The United States has historically not been afraid to carve its own path with its international tax policies. However, many of the lawmakers currently leading the charge on tax reform now view some of those unique policies as hampering the competitiveness of U.S. firms.

The most prominent reform plans remain those proposed by President Trump and the House Republicans (for details, see the chart at the end of this report). Both have criticized current U.S. international tax rules, namely the comparatively high statutory corporate tax rate, the taxation of U.S. firms’ foreign-source income, and built-in incentives that encourage multinationals to “invert” and move their corporate residences abroad for U.S. tax purposes.

Both Trump and the House Republicans would adopt a territorial tax system that exempts active business income earned abroad, which would entail a transition from the current system of worldwide taxation. As part of that transition, the plans would impose a repatriation tax on earnings that U.S. firms currently hold overseas through arrangements that allow them to defer U.S. tax on the income (see sidebar). The House Republican plan says it would repeal most of Subpart F, “some of the most complex rules in the tax code . . . designed in the 1960s to police our worldwide system of international taxation,” although it would retain the rules on foreign personal holding company income, “which counter the potential for truly passive income to be shifted to low-tax jurisdictions.”

The more controversial aspects of the proposed reforms related to tax changes for imports and exports. The House Republican plan would have made the U.S. tax system “destination–based,” imposing border adjustments that effectively taxed imports, by denying deductions for foreign input costs, and exempted income from exports. The plan would have also moved the tax system “toward a cash–flow tax” by allowing full and immediate deductions for most expenditures. Thus, the House Republican proposal is often referred to as a destination–based cash–flow tax (DBCFT).

However, on July 27, the “Big Six,” a group of leading Republicans from the House, Senate, and Trump administration, released a joint statement on tax reform, in which they announced they would set aside the border–adjustment tax (BAT) proposal for the sake of advancing tax reform.
Review of Obama–Era Regulations

President Donald Trump signed an executive order April 21 requiring the Treasury Department to examine “all significant tax regulations” issued on or after January 1, 2016, and recommend whether they should be modified or repealed if they are too burdensome or complex. In response, Treasury released a report (Notice 2017–38) that identified eight sets of regulations that it may rescind or modify, including:

- final and temporary regulations (T.D. 9790) under Section 385 on the treatment of certain interests in corporations as stock or indebtedness;
- final regulations (T.D. 9794) under Section 987 on income and currency gain or loss with respect to a qualified business unit; and
- final regulations (T.D. 9803) under Section 367 on the treatment of transfers of property to foreign corporations.

The executive order requires Treasury to issue a final report in mid–September recommending the actions that should be taken with regard to the identified regulations.

Debt–equity documentation rules delayed. Many tax practitioners urged the government to act quickly on its decision regarding the Section 385 regulations so that companies would know whether to start developing the complex documentation processes required by the rules. On July 28, Treasury and the IRS announced, in Notice 2017–36, that the documentation requirements of those regulations would not take effect until 2019, rather than 2018, as had been specified in the regulations.

Lasting impact of the rules. Even if the Section 385 regulations get repealed, they have “already served to enhance the focus on those transactions and how you go about documenting those transactions,” said Sherif Assef, a principal with KPMG LLP in New York, on July 20. “People are looking at the broader issue of intercompany financing. It’s got attention, in court cases and otherwise, and that’s going to continue whether there’s 385 or not.”

Companies are concerned about documenting their related–party debt for several reasons, Assef said, including new transparency requirements from the OECD and possible new legislation in foreign countries. When Treasury pared down the scope of its Section 385 rules in the final version, issued in October 2016, companies didn’t necessarily scale back their compliance efforts, he said.

Stopping Inversions

“...We always thought the problem of inversions needed to be dealt with through some kind of tax reform that took the pressure off companies to go out of the United States in order to be taxed in some kind of way where they thought they could compete.”

— Robert B. Stack
Deloitte Tax LLP
Killing the Trillion-Dollar BAT

Trump administration officials and top congressional lawmakers said in a joint statement July 27 that the border-adjustment tax wouldn’t be part of negotiations on tax legislation. The announcement was a victory for retailers and other import-heavy industries and for groups backed by billionaire brothers Charles and David Koch, which had strenuously opposed the measure.

Republican leaders billed their decision to abandon a controversial plan to tax companies’ domestic sales and imports as an essential step toward unifying their efforts to overhaul the U.S. tax code—but its death adds new complications to an already intricate task.

