SQUIRE PATTON BOGGS

The Tax Reform Winds Are Blowing – What You Need to Know About Developments Around the Globe

Winds of change are fiercely blowing through the global tax environment and new tax policy developments seem to occur on a weekly basis. The below summary provides highlights of these developments from around the world, including the US, the European Union and Europe generally, and concluding with the Asia Pacific region.

United States

The drumbeat for tax reform has grown louder and louder over the past four years in the US. It is now more than 30 years since the last major reforms to the US tax Code, and the US Congress has recently made significant strides toward reforming America's tax laws. Beginning with former House Ways and Means Committee Chairman Dave Camp's (R-MI) work in the 113th Congress, House Republicans organized Tax Reform Working Groups that culminated with the introduction of comprehensive tax reform legislation. Next, in December 2014, Senate Finance Committee Republican staff released their proposal, "Comprehensive Tax Reform for 2015 and Beyond." Then, with Senator Orrin Hatch (R-UT) at the helm, the Senate Finance Committee organized five of its own Working Groups, with each producing a bipartisan discussion draft on their specific tax policy issue. Work has since continued, and most recently, House Republicans produced their own "Blueprint," which they titled "A Better Way."

In watching the debate evolve over the last several years, it has become increasingly clear that tax reform in the US is necessary. Most parties agree that the current US tax Code makes it difficult for US companies to compete with their counterparts abroad and discourages investment in America. Moreover, it is clear that the US tax Code has not kept pace with the global economy. In fact, the tax Code has arguably not even been properly adjusted to reflect the current business landscape in the US. Just look at the tax treatment of passthrough entities compared to C corporations. With more than 60% of business net income now attributable to passthrough entities – a rate that is nearly double what it was when the US last successfully passed tax reform legislation – it is clear that the time to revamp the US tax Code is here.

Unfortunately, given the current political dynamic, it is unlikely that lawmakers will come together and successfully overhaul the nation's tax laws until at least 2017. While both Republicans and Democrats are working to find common ground and reform the tax Code (their efforts are discussed in further detail below), the growing rate of corporate tax inversions is causing a divergence in how each party chooses to approach tax reform in the near-term. Though both sides agree that inversions are an issue that must be addressed, Republicans are continuing to press on with their comprehensive tax reform efforts, as they believe the only solution to the inversion "epidemic" is an overhaul of the nation's tax Code. Democrats, however, are growing increasingly impatient with the delay in enacting tax reform and are thus pushing for a more immediate solution in the interim by pursuing anti-inversion legislation.

Beyond inversions, lawmakers must now work in an ever more global tax landscape, with the global implementation of the Organisation for Economic Co-operation and Development's (OECD) Base Erosion and Profits Shifting (BEPS) Project in particular continuing to have a major influence on the tax reform debate in the US.

Earlier this year, Bob Stack, Deputy Assistant Treasury Secretary (International Affairs), emphasized that from his perspective, the US need only implement about half of the 15 BEPS Actions (including Actions 2, 4, 8-10, 13 and 15). According to Mr. Stack, many Actions do not need to be implemented in the US because they are already addressed via existing tax laws and policies.

That said, and regarding Action 13, on June 30, the Internal Revenue Service (IRS) published a final rulemaking, which requires annual country-by-country reporting (CbCR) by US persons that are the ultimate parent entity of a multinational enterprise group with annual revenue for the preceding accounting period of US$850 million or more. The CbCR period in the US begins with the first taxable year after June 30, 2016; though, other countries implementing similar regulations have opted to use Action 13's CbCR requirements for annual accounting periods that began in January 2016. Given that foreign units of US multinational corporations could be subject to CbCR in other jurisdictions for the 2016 tax year, the final CbCR rules provide for voluntary CbCR reports to be filed with the IRS for 2016 and exchanged with foreign jurisdictions.

