US

The Path to Tax Reform: Without a Blueprint, Where Are We Headed?

With Congress back in session following its August recess, one agenda item stands above the rest in terms of priority: tax reform.

After several failed attempts at repealing the Affordable Care Act earlier this year, and with few other major achievements nearly nine months into the 115th Congress, Republicans are in need of a win and hoping it might come in the form of reforming the nation's tax laws. Still, there remain many obstacles that could derail their quest for tax reform.

How Did We Get Here?

As we discussed more than a year ago, the House Republican tax reform "blueprint" served mostly as a conversation starter about tax reform. However, since its release, many of the House Republicans' proposals – the border adjustable tax (BAT), in particular – received pushback from a variety of industries and ultimately forced tax-writers to reassess their approach to tax reform.

Enter the "Big Six" (Speaker of the House, Paul Ryan (R-WI); House Ways and Means Committee Chairman, Kevin Brady (R-TX); Senate Majority Leader, Mitch McConnell (R-KY); Senate Finance Committee Chairman, Orrin Hatch (R-UT); Treasury Secretary, Steven Mnuchin; and National Economic Council Director, Gary Cohn). Having seen how a lack of consensus ultimately led to the GOP's inability to repeal and replace the Affordable Care Act, the Big Six have spent the last several months meeting together in an effort to agree upon key tax reform principles to guide tax-writers' efforts to enact tax reform legislation this year. After significant anticipation and speculation about this additional guidance, the Big Six, just prior to the August recess, released their joint statement on tax reform – a brief statement that addressed only a few of the high-level principles contained in the House GOP's original blueprint.

The Big Six have spent the last month and a half continuing to seek agreement and hash out key policy details. Having reportedly made significant progress, they are expected soon – potentially as early as next week – to release a detailed framework for tax reform that is intended to serve as a passing of the baton to the tax-writing committees to complete the task of tax reform. While this framework is largely a product of the Big Six, there is an active effort underway to get feedback – and ultimately buy-in – from tax-writers, who want to ensure that they are playing an active role in shaping tax reform. That said, how much guidance it will provide remains uncertain, as Chairman Hatch recently stated that the Finance Committee with not merely "rubber stamp" any framework.

What's Next?

While we do not expect any additional hearings in the House, Members are continuing the work behind the scenes this month by holding "listening sessions" to discuss individual, business and international tax policy issues. Moreover, in advance of the release of the framework by the Big Six, House Ways and Means Committee Republicans are expected to meet on September 24-25 to discuss the framework so that committee members are comfortable with the product and feel they have appropriate input into the process. Once the framework is set, we anticipate the Ways and Means Committee will move forward shortly thereafter in marking-up their version of tax reform legislation – a process likely to play out over the course of several weeks during mid-to-late October.

As for the Senate, with two hearings on tax reform (individual and corporate) under their belt, the Senate Finance Committee is expected to hold its third and final hearing on tax reform this Congress (like in early October), where it will focus on international tax reform issues. Once finished with hearings, the Finance Committee is also expected to move forward with drafting and marking-up its version of tax reform legislation.

While the White House generally plans to allow tax-writers to take the lead going forward, President Trump will likely attempt to leverage the power of the bully pulpit to try and help get tax reform across the finish line. In fact, over the next two months, the President plans to travel to more than a dozen states – many states where he won the Election and there is a Democratic Senator up for reelection – to make the sales pitch for tax reform and put pressure on potentially vulnerable Democrats to earnestly engage in the process. Though the President will clearly face an uphill battle in negotiating with Democrats, it appears that he is attempting to avoid a repeat of healthcare reform by building a buffer so as to be able to lose a few Republicans and still have sufficient votes to enact tax reform.

Can We Actually Get to Tax Reform?

It is clear that there is a palpable desire – indeed, a political imperative – for enacting tax reform in 2017. However, despite the groundwork that has been laid through hearings, legislative proposals, etc., there are nevertheless certain realties that will challenge even the most valiant efforts to overhaul the nation's Tax Code.

