Chief Tax Officer Outlook

Top-of-mind issues for tax leaders — seventh global edition

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Never before has the tax department played such an integral role in the success of the business. Chief tax officers (CTOs) and other tax leaders are expected to align tax with business goals, drive strategic value, increase transparency and improve the efficiency of tax operations. This publication is designed to highlight top-of-mind issues for tax executives and the ways tax leaders are addressing these opportunities and challenges.

Topics addressed in this edition[1]

- **H.R. 1 signed into law — now what?**
- **The taxation of multinational entities**
- **Responding to "performance pay" rule changes**
- **Efforts to influence the conversation**
- **Interim measures for taxing the digital economy allow time for global consensus**

[1] This report was first published as 'Chief Tax Officer Insights' by KPMG LLP in the US, a limited liability partner and the US member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"). In its current form, the report has been expanded upon to provide a global context and address audiences in addition to those in the US. As with the original report, the information throughout is based on discussions between KPMG professionals and CTOs, as well as with government contacts.

H.R. 1 signed into law — now what?

It's fair to say that the new US federal tax law has generally been well received by the business community, particularly in light of the reduction of the top corporate rate to 21 percent. The reduction from the former top rate of 35 percent is intended to make the US corporate rate more in line with those in other parts of the world and could have a number of significant effects on US corporations. The new law, however, was passed in record time and a result of this speed is that there's a good deal of uncertainty and lack of clarity regarding many of its provisions, including the steps necessary for implementation.

Further complicating this issue is a difficult political environment on Capitol Hill. At this point, there does not appear to be the appetite or enough support in Congress to pass a technical corrections bill to clarify provisions. Bear in mind that, with longstanding congressional rules, it likely will take 60 senators to approve technical corrections, while only 50 were needed to pass the law itself.

In place of a technical corrections package, CTOs are looking for guidance from the Treasury and the IRS. Some guidance has been issued, and a whole slew of additional guidance has been promised to arrive well before the end of 2018.

In this issue of *CTO Insights*, we'll address three aspects of the new tax law that CTOs are particularly concerned with:

- the taxation of multinational entities
- executive compensation and Section 162(m) changes
- efforts to influence the conversation.

The taxation of multinational entities

The tax law includes several new international tax provisions that may affect companies that do business globally. This includes sections on global intangible low-taxed income (GILTI), base erosion and antiabuse tax (BEAT), and foreign-derived intangible income (FDII). The aim of these rules is to curb the erosion of the US tax base by equalizing the US tax burden on exported goods and services and controlled foreign corporation earnings, and by reducing the benefits of related-party deductible payments.

These provisions are proving to be complex, often ambiguous, and interrelated, and they also involve foreign tax credit provisions. If one of the goals of tax reform was simplification, then the new tax law may have missed the mark, particularly with respect to the international provisions. What's more, some CTOs are concerned that the cost of the international tax provisions may unintentionally offset the savings corporations could receive from the tax rate cut.

The uncertainty over how to implement these provisions has placed tax functions under tremendous pressure. They're being asked to deliver detailed insights about how the tax law affects current business conditions, as well as its mid- and longer-term implications so companies can plan for the future. At the same time, they're responsible for calculating tax obligations for quarterly filings.

CTOs are also struggling to determine their company's effective tax rate (ETR) when making earnings calls, writing up press releases, or meeting with audit committees. Assembling projection models has proven to be extremely difficult, and changing even one assumption can totally alter calculations given the interrelation of all the provisions. 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. CTOs have found that senior management and boards generally are not satisfied with ETRs presented as a range — they want certainty. So CTOs are trying to come up with creative ways to explain the issue, for example, relying on illustrations.

A good deal of uncertainty exists about what position organizations should be taking with respect to the international tax provisions. It has also become clear that BEAT is impacting far more global businesses than previously expected. Until technical corrections or formal guidance is issued, the consensus seems to be that if the provision seems "broken but clear," CTOs should follow the law as stated. However, where the law is ambiguous or unclear and in the absence of guidance, CTOs should do their best to determine the statute's meaning, take a reasonable position, use best estimates, and be consistent.

