On 1 December 2015, both the US House Ways and Means Subcommittee on Tax Policy and the Senate Finance Committee held international tax hearings that covered the implications for US tax policy and US-based companies of the final Organisation for Economic Co-operation and Development (OECD) Base Erosion and Profit Shifting (BEPS) reports, concerns about European Commission state aid investigations, and whether any approaches short of tax reform would successfully curb inversions.

Witnesses at the Ways and Means Subcommittee on Tax Policy hearing were:

Panel I
- Robert B. Stack, Deputy Assistant Secretary for International Tax Affairs, US Department of the Treasury

Panel II
- Barbara Angus, Principal, Ernst & Young
- Gary Sprague, Counsel, The Software Coalition
- Catherine Schultz, Vice President for Tax Policy, National Foreign Trade Council
- Martin Sullivan, Chief Economist, Tax Notes
Chairman Charles Boustany opened the hearing of the newly named Tax Policy Subcommittee by stating that the BEPS project was motivated by a need by many countries for revenue, and the premise of ensuring multinational companies pay “their fair share of taxes,” noting that this “is a highly subjective standard set by the OECD that seems to unnecessarily target American companies.”

In testimony, Stack said the BEPS project “shined a spotlight on so-called stateless income, a phenomenon that is a byproduct of outdated tax rules,” and he stressed the Administration’s support for business tax reform, including lowering the corporate rate and reforming the US international tax rules. However, a number of Republicans on the panel argued the President was not taking enough of a leadership role on tax reform.

Regarding BEPS, Republicans on the subcommittee clashed with Stack over whether Treasury did enough to protect the interests of US companies during the BEPS negotiations. Stack asserted that the final reports on country-by-country reporting and transfer pricing included helpful changes for US companies that would not have been made if the United States had not participated in the BEPS process. He said he was encouraged that continued progress would be made in negotiations related to dispute resolution.

Boustany questioned Stack regarding the extent to which Treasury consulted with Congress during the development of the BEPS final reports. A similar sentiment was expressed at the later Finance Committee hearing by Chairman Orrin Hatch, who said Congress had “neither a seat at the negotiating table nor a meaningful opportunity to weigh in with the administration on the substance of the proposals.” Stack noted two items in particular that need congressional action, regarding interest deductibility and hybrid securities. He said the Administration was very careful to ensure that these items were not treated as minimum standards in the final reports because they could not be implemented in the United States without congressional approval. Also, OECD tax treaty changes will need to be ratified by the Senate, he said.

State aid

One area of agreement, however, came over the European Commission state aid investigations. Boustany said there is concern that the investigations represent another instance of a revenue grab by other countries and could expand beyond the initial cases. Stack expressed concern that foreign taxes would be imposed retroactively, and said it would be more appropriate for any new approaches to apply prospectively.

He said that Treasury has not analyzed whether the cases would give rise to creditable foreign taxes; if they do, US taxpayers could wind up “footing the bill” for the extra taxes paid abroad. Stack for the first time indicated that the United States has expressed its concerns to European Union (EU) representatives.

Boustany said members would explore options to respond to the potential retroactive imposition of taxes, and that the investigations would appear to be going after advanced pricing agreements already in existence. Representative Pat Tiberi said it is “outrageous” what the European Commission is doing to retroactively target multinational companies.

Stack also addressed the issue during his later appearance at the Finance Committee, saying the effort appears to be disproportionately targeting US companies to tax income that no member state had the right to tax under internationally accepted standards. Finance Committee Ranking Democrat Ron Wyden said he shared concerns with Stack that the state aid investigations could result in retroactive tax increases that could leave US taxpayers footing the bill through foreign tax credits. Stack said he believes the target of the effort is unrepatriated foreign earnings that US companies hold overseas.

Inversions

Ways and Means Subcommittee on Tax Policy Ranking Democrat Richard Neal’s opening statement focused on inversions, saying Congress must act immediately to stop the flow of transactions “until we can meaningfully fix our broken tax code.” Neal asked whether anything could be done now to address inversions. Stack mentioned the President’s FY 2016 Budget proposals to reduce Section 7874’s existing 80% test of shareholder continuity to a 50% test, and tighten interest stripping rules under Section 163(j). He said a foreign multinational does not need to do anything fancy to strip income out of the United States and that 163(j) currently permits far more interest stripping than the nation can probably afford “or that is based on sound tax policy.”

