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Tax Policy

- What's Next After Tax Reform: Bloomberg Tax Roundtable
BNA Snapshot
- Practitioners share federal, state, international, transfer pricing insights
- Unintended consequences of the rapidly passed legislation are likely



By Sony Kassam, Colleen Murphy, and Laura Davison

Bloomberg Tax spoke with tax practitioners about their expectations for corporations, states, and foreign countries now that the U.S. has passed a tax cut package.

The new tax act (Pub. L. No. 115-97) made sweeping changes to the tax code, and has created as many opportunities for corporations to plan as it has questions about its effects. We asked Bloomberg Tax advisory board members to share their insights into what to expect during the next year—and beyond.

The practitioners were: Lisa M. Starczewski, a shareholder at Buchanan Ingersoll & Rooney PC in Philadelphia; William Alexander, of counsel at Skadden, Arps, Slate, Meagher & Flom LLP in Washington; John L. Harrington, a partner at Dentons in Washington; Richard S. Franklin, a member at Franklin Karibjanian & Law PLLC in Washington; and Joe Huddleston, executive director of the national indirect tax group at Ernst & Young LLP.

The reporters were Laura Davison, Colleen Murphy, and Sony Kassam.

Here's a wrap-up of the discussion. The questions and responses have been edited for length and clarity. For a complete transcript, see <http://src.bna.com/vG3>. A podcast is available at <http://src.bna.com/vKv>.

Federal Tax

Davison: How can we expect estate tax planning strategies to change between now and when the doubled exemption amount expires in 2026?

Franklin: The act leaves the entire estate, gift, and GST system in place, which made it easy for this Congress to make the change. But it also makes it easy for, you know, future legislation to unwind these changes or simply leave them as they currently are, and they will sunset in 2026. ...

So, this provision is great for the uber-wealthy. It's going to make it much more complicated planning-wise for families who are not able to immediately use the exclusion. And in some sense, if they can't do it it's a use it or lose it system. In 2026 it sunsets. So, for those families that can't use it prior to that time, you know, it will be in effect illusory and somewhat confusing because it makes the planning options more complicated.

Davison: What planning opportunities exist with the new law? What planning can happen now and what needs to wait until the IRS issues guidance?

Starczewski: I think everyone knows this, but I think it's very important just to think about it for a minute. We have this massive new tax act. ...

We have all been digesting, reading, thinking, analyzing. We've had two and a half weeks. We've had prior versions, but there are significant differences between those versions and what we ended up with in some instances. And so, the point is it's new. It's very new.

And secondly, it came to us in a relatively unique way—a fast, unique way. We didn't get the benefit of hearings and debates and learning with respect to the intent behind these provisions, the way in which they're intended to be applied. ...

Everyone wants to talk about choice of entity as, you know, a planning opportunity. We get calls from clients on choice of entity literally every day. I personally don't believe and I haven't talked to many people who believe that we're going to see this wholesale, you know, conversion to C corporations. ...

But there is no question that for people starting new businesses, choice of entity got a little bit more complicated, a little bit different than the items we focused on before. ...

So for me, you know, I think it's very important to understand that under the Tax Act there's no quick and easy answer to what should we change. You know, if this and this are true, do we do this? It's more like a matrix. There are a lot of factors.

Alexander: What I think they're mostly focused on right now is if they have a multinational business, how to structure that. Their worldwide business, is it configured the right way? And I think that's really where a lot of their attention is going to be. ...

In terms of the attractiveness of, you know, subchapter C, well, the rates are lower, but again, you know, there are a lot of things that have changed. ... People will be sitting down in front of a spreadsheet and saying, is this good for me? One of the things people have to be mindful of is the fact that it is a lot easier to get into subchapter C than to get out.