Though the BAT had circled the drain for months, its last gasp on July 27 greatly increased the chances that any tax cuts Congress delivers will be shallower than President Donald Trump and other GOP leaders want, or shorter-lived, experts said. Without the proposal’s estimated $1 trillion in new revenue, a resulting bill may look more like the temporary tax cuts of 2001 than the once-in-a-generation overhaul of 1986 on which Trump and lawmakers have set their sights.

Replacing the revenue. The death of the BAT “means a lot,” said Douglas Holtz-Eakin, who leads the GOP-aligned research and advocacy group American Action Forum. “Obviously it was a big pay-for, so it puts pressure on the other pay-fors. There’s a lot at stake.”

From BAT to VAT?

One of the principal arguments the House Republicans advanced regarding their proposed border-adjustment tax is that it would offset the perceived advantage that value-added tax (VAT) rebates provide to foreign exporters. So is it possible that lawmakers might turn to a VAT in the hunt for revenue? Unlikely. A VAT is thought by many to be just as tough a sell politically as the BAT.

Taste of Europe. “If DBCFT proponents are claiming that the DBCFT should be approved by the WTO because it is essentially the same as a VAT, why not take the next step and simply adopt a traditional VAT? The answer may be that the Republicans simply never considered proposing a VAT in the first place. More likely, however, they decided that an outright switch to a VAT was too extreme for the American people. Conservatives, especially, are thought to consider a VAT to be politically unpalatable.” – Peter A. Glicklich et al. Glicklich is a partner at Davies Ward Phillips & Vineberg LLP and is a member of Bloomberg BNA’s U.S. International Advisory Board.

Something for everyone. Many Republicans remain opposed to a VAT because they fear it will lead to a much larger role for the government, but some entertain the idea in exchange for higher income tax cuts. Democrats who call the tax regressive should keep in mind that “government spending that could be financed by a VAT is super–progressive in its application,” said Edward Kleinbard, a business and law professor at the University of Southern California.
Safeguarding a Territorial Tax System

Limiting excess foreign returns and denying deductions for offshore earnings are among the options for guarding against base erosion if the U.S. shifts to a territorial system, said Tony Coughlan, tax counsel for the Senate Finance Committee, on June 7. He has seen several base erosion–related proposals as part of the mix for tax reform, he said. “There’s a lot of talk about base erosion. People get into it pretty quickly once they start talking about territorial,” he added.

U.S. corporations have long advocated shifting to a territorial system, which would exempt most or all foreign income from U.S. taxation. But critics claim it could result in erosion of the U.S. tax base unless measures are included to prevent income shifting—a much stickier subject, which often pits different industries against each other.

Coughlan said the proposals he has seen include stronger Subpart F rules, limits on excess returns in foreign jurisdictions, and “round-trip” rules that would tax income from intangible assets used for sales or services in the U.S. He said he has also heard suggestions that a territorial system, which exempts foreign income from U.S. taxation, should also disallow deductions for U.S. entities that contribute to that income.

Global Minimum Tax?

Members of Congress seeking a new glue to hold hopes of tax reform together are toying with one of the few bipartisan ideas left in Washington—a minimum tax on U.S. corporations to ensure that their earnings anywhere on the globe are taxed. Variations on the idea are in both the tax reform draft offered in 2014 by former Rep. Dave Camp (R–Mich.)—which Senate staffers picked up and explored through June and the first part of July—and in alternative proposals now circulating on Capitol Hill.

A shift to a territorial tax system, which exempts overseas income, could encourage profit-shifting from the United States; a global minimum tax would avoid that rush and make the policy more feasible. It would also avoid the perception that a deemed repatriation of currently deferred income, another key goal of the tax reform push, would be a repeat of the 2004 tax holiday, which the Joint Committee on Taxation said ultimately reduced revenue and may have encouraged companies to defer more income.

Supporters say it is a simpler concept than the border-adjustment tax provision in the House reform blueprint, though critics say the residency–based approach puts pressure on a U.S. company’s headquarters and could lead to inversions.

Non-starter. “Policymakers in Washington should be focused on making the American economy more competitive, rather than looking for new revenue streams from American businesses and their customers,” Americans for Prosperity Chief Government Affairs Officer Brent Gardner said. “Congress needs to get busy with their plan to un–rig the American economy and move on from unproductive policies, whether it be the BAT, VAT, or foreign minimum tax."
Repatriation Tax

The transition to a territorial system is likely to be accompanied by some sort of transition tax on deferred foreign earnings. There’s strong consensus among policy makers about this one-time tax on companies’ offshore earnings, which would allow them access to the stashed cash while also giving U.S. tax revenue a one-time boost to pay for other aspects of a new tax plan—or for infrastructure improvements.