First and foremost is the need for a budget. While there continue to be calls for bipartisan tax reform on both sides, it is presently unlikely given the current politics in Washington DC. As such, the Senate will almost certainly need to use the budget reconciliation process to pass its tax bill with a simple majority. To do that, however, Congress must first pass a FY 2018 budget with reconciliation instructions for tax reform. While that may sound simple, both Chambers have thus far found the process to be challenging. In the Senate, though nothing has been finalized, it is rumored that Senators Bob Corker (R-TN) and Pat Toomey (R-PA) – both of whom sit on the Senate Budget Committee – have reached agreement on the size and scope of tax reform that they think will garner enough support to pass out of committee and to the Senate floor before month's end. In the House, the Freedom Caucus has thus far been hesitant to support any budget proposal without knowing more details about tax reform. Though many are confident that the House will ultimately get sufficient buy-in to pass a budget, the House budget will then need to be reconciled with the budget the Senate passes – which may add further difficulties to the mix and continue to slow the process.

From a sheer logistical perspective, the long-list of legislative items that Congress needs to address before year's end (i.e., funding the government and reauthorizing the Federal Aviation Administration, the National Flood Insurance Program and the Children's Health Insurance Program) is also problematic, as lawmakers will have limited time to consider comprehensive tax reform. Moreover, the recent deal to fund the government and extend certain programs through December 8 means that Congress will likely be forced to turn their attention to these matters during a period where tax reform should, in theory, be front and center in Washington DC.

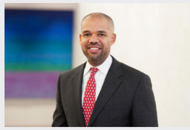
Finally, the inter- and intra-party politics also have the potential to play a key role in determining the success of tax reform efforts. Though Democrats writ large have little incentive to work with Republicans under the auspices of tax reform via reconciliation, certain Democratic lawmakers who might feel vulnerable heading into the 2018 Election and are up for reelection will have to make their own determination on how to participate in the tax reform debate. On the other side of the coin, some Republicans are growing concerned about the President's recent deals with Democrats and may be more willing to work with other Republicans that may share a different viewpoint (e.g., revenue neutral tax reform) on certain tax policies for the sake of getting a deal done without looking to Democrats for votes. Still, some Republican constituencies (i.e., the Freedom Caucus) may well be unmoved in their positions despite the threat of President Trump's willingness to negotiate across the aisle, potentially setting up an interesting fight within the Republican Party.

Conclusion

With the potential for the most significant reforms to the US Tax Code in 30 years on the horizon, congressional leadership and the Administration can be expected to pull out all the stops this year to ensure that tax reform is successful. Nevertheless, there remain serious doubts about the feasibility of enacting comprehensive tax reform, with some suggesting that the ultimate outcome could essentially be another round of Bush-era tax cuts. As the debate continues, now is a critical time for all those with an interest in tax reform to be actively engaged with tax-writers.

Note: Next week, following the release of the tax reform framework, our team will provide a thorough analysis of the tax policies it contains and the implications for businesses – both in the US and abroad.

Contacts



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Australia

Tax Changes for Foreign Investors in Australian Real Estate

Over the last few months, Australia has seen the release of its federal and state/territory budgets for 2017-18.

After recently claiming the title of "the economy with the longest sustained economic growth of 25 years" and a number of states reporting sizeable surpluses, there is much room for optimism. However, faced with increasing national debt and a booming property market, the federal and a number of state budgets have seen an increase in taxes that will impact foreign buyers of primarily residential property.

The federal government has made significant changes to foreign resident capital gains tax withholding arrangements and several states have increased surcharges on land transfer duties and annual land taxes for foreign property buyers and owners. These surcharges will apply to foreign individuals and foreign-controlled entities, including entities that are based in Australia and, in some cases, having foreign ownership of as little as 20%.

Residential Property in Australia

Residential land in Australia includes land with at least one dwelling, or vacant land that is zoned for residential use. However, each state defines residential property differently and specific types of property may be categorized as residential property depending on the state. For example, short-term accommodations such as hotels, motels, boarding houses and student accommodation and properties such as retirement villages may or may not be classified as residential property depending on the state.

Federal Changes for Foreign Investors

The Australian federal government has announced substantial changes to the arrangements for collection of capital gains tax in relation to foreign property vendors.

