SQUIRE PATTON BOGGS

International Tax Newsletter

United States – Tax Reform Update

Don Moorehead

On May 4, shortly after returning from its spring recess, Republicans in the House of Representatives finally garnered enough votes to adopt and send to the Senate legislation that would repeal the 2010 Affordable Care Act, widely known as Obamacare. That action paved the way for the House to turn to its other prime domestic priority – the enactment of legislation providing for comprehensive and permanent reform of the US federal tax system. House action on Obamacare was preceded by the Trump Administration's release, on April 26, of its long-awaited plan (the Trump Plan) for what Administration officials characterized as the "largest" tax cut in history.

For businesses, the Administration has proposed a 15% tax rate for corporations and pass-throughs, such as partnerships (but with the pass-through provisions structured in unspecified ways to limit their application to small and medium-sized businesses and prevent tax avoidance by wealthy individuals). In addition, the corporate tax would henceforth be applied on a territorial, rather than a worldwide, basis (a change from the President's campaign tax package) and a "very competitive" tax would be imposed on prior years' unrepatriated foreign earnings of US-controlled foreign subsidiaries. The President has subsequently said that the Administration envisioned a 10% rate for these deferrals, a rate somewhat higher than proposed by the House Republican "Blueprint" for tax reform.

For individuals, the current seven tax rate brackets for ordinary income would be reduced to four under the Trump Plan, with the top rate set at 35%; all itemized deductions (other than those for charitable contributions and mortgage interest) would be eliminated; the standard deduction would be doubled; and the alternative minimum tax and the estate tax repealed. Finally, the 3.8% tax on net investment income (enacted in 2010 as part of Obamacare) would be repealed, thus restoring the 20% maximum tax rate on capital gains and qualifying dividends. Elimination of this tax was included in the House-passed Obamacare repeal bill.

In many respects, the release of the Trump Plan has added to the fluidity and uncertainty surrounding the tax reform process.

First, virtually no specifics were provided with respect to any of the Trump proposals and Administration representatives indicated that design details not mentioned in the Trump Plan would be negotiated with Congress as the process moved forward.

In addition, the Trump Plan was silent on the one of the most controversial provisions in the House Republican tax reform Blueprint: structuring the corporate income tax so that it would be border adjustable (BAT) with exports exempt, and imports taxable, and no deductions for net interest expense. The President has subsequently indicated that BAT is not what he has in mind (as opposed, possibly, to an as yet undefined "reciprocal tax") and Administration officials have indicated that they would prefer to retain the deduction for interest expense. Nevertheless, and even though BAT appears to have little support from the Administration and has gained little traction in the Senate, the House Republican leadership is apparently continuing to consider modifications to BAT, intended to attract increased support as the Ways and Means Committee prepares to move forward with formal hearings on the Blueprint. The initial round of those hearings is now expected to occur on May 18 and 23.

Second, because the Trump Plan provides no revenue offsets to its proposed tax cuts (a key role played by BAT and the interest deduction allowance in the Blueprint), there is increased speculation in some quarters whether the process will ultimately lead to a temporary tax cut (as occurred in 2003), rather than permanent substantive reform of the Internal Revenue Code.

This possibility arises from the fact that the Congressional Republican leadership appears inclined to use the budget reconciliation process to avoid the need to attract support from Senate Democrats. This is made all the more likely given that the Senate Democratic leader (Senator Schumer of New York) has made his opposition to both the Trump Plan and the Blueprint clear. One of the budget reconciliation rules that would apply in such a case would effectively require the "sunset" of tax provisions that would increase the deficit in years beyond the 10-year budget horizon. Thus, if the BAT and interest deduction provisions of the Blueprint fall by the wayside, and are not replaced by other revenue increase provisions, the use of budget reconciliation process may result in temporary tax legislation. This is a prospect that some Republicans are anxious to avoid, if possible, but which others may nonetheless be prepared to accept if a revenue neutral package cannot be crafted and gain the necessary support.

Even the use of the budget reconciliation process to pass tax reform/tax cut measures will, of course, still require almost Republican unanimity, not only in the Senate (in particular), but also in the House (albeit, perhaps, to a lesser extent).