However, targeting true offshore cash piles rather than genuine foreign investments may prove to be a complex problem and an administrative headache, as it requires an analysis of what constitutes cash as opposed to other investment.

Both the plans proposed by then-Rep. Dave Camp in 2014 and the House Republicans in 2016 both include two rates, one for cash and another for non-cash holdings. The plans would tax “cash or cash equivalents” at 8.75 percent and other investments at 3.5 percent.

It is unknown how much of currently deferred offshore earnings are held as cash. Accounting rules require companies to report how much is “permanently reinvested offshore” in order to book a tax savings in financial statements, but that amount refers to future plans and could include current cash investments. The dual rates would, in theory, target offshore cash stockpiles without hurting real brick-and-mortar investments. But determining the categories—and preventing companies from planning around them—could be a difficult issue.

The legislation would also likely need a rule to prevent taxpayers from quickly deploying cash to take advantage of the lower rate, or other gaming techniques.

Defining cash. “We don’t really have a very clear definition of cash and cash equivalent in the tax code,” said Peter Merrill, a principal with PricewaterhouseCoopers LLP’s Washington National Tax Services tax practice. “And very little in the way of regulations that provide guidance on that.”

A Future for FATCA?

As part of tax reform efforts, some conservative lawmakers are pushing to repeal the Foreign Account Tax Compliance Act, which requires overseas banks to disclose information to the IRS about U.S. citizen–owned accounts. Rep. Mark Meadows (R–N.C.) and Sen. Rand Paul (R–Ky.) have introduced legislation (H.R. 2054, S. 869) that would eliminate the law and have asked the Treasury Department to stop enforcing it.

No going back now. Other members of the OECD have now adopted reporting and disclosure requirements similar to FATCA, said Doug Andre, a partner at Ivins, Phillips & Barker, Chartered. This type of standard has been embraced by many foreign governments, he said. “If U.S. were to step away from that, I wonder how effective that would be,” Andre said.
## Tax Reform Watch

### Impact on International Tax

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Imports &amp; Exports</td>
<td>No provision.</td>
<td>Not specifically addressed.</td>
<td>Not specifically addressed.</td>
<td>Border adjustments exempting exports and taxing imports. Products, services and intangibles that are (a) exported from the United States will not be subject to U.S. tax regardless of where they are produced; and (b) sold into the United States will be subject to U.S. tax regardless of where they are produced.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Editor's Note: On July 27, 2017, a group of leading Republicans from the House, Senate, and Trump administration announced the following in a joint statement: “While we have debated the pro-growth benefits of border adjustability, we appreciate that there are many unknowns associated with it and have decided to set this policy aside in order to advance tax reform.”</td>
</tr>
<tr>
<td>Taxation of Foreign Income (Business Income)</td>
<td>Worldwide tax system.</td>
<td>Not specifically addressed.</td>
<td>Territorial tax system.</td>
<td>Territorial tax system; active business income (in particular products, services and intangibles sold outside the United States) will not be subject to U.S. tax.</td>
</tr>
<tr>
<td>Taxation of Foreign Income (Investment or Passive income)</td>
<td>Worldwide tax system</td>
<td>Not specifically addressed.</td>
<td>Territorial tax system.</td>
<td>100% exemption for dividends from foreign subsidiaries.</td>
</tr>
<tr>
<td>Anti-Deferral (Repatriation Tax)</td>
<td>No provision.</td>
<td>One time 10% tax on deemed repatriated profits held offshore.</td>
<td>One time tax on money held overseas. Rate not specifically addressed.</td>
<td>8.75% rate for accumulated foreign earnings held in cash or cash equivalents; 3.5% rate for other earnings. Liability paid over 8-year period.</td>
</tr>
<tr>
<td>Anti-Deferral (Ongoing Income of Foreign Subsidiaries)</td>
<td>Subpart F rules tax passive income (with some exceptions) and selectively tax components of active income.</td>
<td>Not specifically addressed.</td>
<td>Not specifically addressed.</td>
<td>Bulk of Subpart F rules repealed.</td>
</tr>
</tbody>
</table>

**Dig Deeper.** There’s of course much more to the story than what you see here. For a free trial of our complete tax and accounting coverage of international taxes, including detailed explanations of current law and real-time news on reform, go to [https://www.bna.com/btax32](https://www.bna.com/btax32).