Like Stack, Sullivan argued for tough earnings stripping rules, saying “it is common practice for foreign-headquartered multinationals to shift income out of the United States by paying interest on related-party loans from foreign affiliates.”

However, Republicans reiterated their objections to targeted anti-inversion proposals. Representative Mike Kelly said, with regard to the Administration’s Section 7874 proposal, which is similar to Democratic legislation put forward in Congress, that a “bigger stick swung harder” will not be encourage corporations to stay in the United States.
BEPS

With regard to the BEPS project going forward, Stack said Treasury will be focused on implementation and monitoring of changes in other countries, particularly on how country-by-country (CbC) reporting is done and whether rules are applied in a fair and efficient manner. Several Republican members expressed concern about master file documentation under BEPS Action 13, along with country-by-country reporting. Stack noted that companies have a certain amount of discretion in deciding what to put in the master file. Angus said the master file is in narrative form, so precisely what information is provided and how it is described is in the hands of companies. They will need to approach it very carefully to be compliant and also provide themselves as much protection as possible because other countries do not protect information the way it is protected in the United States, she said. Schultz also mentioned compliance burdens, saying that “completing the CbC report will be cumbersome and expensive for taxpayers, particularly for taxpayers who have operations in many countries.”

In her testimony, Angus said that US-headquartered companies could be adversely affected by actions related to the BEPS final reports that are taken in foreign countries. Tax policy choices made by other nations should be considered in redesigning the system in the United States, which currently “is an outlier relative to the corporate tax systems of our major trading partners, both in terms of the corporate tax rate and the worldwide approach for taxing the foreign income of US-based companies,” she said.

During questioning, Angus expressed concern about the vagueness of some of the rules in the BEPS recommendations, singling out proposed changes to the permanent establishment rules, which set a threshold for when a company is considered to have a taxable presence in a country. She said the BEPS recommendation would move away from a relatively clear set of rules to much vaguer standards, so a company entering into business in a country will not know when it will cross the line and be considered to be like a domestic company and subject to the full rules and compliance procedures in that country.

Sprague said BEPS measures will increase the amount of foreign tax that US-based software companies with foreign operations must pay, and will increase their foreign compliance burdens.

Senate Finance Committee

In addition to Stack, witnesses at the Senate Finance Committee hearing, titled “International Tax: OECD BEPS & EU State Aid,” were:

► Dorothy B. Coleman, Vice President, Tax and Domestic Economic Policy, National Association of Manufacturers
► Michael Danilack, Principal, PricewaterhouseCoopers

In an opening statement, Chairman Hatch mentioned concerns lawmakers have heard from the business community that the BEPS project could be used to further undermine our nation’s competitiveness, unfairly subject US companies to greater tax liabilities abroad, and subject American companies to reporting requirements that could involve significant compliance costs. Wyden expressed concern about “aggressive actions undertaken by the European Commission targeting what it has described as unlawful ‘state aid’ but which look an awful lot like the tax planning strategies our broken tax code drives multinational firms to pursue.”

Coleman said manufacturers are concerned that the master file requirement under BEPS Action 13 would force them to disclose an unprecedented amount of proprietary information about their global operations to foreign governments. Danilack discussed the ramifications of “setting forth broad and ambiguous concepts without taking the time to work through the ambiguities, which is essential to proper implementation and administration of the concepts.”

Reiterating recent comments, Senator Rob Portman suggested a nexus requirement in the BEPS final report that activity related to intellectual property (IP) income be conducted within a country in order to qualify for a reduced tax rate could result in US jobs being moved overseas. Stack took issue with that assertion, saying he did not believe that the nexus requirement would lead to US research and ownership of IP moving overseas overnight.

Senator Mark Warner said he hoped that, as members look at a potential tax extenders package, some of the provisions that might be part of an international tax reform proposal would not be made permanent now because that would incentivize companies to keep more earnings offshore and make it more difficult to reform the system. “I know there is discussion of making some provisions permanent now that I think would dramatically benefit American companies, but benefit them...in keeping those revenues and profits offshore,” he said.
For additional information with respect to this alert, please contact the following:

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