As of now, however, there is no certainty that the so-called "deficit hawks" would be willing to support tax legislation involving rate cuts of the magnitude contemplated by the Administration, or by the Blueprint, if that would result in a significant increase in the projected deficit. Moreover, it is not certain that these members will accept the Administration's argument that the tax cuts will create strong economic growth, and thus, under dynamic scoring methodologies, new tax revenues that will more than offset their cost. In addition, as illustrated by the differences over BAT and interest deductibility, it is clear that, as of now, there is no consensus among Congressional Republicans themselves, or between those Republicans and the Trump Administration, on the key components of a tax reform/tax cut package.

It is not currently entirely clear, therefore, how the Senate will proceed with respect to tax reform. Indeed, the Chair of the Senate Finance Committee (Senator Hatch of Utah) was quoted recently as saying, "It's too early; we are just getting into it." What is clear, however, is that BAT has attracted little support in the Senate and, further, Chairman Hatch is skeptical about the Blueprint's proposed elimination of the interest expense deduction.

As of now, it is possible that the Senate may pursue a more traditional approach to tax reform with the issue of integration of corporate and individual income taxes (so called "corporate integration") beginning to attract renewed attention in some quarters. The Senate, of course, will initially be preoccupied with the Obamacare repeal legislation and so its timing with respect to tax reform remains unclear.

On balance, we anticipate that both the Trump Administration and Congressional Republicans will continue to actively pursue tax reform with the objective of enacting legislation by year-end. The situation will remain fluid for some additional period of time, however, not only on substance, but also on the larger key question of whether that legislation will consist principally of a (perhaps temporary) tax cut or a permanent reform of the federal income tax system. While it remains possible that the House will, as in the case of the Obamacare repeal legislation, act first on tax reform with the Senate to follow thereafter, there has been discussion of an alternative approach in which the Administration and House and Senate Republicans would seek an agreement on a package of tax reforms and/or reductions that could be passed by both the House and the Senate somewhat contemporaneously.

Whatever path the Administration and Congressional Republicans take (possibly including some effort to attract a modest degree of support from Senate Democrats), the first step likely will be adoption of a budget resolution for the 2018 fiscal year with reconciliation instructions calling for the passage of tax reform legislation under the budget reconciliation rules. As ever, watch this space.

France – President Macron's Fiscal Proposals

Philippe De Saint-Bauzel and Stephanie Negre

The newly elected President of France is Emmanuel Macron, the youngest leader of the Republic since Napoleon. Much is expected, and perhaps hoped for, from President Macron. While his election reflects the populist revolt against the traditional political elite seen around the globe, it would appear that President Macron hopes to rejuvenate and reunite a divided France by reclaiming the center ground, protecting the nation's social traditions, reaffirming its commitment to a reformed Europe and, at the same time, liberating work and business. It is going to be a tricky balancing act.

In what follows below, we summarize the tax (and wider fiscal) proposals advanced by President Macron during his campaign.

Consistent with his broader aims, President Macron's policies are rooted in liberal economic and political tradition, but reinforced by fiscal discipline. He aims to invest in order to boost future economic growth, while at the same time, cut both taxes and public spending. His proposed reforms are aimed at restoring investor confidence in, and improving the economic attractiveness of, France at a particularly challenging time.

Economic Diagnosis: A New Growth Model Required

President Macron's view is that, in recent years, French economic growth has been slow and mass unemployment an enduring problem. Therefore, he has proposed policies that he hopes will transition France's economy toward a new "growth model" over the next five years. That new growth model is built around three broad aims:

- Develop and enhance the skills of each French person
- Build on innovation
- Promote more "resource-efficient" lifestyles

This gives President Macron's fiscal policies two discernable priorities:

- Fiscal responsibility – reducing taxes and public spending to create a more balanced national budget (aiming to keep the deficit below 3% of GDP, in line with EU requirements) to reduce the level of France's unsustainable debt
- Promoting both private and public investment in the country's future

These priorities are outlined in more detail below.