Beyond CbCR, there is unlikely to be other significant regulatory or legislative movement on other BEPS Actions in the US – at least in the near-term. For example, although the US participated in the negotiation of the draft multilateral instrument (and used those negotiations to push for the inclusion of arbitration provisions), it is unlikely that America will ultimately sign on to the multilateral instrument, but will instead enter into bilateral agreements with select nations. Moreover, while Mr. Stack has acknowledged that various items require legislative action to implement (e.g., Actions 2 and 4), Congress is unlikely to move on these actions, both for technical reasons (the sheer length and complexity of Action 2) and political reasons (the Republicans' preference to deal with earnings stripping and other base erosion efforts via broad tax reform efforts).

Domestically, despite gridlock and politics getting in the way, both the Obama Administration and Congress have continued to lay the ground for tax reform with:

- The US Treasury Department having proposed various anti-inversion regulations;
- House Republicans putting out a tax reform Blueprint;
- Senate Finance Committee Chairman Hatch continuing his work on "corporate integration" legislation; and
- Senate Finance Committee Democrats preparing their own comprehensive proposal for tax reform.

First, in an effort to take more immediate action, the Obama Administration has spent the last two years – much like Congressional Democrats – focusing on how to stem the rate of corporate tax inversions. In 2014, the US Treasury Department issued Notice 2014-52 – the first in what would be a series of anti-inversion regulations – that addresses: (1) the treatment of cross-border business combination transactions under sections 7874 and 367 of the tax Code; and (2) post-transaction steps that taxpayers may undertake with respect to US-owned foreign subsidiaries (under sections 304(b)(5)(B), 956(e), and 7701(l) of the tax Code) to make it more difficult to access foreign earnings without incurring additional US tax liability. Then, in 2015, the US Treasury issued its second notice, 2015-79, which, in addition to modifying certain rules under Notice 2014-52: (1) provides three new rules under Section 7874 designed to make it "more difficult for US companies to invert"; and (2) announces additional rules intended to "reduce the tax benefits of inversions." Most recently, the US Treasury on April 4 issued regulations under section 385 of the tax Code, which targets so-called "earnings stripping" practices by allowing the government to re-characterize debt as equity under certain circumstances.

Discussed in-depth in our previous alert, these regulations have received broad criticism from both political parties and a wide range of industries for being overly broad in nature and for their potential to negatively impact regular business practices, such as cash pooling. In fact, on July 6 – just one day prior to the close of the comment period on the regulations – US Treasury officials met with lawmakers to discuss the proposals. Despite the significant pushback, it appears that the US Treasury is committed to moving forward with the regulations this year and is still scheduled to hold a hearing on the proposals on July 14, providing the public (which in total submitted nearly 30,000 comments on the proposal) an opportunity to advocate their position in person. Looking ahead, given the US Treasury's unwillingness to heed their concerns, thus far, Republican tax-writers have promised to "consider all legislative options" to prevent this "unilateral action from the Administration."

Additionally, as mentioned above, representing the Republicans' most recent efforts, on June 24, House Ways and Means Committee Chairman Kevin Brady (R-TX) released the House Republicans' long-awaited tax reform Blueprint, which sets forth the GOP's policy vision for 2017. The Republican Blueprint "represents a dramatic reform of the current income tax system." Specifically (and as discussed in greater detail in our previous alert), the proposal addresses various issues, including: (1) individual taxation; (2) corporate taxation; (3) international taxation; and (4) the need to reform the IRS.

Importantly, however, House Republicans acknowledge that their proposal is only "the beginning of [the] conversation about how to fix [the US's] broken tax Code." For example, beyond the Blueprint, Chairman Hatch is expected in the coming weeks to release his "corporate integration" proposal aimed at eliminating the double taxation on corporate income by providing a dividends-paid deduction. While not incompatible with the House Republicans' approach, Chairman Hatch's proposal underscores the differences that remain to be resolved.

