U.S. Tax Reform and Potential Effects on Cross-Border Transactions

Alejandro Barrera (Basham)
Jon. P Schimmer (Procopio)
Raúl Villarreal Garza (Procopio)

USMBA
THE U.S.-MEXICO BAR ASSOCIATION
BARRA DE ABOGADOS MEXICO-ESTADOS UNIDOS

ON THE WAY TO A TAX REFORM

- Factors to implement a tax reform
- Preliminary proposals

Background: 1986 Tax Reform

- The last time an important tax reform was passed was on 1986 (Reagan)
- The legislative process lasted for 13 months
- The participants in the 1986 legislative process said that “the planets aligned” to carry out the reform.

LEGISLATIVE PROCESS

i. President/Department of the Treasury (Bill)

i. House of Representatives
   - Committee on Ways and Means

ii. Senate
   - Senate Finance Committee

iii. Joint Conference Committee

iv. President
   - Sign/Veto

LEGISLATIVE PROCESS: SENATE

- Required votes: 60/100
  - Republicans: 52
  - Democrats: 48
  - Independents: 2
- Alternative: “Reconciliation”
  - Simple majority: 51/100
  - Do not increase the deficit after 10 years.

CURRENT SITUATION

- Republican majority in Congress.

- Necessity of a tax reform
  - Capital outflow
  - Highest corporate tax rate among OECD countries
  - GDP growth is below the historical averages
  - Pressure to American Multinationals to implement BEPS

PROPOSALS

- *Camp Bill - Tax Reform Act 2014 (December 2014)*.
  - Presented by the Rep. Dave Camp in the House Ways and Means Committee of the House of Representatives.

- *House Blueprint - A Better Way Our Vision for Confident America (June 24, 2016)*.
  - Presented by Rep. Paul Ryan of the Republican Party in the House of Representatives.

- Donald Trump (April 26, 2017).
  - Presented by the Office of the President.
  - Vs. Proposal as a candidate.

PROPOSALS

- Donald Trump (April 26, 2017).
  - Presented by the Office of the President.
  - Vs. Proposal as a candidate.

- Donald Trump (September 27, 2017)
  - "Unified Framework for Fixing our Broken Tax Code"

TRUMP'S PROPOSAL

"*I think nobody knows more about taxes than I do, maybe in the history of the world. Nobody knows more about taxes.*" — Donald J. Trump, May 2016

2017 Tax Reform for Economic Growth and American Jobs

The Biggest Individual And Business Tax Cut In American History

Top Line:

- The U.S. tax code is overcomplicated and fails to create enough jobs, or provide relief to middle class families.
  - Since 2001, the U.S. tax code has faced nearly 6,000 changes, more than one per day.
  - Taxpayers spend nearly 7 billion hours and over $250 billion annually on compliance costs.
  - The U.S. has the highest statutory tax rate in the developed world, discouraging business investment and job creation.
- President Trump is proposing the largest tax cut for individuals and businesses in U.S. history.
  - It will simplify the tax code, incentivize investment and growth and create jobs.
  - It will provide historic tax relief for middle income families and small business owners.

The Need For Comprehensive Tax Reform

- An overly complex tax code is confusing and burdensome on American taxpayers.
  - The last major effort to successfully reform the U.S. tax code was over 30 years ago under President Reagan.
  - Today, according to the IRS' National Taxpayer Advocate, the federal tax code is nearly four million words long.
  - Congress has made more than 5,900 changes to the federal tax code since 2001 alone, averaging more than one change a day.
  - The National Taxpayers Union estimates that Americans spend 6.989 billion hours at a cost of more than $262 billion on compliance and record keeping costs.
  - Instead of a single tax form, the IRS now 199 individual income tax forms and 235 business tax return forms.
  - Approximately 90% of taxpayers need help doing their taxes.
- Today, with a corporate tax rate of 35%, U.S. businesses face the highest statutory tax rate in the developed world, and fourth highest effective tax rate, which discourages job creation or investment.
  - The U.S. is out of step with its competitors, having the highest corporate income tax rate among the 35 OECD nations and being the only nation that has increased its rate since 1988.
  - A lower business tax rate will discourage corporate inversions and companies from moving jobs overseas.
  - The high corporate tax rate keeps trillions of business assets overseas rather than being reinvested back home.
  - Even President Obama proposed lowering the business tax rate to 28 percent to help spur economic activity.

Tax Reform for Economic Growth and American Jobs: The Biggest Individual And Business Tax Cut In American History

- Goals For Tax Reform
  - Grow the economy and create millions of jobs
  - Simplify our burdensome tax code
  - Provide tax relief to American families-especially middle-income families
  - Lower the business tax rate from one of the highest in the world to one of the lowest
- Individual Reform
  - Tax relief for American families, especially middle-income families:
    - Reducing the 7 tax brackets to 3 tax brackets of 10%, 25% and 35%
    - Doubling the standard deduction
    - Providing tax relief for families with child and dependent care expenses
- Simplification:
  - Eliminate targeted tax breaks that mainly benefit the wealthiest taxpayers
  - Protect the home ownership and charitable gift tax deductions
  - Repeal the Alternative Minimum Tax
  - Repeal the death tax
- Repeal the 3.8% Obamacare tax that hits small businesses and investment income
- Business Reform
  - 15% business tax rate
  - Territorial tax system to level the playing field for American companies
  - One-time tax on trillions of dollars held overseas
  - Eliminate tax breaks for special interests
- Process
  - Throughout the month of May, the Trump Administration will hold listening sessions with stakeholders to receive their input.
  - Working with the House and Senate, the Administration will develop the details of a tax plan that provides massive tax relief, creates jobs, and makes America more competitive – and can pass both chambers.