New Fiscal Policy: Transform, Invest and Spend Less

President Macron intends to lower taxes and contributions by up to €20 billion each year throughout his five-year term. He intends to distribute the cost of these cuts (and the "sustainable" reductions in public spending of €60 billion each year he has proposed) "fairly" between companies and households.

In order to reach his goals on tax, President Macron has proposed a number of specific policies, including:

- Promoting the competitiveness of French companies:
  - Reducing the corporate tax rate from 33.3% to 25% over the five-year term
  - Transforming the Competitiveness and Employment Tax Credit (CICE) for companies by immediately enhancing relief for all employers (and eliminating contributions in relation to any employees on the *Salaire minimum de croissance* (SMIC) – i.e., the French minimum wage
- Supporting the purchasing power of the French public:
  - Eliminating certain social security (sickness and unemployment insurance) contributions for all individuals
  - Providing SMIC employees with a "13th month" of salary (equal to additional income of up to €100 per month) – paid for by a combination of the elimination of social security contributions outlined above and increasing the "activity premium" by 50%
  - Exempting 80% of the French people from local housing taxes (in the eyes of President Macron, the most unfair of all French taxes) by 2020 – the resources of local authorities will, however, remain unchanged as the State will fully reimburse the resulting shortfall in their revenue receipts
- Encouraging investment and production over savings:
  - Simplifying the taxation of savings income by creating a single-rate (of around 30%) tax on all returns from (non-real estate) investment capital (i.e., interest, dividends and capital gains)
  - Replacing the *impôt de solidarité sur la fortune* (ISF) – the annual wealth tax in France – by limiting its scope to capital invested in real estate
  - Strengthening "green" taxes through, in particular, the gradual alignment of diesel and gasoline taxation and raising carbon tax

These tax measures are designed to support an "investment plan" (costing €50 billion over the five-year term) intended to "prepare for the future of France and the French" and initiate the new economic growth model President Macron seeks. The €50 billion is intended to be allocated among six broad areas:

- Training and skills – €15 billion
- Environmental and energy transition – €15 billion
- Health – €5 billion
- Agriculture – €5 billion
- Government modernization – €5 billion
- Local transport and community infrastructure – €5 billion

President Macron believes that the new growth model will be fiscally neutral with the expected economic growth over the five-year term and cuts to public spending paying for his investment plan and tax reductions.

Conclusion

Despite his political inexperience and the infancy of the party he leads, President Macron gradually emerged, almost from nowhere, to be the winner in the race to the Élysée Palace. Of course, it remains to be seen whether President Macron will (or will be able to) implement candidate Macron's fiscal plans in full. What is almost certain, however, is that President Macron's victory will herald a new direction for the future of France – albeit a slightly less radical and slightly more predictable one than that proposed by his opponent in the presidential election.

Germany – License Fees for Use of Trademark Versus Use of Corporate Name

Thomas Busching

On April 7, 2017, Germany's Federal Ministry of Finance provided guidelines distinguishing tax-deductible license fees for the use of trademarks from non-deductible license fees for the use of corporate names. The guidelines apply to transfer pricing situations (i.e., to license fees between related parties).

The need for the guidelines was sparked by a ruling of the Supreme Tax Court on January 21, 2016 in which it was held that license fees for the mere use of a corporate name would not be acceptable (i.e., non-deductible for tax purposes) under German transfer pricing regulations. In contrast, license fees for the use of trademarks, corporate logos, symbols and the like may be acceptable (and, thus, deductible for tax purposes).

On that basis, the guidelines attempt to clarify the tax treatment of license fees for corporate names and for trademarks in those frequent situations in which corporate name and trademark are identical. The guidelines define two principal requirements for tax deductibility:

- The corporate name or trademark needs to be legally protected (i.e., the owner must be able to prevent third parties from using the name or trademark)
- The licensee can reasonably expect a commercial benefit from using the name or trademark

The guidelines are, by and large, silent in terms of the amount of an acceptable license fee. While they do refer to another Supreme Tax Court ruling, dated July 29, 2009, which refers to a market-rate license fee between 1% and 5%, they note that the fee must be assessed on a case-by-case basis.