Moreover, with control of the Senate potentially in flux as the US Presidential Election approaches this November, it is also important to recognize that tax reform proposals have not been limited to the Republicans. Indeed, following a slew of proposals from Democrats in both Chambers over the course of this year, Senate Finance Committee Ranking Member Ron Wyden (D-OR) has confirmed that Senate Democrats are presently working to finalize their own tax reform plan, which will broadly set out their vision for tax reform – including the results of their months-long work on a package of anti-inversion proposals.

In addition to these developments, the recent string of European Union (EU) State aid cases is sure to serve as another outside influence on US tax policy going forward. Over the last several years, the European Commission (EC) has brought cases against various EU member states with respect to certain tax rulings alleging that various sovereigns have provided impermissible aid to certain US-based multinationals in the form of tax treatment or benefits. If the EC prevails, the corporations in question may be forced to repay up to 10 years of "tax savings" to the EU member state that originally granted the tax ruling at issue. Importantly, US lawmakers feel that these US companies are being unfairly targeted and are concerned about the potential consequences should these companies be subject to additional tax liability. As such, in a rare showing of bipartisan unity, both the Administration and Congress have taken a stand and suggested they will take necessary action to protect the US tax base and ensure that US companies are able to compete abroad. In fact, following two letters from Senators Hatch, Wyden, Chuck Schumer (D-NY) and Rob Portman (R-OH) to Treasury Secretary Jack Lew urging the US to respond appropriately to the EU State aid cases, both Congress and the Administration appear in sync that something must be done. In particular, there is discussion about the potential to use section 891 of the tax Code, which allows the President to double US taxes on individuals and corporations from countries that are deemed to have subjected US citizens and companies to "discriminatory or extraterritorial taxes." Moreover, to fill the void before tax reform becomes a reality, it is rumored that one leading Congressional tax-writer may actually soon release legislation aimed at combatting these EU State aid cases.

Looking ahead, US tax policymakers are no doubt going to feel growing pressure from corporations and individual taxpayers to move forward with their tax reform efforts. Beyond pressure domestically, international tax policy developments (e.g., global BEPS implementation and the ongoing fallout for US-based multinationals from EU State aid cases) will further necessitate action to protect the US tax base. It is also important to highlight lawmakers' passage of the Protecting Americans from Tax Hikes Act of 2015 (PATH Act) at the end of 2015, which permanently extended several tax extenders,

thus, also permanently reducing the 10-year revenue baseline against which future tax reform legislation must be measured. In other words, lawmakers will now have more flexibility in getting to tax reform that is revenue-neutral.

Though the next several months leading up to the US Presidential Election will likely be more about messaging than making substantive progress, US policymakers will be well poised come 2017 to move forward with comprehensive tax reform efforts. However, in a challenge that is suited for the likes of Poseidon, there is one question that remains to be answered: Will lawmakers be able to calm the political waters and ultimately be able to reform the nation's tax Code in the 115th Congress? We believe so, but only the Tax Gods know for sure.

Europe

European Union

The EU has made targeting tax avoidance a top priority and included the issue on the agendas of summit meetings with heads of state and government, as well as Council meetings of EU economics and finance ministers.

At the EU summit meeting in late June 2016, EU leaders called on member states to step up the fight against tax fraud, tax evasion, tax avoidance and money laundering. In connection with this, EU member states recently reached an agreement on a landmark anti-tax avoidance directive, with the Economic and Financial Affairs Council adopting this directive on July 12. Member states now have until December 31, 2018 to incorporate the directive into their local laws (except for the exit taxation rules, for which they will have until December 31, 2019). This directive is part of a package of proposals aimed at preventing what is perceived to be common tax avoidance practices utilized by large companies, and essentially implements and builds on the OECD BEPS recommendations. The proposal addresses situations where corporate groups take advantage of disparities between national tax systems and sets forth proposed rules in five key areas, including:

- Interest limitation rules to discourage the transfer of interest to low-tax jurisdictions;
- Exit taxation rules to prevent tax base erosion when assets are transferred to a low-tax jurisdiction;
- General anti-abuse rules to close off abusive tax arrangements;
- Controlled foreign company (CFC) rules reattributing the income of low-taxed foreign subsidiaries to the parent company; and
- Rules on hybrid mismatches between national tax systems.