Last financial year, arrangements were put in place to require purchasers to withhold 10% of the gross proceeds on sale of real estate with a value over AU$2 million as a prepayment of the vendor's potential capital gains tax. The federal government has announced it will decrease this withholding threshold from AU$2 million to AU$750,000 and has increased the withholding rate from 10% to 12.5%. These changes will apply to all disposals from July 1, 2017.

Furthermore, a 50% cap on foreign ownership in new property developments has been implemented, as has a new levy of at least AU$5,000 on foreign owners who fail to occupy or lease their property for at least six months per year. Foreign and temporary tax residents will no longer be exempt from a capital gains tax when selling their main residence in Australia, although existing properties held prior to this date will be grandfathered until June 30, 2019.

Foreign citizens or foreign-controlled entities buying real estate in Australia, with the exception of citizens of New Zealand and Australian permanent residents, may need to apply for approval from the Foreign Investment Review Board. There is a fee for each application, which varies depending on the price of the land being acquired starting at a fee of AU$5,500 for land valued at less than AU$1 million.

State-Based Surcharges for Foreign Investors

New South Wales

As a result of strong land transfer duty revenue and the state government's continued privatization of services, New South Wales (NSW) is basking in a surplus of AU$4.5 billion for the 2015-16 financial year, with average surpluses of AU$2 billion expected over the next four years.

Despite this, the state is facing a housing affordability crisis with record high median house prices in the state capital, Sydney. This has led to the NSW government announcing an increase in surcharges for foreign property buyers.

From July 1, 2017, the foreign residential land transfer duty surcharge will be increased from 4% to 8%. Realizing the disadvantage such increases place on foreign developers, the state government has promised Australian-based foreign-owned developers a refund on the surcharges if their developed properties are sold within five years. This has been backdated so that refunds of the surcharge are available for any surcharge paid from June 21, 2016.

In addition, the land tax surcharge for foreign owners of residential land will increase from 0.75% to 2% and foreign owners will not be entitled to any tax-free thresholds or the principal residence exemption.

South Australia

A 4% conveyance duty surcharge will apply to residential property buyers from January 1, 2018. However, this surcharge will not apply to commercial or industrial property.

Furthermore, as of July 1, 2017, stamp duty on non-residential, non-primary production, property transfers has been halved and it is proposed that this duty will be abolished from July 1, 2018.

Queensland

The 2017-18 Queensland state budget has introduced a 1.5% annual land tax surcharge on absentee land tax payers on land valued at AU$350,000 or more.

Despite the new surcharge, Queensland remains the lowest taxing state for foreign property buyers and owners on the eastern seaboard, with the residential land transfer duty surcharge for foreign property purchasers remaining at 3%.

Other States and Territories

The surcharge on residential land transfer duty for foreign buyers in Victoria remains unchanged at 7%. The surcharge on annual land tax for foreign buyers is also unchanged (at 1.5%) but this is levied on all land in Victoria (not just residential property).

The Australian Capital Territory, Tasmania, Western Australia and the Northern Territory have not introduced surcharges for foreign property developers in their 2017-18 budgets.

Conclusion

Despite the increase in taxation at federal and state levels, Australia still remains one of the most open regimes in the Asia Pacific region with record levels of economic growth. The new budgets aim to help Australia's economy continue to grow and maintain Australia as a competitive market for international investment.

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European Union

New Directive Proposes Increase in Transparency Requirements for Tax Intermediaries

On June 21, 2017, the European Commission (EC) published a new legislative proposal for a directive on the transparency of tax intermediaries.

The proposal has a very wide scope, covering all types of direct taxes (including, for example, income, corporate, capital gains and inheritance taxes).

The definition of "tax intermediary" is also very broad. Any company or professional that designs or promotes a tax planning arrangement having a cross-border element and containing any of the arrangements set out in the annex of the proposed directive, will be covered. This includes lawyers, accountants, tax and financial advisors, banks and consultants.