Two other important points, worthy of note, were made in the guidelines:

- Distribution entities may not be entitled to a relevant license fee deduction since intellectual property is deemed to be included in the respective price of goods
- No license fees may be deductible if they cause a long-term loss situation for the licensee

Spain – Application of EU Parent-Subsidiary Directive to Belgium Dividends

Jose E. Aguilar Shea

On March 8, 2017, the Court of Justice of the European Union (CJEU) issued judgment in case C-448/15 (*Belgische Staat v Wereldhave Belgium Comm. VA and Others*). This case involved the application of the dividend exemption provisions in the EU Parent-Subsidiary Directive (EU Directive 90/435) to dividends paid by a Belgium subsidiary entity to its two Dutch parent Fiscal Investment Institutions (FIIs), which are subject to corporate tax in the Netherlands at a zero rate (provided that they distribute all profits to their shareholders).

The CJEU concluded, in line with the Opinion of the Advocate General, that the Dutch FIIs would not fall within the scope, and therefore, not be able to claim the benefit of the EU Parent-Subsidiary Directive. As a result, the Belgium tax authorities were allowed to assess the 5% withholding tax applicable under the Belgium-Dutch income tax treaty.

Under Article 2 of the EU Parent-Subsidiary Directive, for the dividend exemption to apply, the entities must be "subject to corporate tax," without the possibility of an option of being exempt. In this regard, the defendant argued that the requirement for it being liable for tax does not necessitate the actual payment of the tax, as that liability could be subjective. Dismissing that argument, the CJEU took the position that Article 2 provides a positive criterion for qualifying (i.e., being subject to the tax in question) and a negative criterion (i.e., not being exempt from such tax and not having the possibility of an option to not pay such tax). On that basis, the CJEU concluded that being subject to a zero rate of tax does not satisfy the conditions; an actual liability to pay tax has to arise.

This decision has clear and wide practical importance for the "subject to tax" versus "actually liable to pay tax" discussion on the application of the EU Parent-Subsidiary Directive, and for FIIs subject to special tax schemes in particular.

United Kingdom – Tax Implications of Brexit

Jeremy Cape

On March 29, 2019, the UK will leave the EU, subject to the (remote possibility of the) government revoking Article 50 or (the marginally less remote possibility of) the other Member States agreeing an extension of the two-year period set out in the Lisbon Treaty. From a tax point of view, the immediate impact of Brexit on the UK tax system should be extremely limited.

Tax, and particularly direct tax, generally falls within the competency of the Member States. The UK is not restricted, at least as a matter of EU law, from choosing its rate of corporation tax. It is not required, again as a technical matter of EU law, to have corporation tax at all.

That is not to say that the EU has not had an influence on the design of the UK tax system. It has. Many Member States, including the UK, designed and maintained their tax regimes in the belief that EU law did not apply to tax, at least not in any meaningful sense. In the 1990s, it turned out that this was not true. A series of cases in the European Court of Justice (later the Court of Justice of the European Union) held that a number of tax laws were incompatible with the fundamental principles of EU law. This, as well as costing them considerable revenues, required Member States to make changes to their tax systems so as, broadly speaking, not to impede the four basic freedoms, particularly the free movement of capital. This required, for example, allowing cross-border group relief and reforming broadly drafted "controlled foreign company" rules.

Maybe surprisingly, it was the impact of these cases that, at least in part, started the move in the UK toward a more international, business-friendly tax regime, including exempting both domestic and foreign dividends from UK corporation tax. In most cases, we would not expect the UK to revert to its historic roots; although, it may, for example, act in certain specific areas. For example, the UK might wish to repeal its transfer pricing rules insofar as they apply to domestic transactions, which were required by the EU, but are neither desired by business or by government.

In the international sphere, there will be a small impact on the favorability of the UK as a holding company jurisdiction. Subject to agreement to the contrary, the UK will no longer benefit from the EU Parent-Subsidiary Directive or the EU Interest and Royalties Directive, meaning that in a few cases, dividends that have been paid to the UK from certain EU countries without withholding tax may now be subject to it. There may also be an impact on certain group holding structures to the extent the UK's exit from the EU affects the operation of the limitation of benefits article in a treaty with the US.