In addition, EU member states have agreed to a directive calling for the exchange of tax-related information on the activities of multinationals, including US companies. The only recipients of this information would be national tax administrations, meaning the general public would not be able to access this information. Another proposed directive, released after the Panama Papers revelations, aims to require multinationals with an annual revenue exceeding €750 million to publish the level of profits and taxes paid for each individual country in the EU and in tax havens. The rules would apply not only to companies with EU headquarters, but also to US companies with subsidiaries in Europe. A recent study commissioned by the European Parliament estimates that EU member countries lose between €50 and €70 billion per year in tax revenues due to corporate tax avoidance, and this is one of the stated reasons for the recent increase in State aid cases the EU has been advancing.

Although the anti-tax avoidance measures have attracted unanimous approval from member states, some countries, such as Germany and Spain, joined by European employers groups, have raised concerns that transparency requirements could put EU multinationals at a disadvantage to competitors elsewhere in the world. In addition, other countries raised concerns that sharing data between national tax authorities should not be publicly disclosed, as it could negatively impact the competitiveness of European multinationals.

France

The French government has focused on reducing corporate tax burdens by decreasing labor costs in order to create more jobs and make French companies more competitive. In this context, the government committed itself to decreasing taxes on wages and employment. Specifically, the government indicated that:

- The allowance on the computation basis of the French "company social solidarity contribution" should be increased; and
- Employer social contributions should be decreased.

On the local revenue enforcement front, the French tax authorities have developed a more aggressive stance regarding tax audits and administrative dispute resolution proceedings. For example, the French tax administration is seeking €1.6 billion in back taxes from Google, which has been criticized for its use of aggressive tax planning structures. In addition, the parent-subsidiary regime was amended in order to comply with EU law such that the regime is now extended to include shares without voting rights.

With respect to OECD BEPS implementation, France has implemented CbCR for fiscal years beginning on or after January 1, 2016, which is generally in line with the OECD's recommendations. The 2016 Finance Bill also amended the requirements for contents of the annual transfer pricing declaration. Beginning in 2016, the annual return must be filed electronically, and in the case of a French tax-consolidated group, the return must be filed by the parent company. In addition, the return must now also include the state or territory of the company owning the intangible assets, the nature and amounts of intercompany transactions, and the state or territory of the related entities. With respect to Action 4 (limitation on interest deductions), France has indicated it will not reform its legislation as the current deduction of interest is "in compliance with the highest international standards and already one of the strictest in the world for large companies."

French companies have generally responded to the government's fiscal policy by continuing to monitor and assess ongoing tax policy developments and perform economic and financial modeling so that the impact of any change is known as early as possible. Many companies have also been active participants in tax policy developments and have considered the possibility of working with other similarly affected companies to help the government understand the overall impact of its policies on taxpayers.

Germany

Recent tax policy discussions in Germany have focused on both domestic and international tax matters. With regard to international tax matters, not surprisingly, most discussions have been in the context of the OECD BEPS Project and its implementation. The following points were explicitly mentioned in the ruling Coalition government's coalition agreement:

- Full support of the OECD BEPS Project;
- Implementation of domestic OECD BEPS legislation if the objectives of the OECD initiative are not met on an international level;
- Limitation on tax deductibility of royalties;
- Limitation on tax deductibility of expenses remitted to offshore locations;
- Avoidance of "white income" (i.e., income that is neither taxed in the country of source nor in the country of residence); and
- Implementation of CbCR for certain industries to facilitate the international exchange of tax-relevant information.