Should the proposed directive be enacted, tax intermediaries will be obliged to disclose details of any relevant tax arrangements they design, promote or propose (*before* they are implemented) to respective EU member states' national authorities, who will keep the data in a secure central directory. The fiscal authorities of all other EU member states will then be able to access that information under tax information exchange arrangements (but the public will be prohibited from gaining access to the data).

To be subject to the proposed new rules, a tax intermediary will have to satisfy at least one of the following conditions – it must be either:

- Incorporated in and/or governed by the laws of an EU member state
- Resident for tax purposes in an EU member state
- Registered with a professional association related to legal, taxation or consultancy services in at least one EU member state
- Based in at least one EU member state from where the person exercises their profession or provides legal, taxation or consultancy services

The proposed rules are intended to work as an early warning system that will allow EU member states' national authorities to improve the speed and accuracy of their risk assessment and make timely and informed decisions on how to protect their tax revenues.

It is important to note that the mandatory disclosure of tax arrangements would inform tax authorities about arrangements with a dimension beyond a single jurisdiction. Failure to submit the relevant information to national authorities, would lead to sanctions for tax intermediaries that will be imposed at each EU member state discretion.

The legislative proposal will be examined, and is subject to revision, by EU member states representatives. Examination of the proposal is expected to resume before the end of September 2017.

Although, as a measure relating to tax, the legislative proposal will require the unanimous support of all EU member states to be adopted, given the growing acceptance of, and widespread support for, tax transparency and information exchange between fiscal authorities over the last few years, it is highly likely the proposal will be adopted. While we do not anticipate having any agreement on the proposed directive by the end of the 2017, we expect significant progress to be made for a possible adoption in early 2018.

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UK

Tax Reforms – On Hold But Already in Force?

"Democracy is the worst form of government, except for all the others" may or may not have been coined by Winston Churchill but, as seen in the US, it can make tax reform difficult to implement.

The UK is also experiencing the potentially adverse impact of the democratic process on planned tax reforms.

During the course of 2016, the UK government consulted on major changes to the corporate tax rules on interest deductibility and use of carried forward losses (NOLs). The proposed rules on interest were designed to fulfil the UK's commitment to implement the OECD BEPS recommendations. Following Chancellor Philip Hammond's Budget speech in March 2017, the relevant provisions were included in the Finance Bill (Bill).

In the normal course, the Bill would have been debated in Parliament during the spring/early summer and would have become law during July. The Bill provided for an April 1, 2017 commencement date for the new rules on interest deductibility and losses. However, the regular timetable was thrown off course by Prime Minister May's announcement (on April 18) to call a general election on June 8.

A Finance Act had to be passed by Parliament before it was dissolved at the end of April, not least to allow for the continued collection of income tax (which, unlike all other UK taxes, has to be renewed each year). As there would be no time for any debate, the Bill was pruned of any elements that did not command immediate cross party support. This included the provisions on interest deductibility and losses (and several other key parts of the Bill).

The Conservatives, then confident of election victory, pledged to reintroduce the provisions with the same April 1, start date. The government, however, failed to secure a House of Commons majority at the election on June 8, but remain in government with the support of a minority Northern Irish Democratic Unionist Party's 10 MPs.

So where does that leave the proposed reforms on interest deductibility and losses? After the election, the government restated its intention to make the changes and for them to be effective from April 1, 2017. A new Finance Bill was finally published on September 8, which includes the relevant provisions and they will now be subject to scrutiny in Parliament. A government bill would normally make it into law, but with Parliament divided across parties by, and preoccupied with, Brexit legislation, the government's narrow majority and a politically weakened Prime Minister, this cannot be guaranteed. Besides which, the provisions still need proper scrutiny and debate to help smooth out some of the rough edges left in the original drafting. Again, whether they get it cannot be guaranteed.

In the meantime, UK companies and their advisors are left in an uncomfortable position. They have to assume that something close to the version of the new rules originally published in March and now republished in September probably already applies to them but they cannot say for certain. The smooth implementation of key tax reform looks to be another casualty of Prime Minister May's decision to call a snap election.

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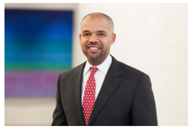

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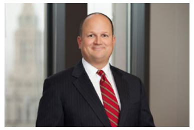

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