All of these issues are likely to be manageable, whether by the UK renegotiating some tax treaties or by groups restructuring as necessary.

One of the main requirements of membership in the EU is having a VAT system designed in accordance with EU Directive 2006/12/EC. The UK could abolish VAT on March 29, 2019, but it will not because VAT raises too much revenue. The UK may well, however, look to make changes to the VAT system that are not permitted by Directive 2006/12/EC (for example, there has been discussion recently as to whether VAT should be imposed on private school fees, which is currently prohibited under EU law), but is unlikely to be a priority for the UK government, faced with having to resolve other, more urgent Brexit-related challenges.

The more significant impact of Brexit on the UK's tax system may, therefore, be a tangential one. If the UK, freed of the perceived shackles of the EU, seeks to redefine itself and its global role, it may also wish to redefine its tax strategy. It has been mooted that the UK may turn itself into a tax haven (very unlikely), reform its tax system to resemble Singapore (still unlikely) or, at the other end of the spectrum, look to ensure that the wealthy pay more of their "fair share" of tax (less unlikely).

As recent attempts at tax reform in both the UK (e.g., increasing national insurance contributions for the self-employed) and the US (e.g., border adjustability) have demonstrated, tax reform, like healthcare, is complex. With the UK government having to spend a lot of political capital on other aspects of Brexit, tax reform may take a back seat.

United Kingdom – The UK Tax System's Approach to the Gig Economy

Patrick Ford

Tax systems can sometimes struggle to keep up with the times, and the changing world of work is a clear example. Statistics back up anecdotal evidence that self-employment is on the increase in the UK, and we now have a burgeoning "gig economy." A major difficulty when it comes to making and interpreting tax law in light of this development is that the circumstances of, and motives for, self-employment vary greatly.

Self-employment has typically been viewed in the UK as an entrepreneurial activity that generates business and jobs for others and should be encouraged for the benefit of the economy. This is evidenced by the tax system that favors self-employment over employment. For example, the self-employed pay a lower rate of employee's National Insurance contributions (NICs) and no employer's NICs are payable in respect of self-employment. The self-employed can also potentially benefit from more tax deductible expenses than employees and may choose to provide their services via their own company and pay themselves through dividends at a lower tax rate than salary.

Many freelancers, however, do not fall within this concept of an entrepreneur. Many essentially do the same work as an employee, but enjoy the flexibility of freelancing. Others can only find work as freelancers due to businesses preferring the lower costs (including the significant employer's NIC savings), administration and exposure under employment law involved in engaging self-employed individuals. And some individuals might choose self-employment due solely to the tax savings available when compared to traditional employment. The stark theoretical division between employed and self-employed, so important for UK tax purposes, is increasingly blurred in economic reality.

Understandably the UK government would like the employed and self-employed to be taxed in the same way whenever, in substance, they work in the same way. This is consistent with both promoting fairness in the tax system and raising more revenue. It is easier said than done, though, as it is very difficult to widen the employment tax net without causing pain and uncertainty for many of those who are genuinely self-employed.

The most recent example of this was the government's attempt to bring the rate of employee's NICs for the self-employed closer to that for the employed. This was framed by the press and some politicians as an attack on "white van man" (presumably representing a genuine entrepreneur who is not too rich) and the attempt was aborted.

Recent case law has, if anything, made the tax position even more difficult. Recent high-profile employment law cases have held that the relevant individuals were "workers," rather than genuinely self-employed, and so were entitled to employment law rights. UK tax law, however, does not recognize the intermediate category of "worker" that exists under employment law (i.e., a worker can only be employed or self-employed for tax purposes). The clearest conclusion that can be made from the case law is that the test of what constitutes self-employment, whether under tax law or employment law, is often (and increasingly) very difficult to determine with any certainty.

The result of the various moves to resolve these growing difficulties in the UK is a piecemeal framework of anti-avoidance tax legislation, which attempts to counter "disguised self-employment" but largely struggles to hit its target and often has unintended consequences.

