and I mean *really* calculated, Earnings and Profits, you will know that it is difficult. If your process is US GAAP income plus or minus obvious accruals, it is not surprising that you're up at night. You should be. You have work to do!

Wherever we land with tax reform, there is one thing that is virtually certain: the *amount* of Earnings and Profits (E&P), as of the effective date of the new legislation, will be relevant. The timing, of your timing items, will be relevant. This will quite possibly be the last time any of us will need to compute foreign E&P. It behooves us to not just get it right but to get it right in the most minimized fashion we can. If we can legitimately accelerate USD10m of E&P deductions, it could be worth as much as USD1m under the Trump plan!

Let's slay some demons. Here are some of the key items 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 vs. 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?

There will be *a lot* more coming on this topic, including more of our commentary on new proposed legislation, once the latest refresh of ideas comes from Washington. In the meantime, fight the good fight. Get your E&P house in order. Slay those demons!