CTO Insights - Issue Spotlight

Tax reform: The ongoing road to implementation

July 2018

Never before has the tax department played such an integral role in the success of the business. Chief tax officers (CTOs) are expected to align tax with business goals, drive strategic value, increase transparency, and improve the efficiency of tax operations. KPMG LLP's (KPMG) *CTO Insights* is designed to highlight top-of-mind issues for tax executives and ways CTOs are addressing these opportunities and challenges. We are confident that you will find the information in each issue of *CTO Insights* practical and actionable in demonstrating the value you and your department bring to your organization.

Tax reform is not over. While the new U.S. tax law was signed in December 2017, companies are dealing with an ongoing and challenging road towards implementation. The business community has been generally pleased with the results—particularly with the reduction of the top corporate rate to 21 percent—and the U.S. economy has responded positively. However, one of the shortcomings of the law, which was passed in record time, is the complexity and lack of clarity regarding many of its provisions. And thanks to the contentious political environment on Capitol Hill, there is currently not enough bipartisan support for Congress to pass a technical corrections bill.

In this edition of *CTO Insights – Issue Spotlight*, we highlight the ongoing road to implementation, focusing on the international provisions that may affect companies doing business globally and the modeling exercises and scenario planning required to determine what the bill could mean to your organization.

New foreign tax provisions causing confusion

The international provisions include sections on global intangible low-taxed income (GILTI), base erosion and antiabuse tax (BEAT), and foreign-derived intangible income (FDII)—all of which have placed CTOs under tremendous pressure to work through the complexity and deliver detailed insights to stakeholders. The goal of these rules is to curb the erosion of the U.S. tax base by equalizing the U.S. tax burden on exported goods and services and income earned through controlled foreign corporations. While well intended, the international provisions are proving to be complex and often ambiguous. There is some concern that, as currently written, the cost of the international tax provisions may offset more of the savings from the corporate rate cut than was intended, and for some companies these costs greatly exceed any savings. CTOs are looking for clear guidance from the IRS and the Treasury to resolve the ambiguities.

All of this uncertainty has placed tax functions under tremendous pressure. They are being asked by the C-suite, boards, and audit committees to deliver detailed insights about how the new tax law affects current business conditions, as well as its mid- and longer-term implications so companies can plan for the future. CTOs are having difficulty providing simple answers to these questions and are struggling to reliably forecast their company's effective tax rate (ETR) for purposes of press releases and meetings with audit committees. To give themselves some leeway, many CTOs are presenting their company's ETR as a range spanning several percentage points, typically from the mid to upper twenties. But even determining an accurate range can be complicated as the BEAT rate increases from 5 percent in 2018 to 10 percent in 2019, and key questions regarding how the new provisions work remain unanswered pending regulations—in particular the rules for determining how much foreign tax credits can be used to offset the impact of GILTI. CTOs are also feeling pressure on staffing and are discussing the need for extra headcount with senior leaders.

Another issue of growing concern for CTOs is what actions to take—or not take—with respect to intellectual property (IP) that currently is held offshore. Following the OECD's Base Erosion Profit Shifting project, some companies face considerable foreign tax risk from their current IP holding structure and could substantially reduce that risk by moving the IP to the United States where significant development work occurs. Fortunately, the new law offers significant benefits if companies bring foreign IP back to the United States. Nonetheless, while the potential tax benefits are intriguing, there is concern that future elections could put upward pressure on the 21 percent corporate rate as well as the preferential FDII rate. In particular with respect to FDII, change could be further spurred by a successful World Trade Organization challenge. So, some CTOs have expressed reluctance to bring IP back home.

The need for holistic modeling

With such complexity, particularly in the international provisions, CTOs are increasingly turning to modeling to determine the potential impact on their organization. Models that can handle multiple scenarios, are scalable, and take a holistic approach to the new tax bill are of greatest value to CTOs. In other words, you should include all of the new provisions—GILTI, FDII, BEAT, and section 163(j)—as well as scenarios that consider ETR sensitivity to changes in structures and supply chain, and changes in the business forecast, including product mix, at the same time. With so much interconnectivity between the various provisions, there is just too much risk of distorted or completely invalid results if you try to piece together separate ad hoc models.

Even though modeling is generally agreed upon as a necessary approach, CTOs are finding it difficult to do so effectively. With limited clarity and detail available in the new law, modeling with any certainty is difficult pending additional guidance. Having the resources necessary to perform effective modeling is also proving difficult.

Questions to consider

— How are you working through positions and modeling scenarios for GILTI, FDII, and BEAT and the interplay between them?

— If your organization's IP is held offshore, does it make sense to move it back to the United States?

— How are you communicating this uncertainty to senior management?

For further information

Explore the resources below for deeper insights on the topics in this edition of *CTO Insights*.

KPMG's Tax Reform Web site

The site contains numerous resources to help stay abreast of the latest developments, including our Tax Reform Thursdays Webcast series.

KPMG's Tax Function Benchmarking Study 3.0

The survey helps tax professionals gain insight into their practices and identify improvements needed to demonstrate the strategic value that the tax function can bring to their overall organizations.

KPMG's International *Tax Reform Analyzer*

Modeling the potential impact of the new U.S. tax law

For previous editions of *CTO Insights*, please visit KPMG.com/us/cto-insights.

To follow KPMG U.S. Tax on Twitter @KPMGUS_Tax

Contact us

Jeff LeSage
Americas Vice Chairman, Tax
T: 212-872-2100
E: jclesage@kpmg.com

kpmg.com/socialmedia

The information in *CTO Insights* is based on discussions between KPMG professionals and CTOs at their clients as well as with government contacts.

The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.