For example, new legislation took effect from April 2017 to prevent the avoidance of employment tax through the use of personal service companies (i.e., where an individual, who would otherwise be an employee, offers their services via their own company). Legislation known as IR35 already exists in this regard, but the new rules are more effective by moving the tax exposure to the person paying the service company (who is more likely to take a cautious approach), rather than the service company itself. However, the new rules currently only apply to the public sector, which is resulting in some freelancers and employment agencies shunning the public sector or raising their costs for public sector work to compensate for the higher incidence of tax. Increasing public sector costs is a predictable, but unwelcome side effect of this type of piecemeal solution. While the new rules are likely to be extended to the private sector at some (as yet unidentified) point in the future, that may create its own set of unintended consequences as the market adapts.

In light of the changing nature of work and the challenges it is presenting, some advocate a more drastic approach. For example, there have been calls to introduce a new category of worker, or to have an assumption of employment in certain circumstances, or to apply a tax withholding at source to the self-employed. However, there are extensive practical difficulties with agreeing and implementing any of these more radical routes, particularly in the face of those who advocate the current tax advantages of self-employment. If a small increase in employee's NICs for the self-employed is not politically viable, it would take an enormous effort of political will to make more fundamental changes to the tax system that could adversely affect many self-employed workers.

The government commissioned an inquiry into working practices by the Work and Pensions Committee, which published its report on May 1, 2017. The inquiry focused primarily on situations where businesses dictated that their workforces must be self-employed and felt that they incorrectly promoted the idea that flexible working is contingent on self-employed status. It also recognized that, "current ways of categorizing workers are creaking under the weight of the changing economy."

It is worth noting that the inquiry had to be curtailed due to the forthcoming general election in the UK. It could be criticized for not considering any detail the difficulty of distinguishing what it considered to be "bogus" self-employment practices from genuine self-employment. The main specific tax recommendation was that, "the incoming government should set out a roadmap for equalizing the National Insurance contributions made by employees and the self-employed." As explained above, the existing government has already discovered that there is a large amount of resistance to precisely this type of change. While apparently logical in the context of the self-employed working practices on which the report focused, it would not recognize the desire of many to reward genuinely entrepreneurial activities through the tax system – and so we have come full circle and arrived back at the same point that we started out.

It is likely, at least until a more imaginative solution can be found, that we will continue to see a piecemeal approach to tax law in this area. This approach will, at times, struggle to keep up with practice in the gig economy and at other times, shape some of those practices. What is certain is that businesses and freelancers will need to keep a close and ongoing look at the tax consequences of how they operate.

Contacts

Don Moorhead
Partner, Washington
Tax Strategy & Benefits
T +1 202 457 5212
E donald.moorehead@squirepb.com

Philippe de Saint-Bauzel
Partner, Paris
Tax Strategy & Benefits
T +33 1 5383 7408
E philippe.desaint-bauzel@squirepb.com

Stéphanie Nègre
Associate, Paris
Tax Strategy & Benefits
T +33 1 5383 0458
E stephanie.negre@squirepb.com

Thomas Busching
Partner, Frankfurt
Tax Strategy & Benefits
T +49 69 1739 2445
E thomas.busching@squirepb.com

Jose E. Aguilar Shea
Senior Associate, Madrid
Tax Strategy & Benefits
T +34 91 520 0751
E jose.aguilarshea@squirepb.com

Jeremy Cape
Partner, London
Tax Strategy & Benefits
T +44 207 655 1575
E jeremy.cape@squirepb.com

Patrick Ford
Partner, Manchester
Tax Strategy and Benefits
T +44 161 830 5014
E patrick.ford@squirepb.com

Editor

Linda E.S. Pfatteicher
Partner, San Francisco
Tax Strategy & Benefits
T +1 415 954 0347
E linda.pfatteicher@squirepb.com

Deputy Editor

Robert O'Hare
Professional Support Lawyer
Tax Strategy & Benefits
T +44 207 655 1157
E robert.ohare@squirepb.com

26858/05/17