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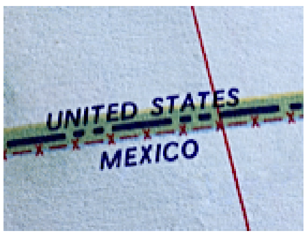
U.S. House Bill's Excise Tax May Hurt Multinationals, Consumers

BNA Snapshot

- Excise tax provision to bring ‘extraordinary opposition’ from companies
- Provision differs from border adjustment tax in multiple ways



By Sony Kassam

A House-proposed 20 percent excise tax on foreign imports from subsidiaries has been called “BAT-lite” and already faces opposition from U.S. multinationals and treaty partners.

They partly worry that international consensus on when a country has net basis taxing jurisdiction over a foreign corporation would be thrown out the window, according to a tax practitioner.

Section 4303 of House Republicans' tax reform bill (H.R. 1) would “force certain foreign corporations that have no connection to the United States other than selling or licensing or providing services to a U.S. affiliate to become (quasi-) net basis U.S. taxpayers with respect to the income generated from such transactions,” John Warner, a shareholder with Buchanan Ingersoll & Rooney PC, told Bloomberg Tax Nov. 3 via email.

Under the provision, the 20 percent tax would be applied on deductible payments made from a U.S. corporation to a foreign affiliate. Multinational groups “would have every incentive to elect U.S. trade or business/permanent establishment status so as to have the 20 percent corporate income tax applied to the relevant payments as reduced by some notional deduction amount,” Warner said.

The provision would affect any multinational group in which foreign affiliates provided more than $100 million annually in goods, services, intellectual property, and other items to U.S. corporations.

House Republicans introduced the Tax Cuts and Jobs Act partly to overhaul the international tax framework. Under the plan, the U.S. would move to what Republicans characterize as a territorial tax system, and implementation would include deemed repatriation taxes. The changes could affect how multinational companies operate, especially those with complex transfer pricing.

Americans for Prosperity, a group funded by billionaire brothers Charles and David Koch, signaled its opposition to the tax, arguing it was similar to the border adjustment tax Republicans abandoned in July.

“If not improved, this ‘BAT-lite’ provision has the potential to make everyday goods more expensive for millions of Americans,” AFP President Tim Phillips said in a Nov. 2 statement.

‘Extraordinary Opposition’

The 20 percent excise tax is going to generate extraordinary opposition, Henrietta Treyz, managing partner and director of economic policy research at Veda Partners LLC, told Bloomberg Tax. The technology, pharmaceutical, insurance and automotive sectors are preparing to join forces to fight the provisions, she said.

The Republicans and bill writers are “going to try and sell it as, ‘we're going after these mean horrible corporations that won't give American workers these jobs,’” said Barbara Mantegani, a tax practitioner and the founder of Mantegani Tax PLLC,. “But the reality is that for the most part, these decisions to make things offshore aren't driven by tax. Car companies make things offshore because they sell it offshore."

Further, the House description of the provision said the tax "would reaffirm the arm's length principle by reinforcing the significance of accurately pricing related-party transactions to avoid subjecting amounts that are in excess of arm's-length prices to U.S. taxation," which is misleading, according to David Chamberlain, assistant professor at California Polytechnic State University. The provision would subject the arm's-length profit to U.S. taxation as well, if an effectively connected income election is made, he said.

"While it may discourage companies from setting transfer prices for imports that are higher than the arm's length amount, it could encourage them to set transfer prices that are too low, thereby putting more pressure on the exporting countries' transfer pricing enforcement," Chamberlain told Bloomberg Tax in an email Nov. 3. "Like BAT, this is a 'beggar-thy-neighbor' effect."

Not the Same

Americans for Prosperity opposed the provision in a Nov. 2 statement, likening the excise tax to the border adjustment tax (BAT)—a levy on imports proposed in a 2015 GOP reform blueprint that Republicans abandoned after it threatened to undermine the overall bill.

"On one hand, it does reduce base erosion in the sense that it doesn't allow U.S. taxpayers to get big expense deductions for importing a bunch of stuff and then turning around and selling it," Mantegani said in an interview Nov. 3. "But on the other hand, I think it does set up a potential for injuring U.S. consumers or making things cost more."

Although the excise tax is similar to the border adjustment tax, Mantegani said the two aren't exactly the same.

The provision isn't "imposing taxes on every single import," she said. "It's only hitting payments between related U.S. companies and foreign affiliates."

The bill's excise tax differs from the border adjustment tax in two other ways. Unlike the BAT, no export subsidy element exists in the excise tax, Chamberlain. Further, if the effectively connected income election is made, it only applies to profits on exports to the U.S. rather than the full price. (For a road map of where to find key provisions in the tax bill, read Bloomberg Tax's analysis.)

The provision is "not nearly as big a revenue raiser as BAT," Chamberlain said. The border adjustment tax was expected to raise revenue by $1.1 trillion, while the bill's excise tax is expected to increase revenue by $154.5 billion over 2018 through 2027.

As a result, "it will be easier to scrap without hurting the deficit cost cap," Chamberlain said in a Nov. 3 email, emphasizing that smaller alternative revenue raisers would be needed.

'Muted Response'

Treyz said she is interpreting the provision to say a company would pay the 20 percent excise tax on top of what they are paying to the foreign government. As such, payments in Ireland, where the corporate rate is 12.5 percent, would be taxed at 32.5 percent.

"Everyone was caught off guard by this," Treyz said. "That's why you are seeing muted response so far. They don't yet have data to show how this would affect them, so they are going through that and figuring it out."

Multinational companies "aren't going to start thinking, 'oh I guess I'll build a new plant in Iowa,' Mantegani said, adding that the provision will essentially "end up being one of those things that U.S. consumers will have to deal with."

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