Executive summary
The Trump Administration and congressional Republican leaders issued a “Unified Framework for Fixing our Broken Tax Code” (the Framework) on 27 September meant to serve as a legislative template for tax-writing committees. The legislative priorities listed in the Framework include international and business tax provisions of interest to United States multinational corporations, including a reduced 20% corporate tax rate, a shift to a territorial tax system, and anti-base erosion measures.

This Alert focuses on the Framework’s corporate and international provisions.

Detailed discussion

Background
The Framework represents five months’ worth of collaboration among the so-called “Big 6” and is consistent with the themes found in the Joint Statement on Tax Reform that the Big 6 released two months ago. These efforts have built on ideas and proposals developed over many years, particularly over the last six years, since former House Ways and Means Committee Chairman Dave Camp and his staff began work on comprehensive tax reform legislation.
Key business tax reform provisions

The Framework envisions a reduced 20% corporate tax rate, with a 25% rate for “small and family-owned businesses conducted as” partnerships and other pass-through entities. It also “aims to eliminate” the corporate Alternative Minimum Tax, and states that committees also may consider methods to reduce the double taxation of corporate earnings. Reducing the double taxation of corporate earnings appears to refer to Senate Finance Committee Chairman Orrin Hatch’s interest in wholly or partially integrating the corporate and shareholder levels of tax resulting in a single level of tax on corporate earnings.

Immediate expensing would be allowed “for the cost of new investments in depreciable assets other than structures made after 27 September 2017, for at least five years” and net interest expense deductions incurred by C corporations would be limited. There are both US and non-US legislative proposals and rules tackling interest expense limitations (e.g., EBITDA-based limitations) on which the tax-writing committees can draw.

The Framework also references special industry-specific tax regimes and indicates that it will update such rules to better reflect economic reality and reduce tax avoidance opportunities.

Shift to territorial tax system

The Framework would replace America’s “existing, outdated worldwide tax system” and allow a 100% exemption for dividends from foreign subsidiaries in which the US parent owns at least a 10% stake. The Framework states that this shift would end the incentive under the current tax system for US multinationals to keep foreign profits offshore. Notably, the Framework’s language references exempt “dividends” and not “distributions,” similar to the June 2016 House Republican tax reform “Blueprint.” This indicates that corporations must continue to track the earnings and profits of their foreign corporate subsidiaries and that foreign branch earnings and gains from the stock of foreign corporate subsidiaries will not receive the benefit of territoriality.

As part of the transition to the new system, accumulated foreign earnings currently held by US multinational companies would be treated as repatriated and subject to tax. The Framework does not define “accumulated earnings,” specify the effective date on the transition rule, or provide the tax rate to which such accumulated foreign earnings would be subject. It does specify, however, that a higher tax rate would apply to earnings held in liquid assets. The June 2016 Blueprint, which called for a similar approach, did include specific rates: 8.75% to the extent held in cash or cash equivalents and 3.5% to the extent held in other assets. The Framework states that it would spread out this liability “over several years”; the Blueprint specified an eight-year period.

Anti-base erosion rules

The Framework states that it plans to protect the US tax base and prevent companies from shifting profits to tax havens by taxing US multinational companies’ foreign profits “at a reduced rate and on a global basis.” This appears to contemplate a minimum tax provision, which is consistent with prior US legislative proposals, most relevantly and recently Ways and Means Committee Chairman Dave Camp’s Tax Reform Act of 2014 (Camp 2014). Camp 2014 would have expanded the subpart F regime to ensure that certain low-taxed income was currently taxed in the US. The Camp 2014 draft accomplished this by creating a new category of subpart F income for deemed intangible income (broadly, income in excess of a fixed return on tangible assets that is taxed at an effective rate below 15%). When coupled with a companion provision relating to foreign earnings earned by a US corporation, this ultimately resulted in a 15% tax rate applying to deemed foreign intangible income whether earned directly in the US or by a foreign subsidiary. Tax-writing committees can also look to how foreign countries are attacking profit shifting under Organisation for Economic Co-operation and Development principles.

The Framework adds that committees will seek to “level the playing field” between US and foreign multinational companies. This language was also used in the Joint Statement on Tax Reform issued in July and, while not providing any detail, broadly implicates inbound investors.

Implications

While there is limited detail on specific provisions, companies should not dismiss this Framework. The lack of specificity most likely reflects a desire to maintain flexibility for tax-writing committees and future negotiations rather than any lack of analysis. Given that tax-writing committees have been working on specific legislation at least since late July (based on the Joint Statement on Tax Reform) and the amount of prior relevant legislative proposals from which to draw, taxpayers should not be surprised if legislation is drafted quickly.
The inclusion of the transition tax in the Framework is very important for taxpayers because it reinforces that there will be an upfront cost for many taxpayers before receiving the benefits of territoriality. The Framework leaves many open questions on how the mechanics of the transition tax would apply, including effective dates and which earnings and profits would be relevant for purposes of applying the transition tax. Nonetheless, taxpayers should be refining their understanding of current tax attributes, modeling the federal and state impact of the transition tax, and taking immediate action to position themselves favorably for both the transition tax and territoriality.

The reduced corporate tax rate and 100% expensing for five years, combined with the shift to territoriality, are all positives for taxpayers. However, further restrictions on net interest expense and the likely elimination of many other deductions and credits are tough to judge at this point. More detail is needed with respect to the rules that the committees intend to incorporate in the tax reform package to level the playing field between US-parented corporations and foreign-parented corporations.

On base erosion, questions persist around the contemplated minimum tax, such as what is the appropriate tax base, what is the appropriate threshold foreign effective tax rate and how would that rate be calculated, and whether there would be some type of extra penalty for “round-tripping” goods or services emanating from the US.

The words “leveling the playing field” were referenced five times in the nine-page document. It is clear that the Trump Administration and Congressional leaders are determined to consider inbound provisions as part of this tax reform. This could refer to “thin capitalization” rules similar to ones proposed in Camp 2014, tightening the earnings stripping rules of Section 163(j), or something entirely different.

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**Endnote**

1. EBITDA: Earnings before interest, taxes, depreciation and amortization.
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