The Coalition has repeatedly voiced its position that BEPS is most efficiently addressed by internationally coordinated and harmonized standards. It principally regards uncoordinated unilateral actions as detrimental to achieving internationally harmonized standards, as this provides room for tax loopholes. Consequently, Germany has only recently acted upon the OECD BEPS Project and proposed draft legislation, the key points being the following:

- Implementation of CbCR;
- Combating "white income" by way of extending the "subject to tax" principle to not only the whole income, but also to parts of the income that have either not been taxed or were taxed at a lower rate in the source country and not only to the whole income; and
- Limiting tax exempt share sales for financial institutions.

Given the fact that the OECD BEPS Actions are more extensive than the proposals tabled at the moment, we can expect more legislative actions in the near future.

Spain

Spain's economy has begun to recover from the great recession over the past several years, growing at a high of 3.2% in 2015 – the highest of the principal EU economies. Due to the economic crisis, Spain approved numerous tax changes focused on recovering the loss of tax revenue, such as:

- Increasing value added tax and personal income tax rates;
- Introducing a limitation on financial costs to 30% of EBITDA;
- Eliminating the deduction of financial goodwill;
- Limiting the use of net operating losses; and
- Reducing some of the existing deductions to the corporate income tax base.

Significant tax reform was implemented in 2015, which reduced corporate income tax to 25% in 2016 from a high of 30% and reduced personal income tax rates to a maximum marginal rate of 45% from a high of 52%. Additionally, several measures were approved in line with the OECD BEPS Project, such as amending the patent box regime in accordance with the modified nexus approach, extending the scope of the CFC rules and implementing new limitations to trigger hybrid mismatches. The CbCR obligations were also approved last year in line with the OECD BEPS' recommendations and will enter into force beginning in 2017.

Recent elections resulted in additional support for the conservative governing party, but the formation of the new government and the effect on Spanish tax is still unclear. The new government will have to face important economic and social challenges related to the high unemployment rate, while promoting sustainable economic growth over the next several years, for which tax policy will play an essential role. With the appointment of a new government expected soon, further tax policy developments are sure to follow.

United Kingdom

One consequence of the global financial crash in 2008 is that it now appears to be accepted wisdom that payment of tax is a moral issue. The debate in the UK has been vigorous, if sometimes ill-informed, about how international tax rules operate, and has increasingly focused on "fairness," as well as stopping "aggressive" and "unacceptable" avoidance by both domestic and multinational businesses and individuals. This approach is now firmly embedded in the underpinnings of both business behavior and government action.

An important driver of UK tax policy has been the government's aim for the UK to have the most competitive business tax system in the G20. Businesses have welcomed changes, which have included a lower corporate tax rate (scheduled to be reduced to 17% in 2020), a simplified and more business-friendly CFC regime, a generous patent box regime, non-taxation of repatriated dividends, exemption for gains on business disposals – the list goes on. In March 2016, the government published a new business tax roadmap, setting out its business tax reform agenda for the future.

On the other side of the equation, successive governments have ramped up steps to address tax avoidance and evasion, including introducing a general anti-abuse rule and tightening disclosure requirements against taxpayers and their advisers. Faced with a tougher approach by government and the courts, as well as trial by public opinion, businesses (both domestic and international) now take a more cautious approach to tax planning with the risk of reputational damage being a key issue. This cautious approach will be reinforced by new rules requiring large businesses to publish an annual UK tax strategy, addressing their attitude to tax planning and their approach to tax risk management and governance.

The UK has also been at the forefront of implementing the OECD BEPS Project. It jumped the gun in 2015 by introducing a diverted profits tax (a penal rate of tax on structures that reduce the UK's tax base and shift profits out of the UK) and has put in place rules for CbCR and information sharing between tax authorities, including taking action to get British overseas territories to fall into line on these requirements. Beginning in January 2017, extended anti-mismatch and anti-hybrid rules will allow the UK to take unilateral action to deny multinational groups the benefit of tax differences between the UK and other countries. Rules in line with OECD recommendations that would restrict deductions for finance costs to 30% of EBITDA are also planned for April 2017. In sum, full implementation of the OECD BEPS Actions in the UK is expected.