Starczewski: I think with respect to the pass-through deduction there's a lot of planning that can happen there. There are going to be ways I think to plan into the deduction and out of the wage and qualified property cap. Maybe there can be some restructuring, for instance, of independent contractor relationships into employment relationships. ... All of this planning is very fact- and circumstance-specific. ... We may see different conclusions than we've seen under current rules in specific circumstances. ... Real estate businesses are highly impacted, I think, across the board by a lot of these provisions. I think for that type of business the business interest limitation may be incredibly impactful. There is going to need to be analysis and modeling about whether a business should elect out of that limitation, because

that needs to be compared, that scenario, with the increased depreciation periods, the loss of bonus depreciation for qualified improvement property.

International Tax

Murphy: On the international side, we've talked a lot about planning today, and certainly one group that's been paying really close attention as this bill has developed and as it was passed is multinational companies. So, what should companies with cross-border operations consider as they're crafting a long-term tax strategy?

Harrington: I think the company needs to decide, you know, whether it needs to change its structure. And that could be fundamental changes, like where the parent company is located—whether it's the United States or somewhere else. It's also going to mean re-evaluating or revisiting more minor issues, such as whether an entity should remain disregarded or a controlled foreign corporation—a CFC—or whether it should convert. ...

Also, you have—you can have assets such as intellectual property that are held in, you know, in a particular holding company—or used in a certain way. ... Then you have to move into the more —call it “transactional issues,” in terms of looking at what you're doing now.

Is there a more favorable way to do it or is it—or what you're doing now is unfavorable; you need to re-visit it?

Murphy: European Union members have been pretty vocal about some concerns that they have, particularly the base erosion and anti-abuse tax provision, the BEAT. The EU has warned about a World Trade Organization challenge over some provisions. What do you think is the likelihood of such a case? What would the impact of that be?

Harrington: Whether to bring a WTO challenge is ultimately a political decision. ... A country could have a very strong case and think, for political reasons, they don't want to bring a dispute. They can also defer bringing a dispute. They can also have a relatively weak case and decide, for domestic consumption or something else, it's worth bringing the case. ...

Since the Ways and Means Committee, the Finance Committee have jurisdiction over trade as well as taxes, presumably they did take a close look at this. ... The track record of the United States on this isn't good. Each time, we seem to think we've found some way to create an incentive for exports, following the rules for consumption taxes without actually having a value-added tax, or sales tax.

But each time that European countries have brought that under GATT [General Agreement on Tariffs or Trade] or under WTO, the U.S. has lost that.

Murphy: Some countries, like China and Australia, have been concerned that the reforms in the U.S. could hurt their own competitiveness, and there's been talk about countries making their own reforms in response. Is there a risk some of that could clash with what the OECD is trying to do around base erosion and profit shifting?

Harrington: A lot of these international provisions really were generated, you know, through Congress, which wasn't really part of the BEPS process. ... I think, in that sort of sense, you know, there's not the same buy-in to BEPS that would have occurred. And also, BEPS, I think, is just reaching its natural

progression, where countries now are starting to implement BEPS, often taking unilateral actions. It's—the same forces that kind of led to BEPS are leading to the unilateral actions. So, I think, to a certain extent, this is just kind of returning to the norm.

State Tax

Davison: Is it safe to assume that many states won't follow the full expensing provision, just as they decoupled from bonus depreciation?

Huddleston: Somewhere close to 30 of the 50 states have substantially missed their revenue projections over the last couple of years. That's causing real problems. So, when you add to that what's happening at the federal level, the likelihood that states would not decouple is very small. ...

Largely, states where they would see a revenue reduction, they clearly are going to decouple, much as they did with bonus depreciation before, but at the expensing level and in depreciation. States will decouple if they have to. ...

I find it very unlikely that states, in their current economic situation, are going to ride any kind of a bus that results in reduction in revenue for them.

Davison: Does the idea of replacing income taxes with payroll taxes or creating a charitable group to fund public services sound like viable ways around the SALT [state and local tax] deduction limit?