TRUMP'S PROPOSAL

- Overview:
  - Simplify Tax Code
  - Lower tax rates; "give American workers a pay raise…"
  - "Make America the jobs magnet of the world by leveling the playing field for American business and workers"
  - Bring back trillions of dollars that are kept offshore to reinvest in the American economy.

  In other words:

  - Widening the tax base;
  - Eliminate deductions and special regimes;
  - Repatriation tax holiday;
  - Change to a territorial tax system.

	Donald Trump Sept 27, 2017	Donald Trump April 26, 2017	*House Blueprint*	*Camp Bill*
Corporate tax rate	20%	15%	20%	Decrease the tax rate to 25% gradually.
Pass-through entities and entities with sole member	25%	15% limited to small pass-through entities (without specifying anti-abuse rules)	Active income of the business capped at 25%, supported by a requirement of "reasonable compensation" to proprietors and managers.	25%
Asset depreciation.	Allows for immediate write off of new investments "other than structures made after September 27, 2017"	Not mentioned.	Immediate and allowing a 100% depreciation for the case of tangible and intangible assets (except land).	• Substitutes the accelerated depreciation (*MACRS*) for a system that extends the period of recuperation and indexes the depreciable base for inflation. • Extends the period of amortization for some intangibles.
Interests	Partially limited	Not mentioned.	Deductible on the future (with special rules for the financial system).	There is no general rule, but limits the amount of interest expenditures that could apply to a shareholder of a USCO with one or more foreign companies in some cases.

Business Entities

	Donald Trump September 27, 2017	**Donald Trump April 26, 2017**	***House Blueprint***	***Camp Bill***
Net Operating Loss (*NOL*)	Not mentioned	Not mentioned.	Carryover allowance indefinitely and indexed to inflation, but not carryback; Limited to 90% of the tax base in the fiscal year.	Limits the amortization to 90% of the tax base for the tax year; abolishes special rules to carryback and of excess losses attributable to capital reductions (*CERT*).
Alternative minimum tax	Repeal proposal	N/A	Repeal proposal.	Repeal proposal.
Credit for research and development.	Maintained	Not mentioned.	Maintained with modifications.	Maintained with modifications.
Inventory method (*LIFO*)	Not mentioned	Not mentioned.	Replaced for the deduction of imported inventory.	Repeal proposal.
New sources of income	Elimination of deductions and credits to special regimes.	Elimination of special regimes.	Elimination of deductions and credits to special regimes.	Miscellaneous

INDIVIDUALS

	Donald Trump September 27, 2017	Donald Trump April 26, 2017	*House Blueprint*	*Camp Bill*
Tax rate	12%-25%-35% - additional tax rate for high-income earners	10% - 25% - 35%	12% - 25% - 33%	10% - 25% - 35%
Standard deduction and personal exemption (credit).	Double Standard Deduction	Double standard deduction	Consolidated personal exemption/ Increase standard deduction	Eliminate personal exemption/ Increase standard deduction
Itemized deductions	Repealed (except mortgage interests and charitable contributions)	Repealed (except mortgage interests and charitable contributions)	Repealed (except mortgage interests and charitable contributions)	Repeal the majority, including mortgage payments and charitable contributions
Alternative minimum tax	Repeal proposal	Repeal proposal.	Repeal proposal.	Repeal proposal.
Net Investment Income Tax	N/A?	Repeal proposal.	N/A	Repeal proposal.
Capital gains tax rate	N/A?	20%	• 50% Capital Gains Deduction – 6% • Interests - 12.5% • Dividends - 16.5%	40% deduction from the capital net gains.
Estate Tax	Repeal proposal	Repeal proposal.	Repeal proposal.	Maintained.

INTERNATIONAL POLICY

	Donald Trump. September 27, 2017	Donald Trump April 26, 2017	*House Blueprint*	*Camp Bill*
Border adjustment tax	Not mentioned	Not mentioned.	Yes, destination-based cash flow system, with border adjustments	Not included.
International tax system	Change to terriotrial tax system, with 100% exemption for dividends from foreign subsidiares (10% holding)	Change to a territorial tax system/	• Change to a territorial tax system with an exemption to dividends received by foreign subsidiaries. • Repeal the majority of *subpart F* (applicable to CFC's), keeping the rules for FPHC for passive income.	• Deduction of 95% of the foreign portion of the dividends received by foreign subsidiaries; • Rules to avoid the transfer of benefits abroad; • Minimum tax of 15% over external income of a CFC; • Modification to the active financing exception.
Repatriation of income and earnings	Accrual of income from foreign source in the previous system. Higher rate for liquid assets. Payment of tax liability spread-out over years.	Accrual of income from foreign source in the previous system (tax rate to decide with Congress)	Repatriation at a tax rate of 8.75% if kept in cash or equivalents, 3.5% if not, payable in 8 years.	Repatriation at a tax rate of 8.75% if kept in cash or equivalents, 3.5% if not, payable in 8 years.

CONCLUSIONS

- Border Adjustment Tax ☠️
- 20% corporate tax rate (actual 35%)
- 25% tax rate for income earned through pass through entities (current 39.6%)
- "Territorial" regime (?)
- Repeal "ObamaCare Tax" (3.8%)
- Repeal of Estate Tax – 40%
- Special tax regime for repatriation of foreign earnings in the form of deferral?

CONCLUSIONS

- Less demand for imports in the USA – More offer for exports.
- Dollar strength
- Will the USA become a tax haven?
- Major access to credit in the USA (Financial sector grows), less financial cost for MNEs
- Likely rise in tech and pharma shares due to high level of offshore earnings.
- More investment in the USA. – + Technological development
- Redefinition of tax treaties.
- More deficit in the USA?