In terms of the Brexit vote in the UK, leaving the EU seems unlikely to change the general direction of tax reform; although, responding to any economic fallout may restrict the opportunity to reduce overall tax costs. Indeed, it may give additional freedom to introduce tax incentives that would currently be subject to challenge under EU State aid rules. Moreover, because the UK is already implementing the OECD BEPS Actions, it probably does not need the added incentive of the draft EU Directive. Given the anticipated timeline to implement the UK's departure from the EU, it seems likely to be a number of years before we are able to assess the full impact Brexit will have on UK tax policy.

Asia

Asia Pacific

Although the changes do not appear to be as dramatic as those we have seen in the EU, Asia has nevertheless seen some interesting tax policy developments over the last year. China has been actively working to implement the OECD BEPS Project, continues to offer tax incentives for activities such as innovation and has been taking steps to strengthen its international cooperation through signing on to mutual agreements, such as the Multilateral Competent Authority Agreement. Japan has also been working to come into compliance with the OECD BEPS Project. Additionally, while working to lower its corporate tax rate from a rate of over 40% in 2011 to a rate lower than 33% in 2016, Japan will increase its consumption tax rate from 8% to 10% in 2017. Finally, as Singapore strives to remain as the location of choice for headquarters for Asia operations, the nation continues to offer incentives to attract and retain businesses, while publicly stating its intentions to maintain efforts to prevent tax evasion.

Australia

On July 2, 2016, Australia had a double dissolution election for both houses of Parliament. Unfortunately, the result was close, and at the time of writing, it was not clear whether the Liberal/National Coalition would be able to form a majority government. Whatever happens, it is clear that the minority parties and independent senators will play a key role in passing any tax reform legislation – legislation that will likely be heavily negotiated. Therefore, it is unlikely there will be any broad, sweeping tax reforms in Australia over the next three years unless it has bipartisan support.

Nevertheless, both major parties are committed to cracking down on multinationals to ensure they are paying their "fair share" of tax in Australia. There is also broad public support for measures that tax foreigners. Three of the major states of Australia have introduced stamp duty surcharges (of up to 7%) on foreign individuals or controlled entities purchasing residential land in Australia. There are also annual land tax surcharges of up to 1.5% on foreign-owned or -controlled land. In addition, beginning on July 1, 2016, foreign vendors of land (or land-rich entities) in Australia became subject to 10% withholding from the proceeds of sale.

Australia has already implemented many of the OECD BEPS Actions, including CbCR; and the nation is also presently consulting on legislation to prevent hybrid mismatches. Additionally, Australia has pursued comprehensive multinational anti-avoidance laws, which seek to tax profits on sales made to customers in Australia and imposed a goods and services tax (GST) on digital products and services used by Australian consumers. Australia already had strict CFC rules and has recently tightened thin capitalization limits. The Australian Treasury Department is also currently consulting on ways to adopt the OECD's updated transfer pricing guidelines.

Australia has also proposed a diverted profits tax for multinationals with revenue over AU$1 billion, which would apply beginning July 1, 2017. While the Australian Treasury Department is undergoing consultation on this measure, it is uncertain whether, and in what form, the proposal will proceed. It is also uncertain whether the Liberal/National Party's proposed reduction in the corporate tax rate from 30% to 25% will be move forward, as it was rigorously opposed by Labor and the other minority parties throughout the election campaign and is, thus, unlikely to make it through the current Parliament.

Despite the current political uncertainty, it is likely that Australia will remain at the forefront of implementing measures designed to ensure multinationals pay their "fair share" of tax in Australia and in implementing the OECD BEPS Project.

Conclusion

As we look ahead, tax policy will continue to evolve and develop with countries simultaneously trying to attract new investment and trying to appear tough on tax avoidance. This is potentially quite a tricky balance to find, but it may be required in today's environment where the court of public opinion seems to matter as much (if not more) than the substance of tax policy.

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