Huddleston: Keep in mind, there's a real distinction here between individual citizens of the state—who are going to see a direct impact on themselves, particularly in those high tax states that we all know around the country—whether it's California, New York, Connecticut. The individual citizens are going to see an impact.

The state governments, on the other hand, may not see anything but a marginal impact as a result of that. So, there's the real question, as between the two—do the citizens and the state demand some kind of action? Because if you're talking about state revenues as a result of this cap, the alteration is going to be marginal.

Transfer Pricing

Kassam: Now that we have a lower corporate income tax rate of 21 percent, do you think U.S. companies will consider moving their operations and their intangibles back to the U.S.? How do you think the new foreign-derived income rules factor into that?

Harrington: There can be tax costs to moving operations. If you're in a foreign country, there can be an exit tax. ... When you pre-move something into the U.S., sort of like if you're a corporation, it's easy to get in, it's hard to get out. ... If you move intangible property in the U.S. you've got to be pretty sure that you're not going to move it back out. ...

If you do this to benefit from the foreign-derived intangible income, it also raises the question about how long ... you feel that those rules are going to continue to stay there. It's supposed to become less favorable over time. ... If there's changes to the act to raise revenue or for political reasons, this is the one that might be taken into account. So, even if it's available now ... you don't know how long it would be available, at least in its present form.

Kassam: Since there's so much of a focus on intangibles and where it's placed, how likely is it that U.S. companies will face more audits by foreign tax administrations?

Harrington: Companies are particularly concerned about it as country-by-country reporting comes online. ... Also, you have to be concerned about potential double or multiple taxation because the U.S. rules for outbound transfer intangible have been tightened as well. ...

Because it's intangible, you don't know where it's located, and that's created opportunities for companies, because they've often been able to tell a foreign government, "Our intangible properties are located here or somewhere else and are low taxed." ... The flip side of that is it's hard to prove it's not there, either.

Final Thoughts

Kassam: What aspects of the new tax law do you think have the most staying power? And what aspects do you think would need to be revised because of unintended consequences?

Starczewski: I do think that we are going to have consequences we didn't expect. Even just something as simple as business losses and the fact that they are so limited now out of pass-throughs.

Alexander: I wouldn't be surprised if six to 12 months into the next major recession we have loss carrybacks again. ... Until then it's going to be a little bit rough for struggling businesses. ... Loss carryback is cash in hand. It's not just a tax asset, and their competitors are going to have an extra, if they're profitable, an extra 14 cents on the dollar. So, their situation may be rough in the short-run, but if things get really rough for the country as a whole, I wouldn't be surprised to see that return.

Harrington: From a political standpoint, they have to take into account the fact this was passed with only Republican votes, and so if the Democrats take one or both houses then you would expect there to be changes over the types of things they've criticized in the bill. ...

From a practical standpoint, ... the more novel and the more complicated the provision, the more likely it's going to have unintended consequences and need to be tweaked. ... In the international area, I see the GILTI and the foreign-derived income—intangible income and the deemed repatriation provision as being areas that probably fall in that category.

Franklin: Historically the modern estate tax has been around for 101 years and it's been gone for one year. ...

And we look at first world countries. The United States, by some metrics, is the most unequal country for income and wealth inequality. So, just looking at the landscape, to me, says the gift, estate and GST tax system will endure. ... Repeal is alluring, but I think it's ephemeral and it's imprudent if your idea is you want to preserve family wealth to rely on the vagaries of our government about keeping or not keeping the federal estate tax. ...

Even the carryover basis there will be lots of games that people play with increasing the basis of assets, which not only will affect the federal system, but the states as well.

Huddleston: One thing that I believe will endure is that the relative significance of state and local taxes is increased, both for the individual and for the corporations, and the scattershot approach that the states have always used will continue to be a huge problem for both corporate and individual planning. Some of

the unintended consequences could well reach into the area of both corporate and individual migration.

Do businesses, do individuals stay in the states they're in? Or if there are dramatic shifts in the relative tax burden, do they begin to find other places to have their headquarters or to live?

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