? Questions to consider

- How are you gathering the data needed to compute foreign taxes and credits (e.g. D&A tools, ERP systems)?
- If intellectual property (IP) is held offshore, does it make sense to move it back to the United States?

Responding to "performance pay" rule changes

The new tax law made some significant changes with respect to the rules regarding executive compensation paid by corporations, especially around "pay-for-performance" rewards. It's unlikely that these changes will affect the total amounts paid to executives; however, they may cause companies to reconsider how they're paying their executives.

Generally speaking, under the old law and prior to 2018, a public corporation could not deduct compensation in excess of USD1 million paid out to its CEO and three highest-paid employees. Performance bonuses, options, equity, deferred compensation, and similar pay-for-performance rewards were not included in this USD1 million limit and could be deducted. Under the new tax law, CFOs are included as part of this group of covered employees; so now it's the CEO, CFO, and the three highest-paid employees. Another change: Once you're considered a covered employee, you're always a covered employee — even after retirement. So the USD1 million deduction limit will continue to apply.

How will this influence executive compensation? The positive news, at least from the executive's standpoint, is that it probably will not have a major impact. The reality is that many companies are already paying out base salaries in excess of USD1 million for competitive reasons and the tax deductibility of such compensation is not viewed as a major factor in putting together pay packages. Also, shareholders and investor committees like the concept of pay-for-performance rewards, so they're likely to continue regardless of their deductibility. What may change, however, is the way performance pay is structured. Since tax deductibility may no longer be a factor, companies may look to structure the payments as cash rewards or restricted stock rather than, for example, as stock options.

A number of CTOs have reported that their companies are also considering making changes to severance packages for retiring executives as a result of the tax law changes. As noted earlier, a covered employee remains a covered employee, even when retired. As a result, some CTOs are wondering whether it makes tax sense to spread lump-sum payments of more than USD1 million over several years via a supplemental employee retirement plan or annuity-type arrangements.

The tax law provides that payments made under a "written, binding contract" executed on or before 2 November 2017, can still be grandfathered and deducted under the old rules; however, there's a caveat to this exception. If a company has the right to raise or lower the amount of the payout, this discretion may result in the contract not being considered binding.

CTOs are hoping for some guidance or clarification on this matter. In its absence, many are taking a more conservative position. If the company can alter the amount of the performance pay, then it's being made under a nonbinding contract and is, therefore, not grandfathered. If guidance comes out later that allows for their arrangement to qualify under the grandfather exception, the companies can reverse the tax treatment if it's worth doing so.

Questions to consider

— Have you reviewed executive contracts executed on or before 2 November 2017, to determine if payments can be grandfathered?

— Are you looking into revising executive compensation plans with respect to pay-for-performance rewards?

— With the USD1 million deduction limit, does it make tax and business sense to spread executives' lump-sum retirement payments over a longer period of time?

Efforts to influence the conversation

As noted earlier, the new tax law was pushed through Congress in record speed. It appears to benefit most large businesses but contains a number of ambiguities. While many CTOs have requested that their company's government affairs teams and industry groups get clarification and guidance, they have had limited success. The general feedback received is that the divided Congress has little appetite for making changes to the tax law.

CTOs report that their industry lobbyists and company's government liaisons are either reluctant to push Congress too forcefully for additional legislative changes — with many simply showing appreciation for their efforts in passing a new tax law — or have moved on to other issues. The consensus is that clarification is highly unlikely to come from Congress in the form of a technical corrections bill for the reasons mentioned above.

Treasury reportedly is receptive to issuing regulations on the international tax and other provisions and has promised additional guidance in a number of areas well before year end. However, Treasury is still trying to figure out the limits of its authority and does not want to go beyond the scope of the new tax law. The bottom line is that no one seems to really know when it might happen, how extensive it will be, or even what positions Treasury might be taking.

Companies undoubtedly will continue to seek clarification. Most CTOs believe that it's more effective to work through industry associations, part of a group of companies within an industry, or even cross-industry if there are common concerns. The IRS and Treasury prefer to address issues on a more comprehensive basis as opposed problems only affecting one or a limited number of companies.

Questions to consider

— Are you conducting lobbying efforts through your industry organization, cross-industry groups, your government affairs team, or all?

— What information has been brought back and has it been valuable or actionable?

— Have you compiled a list of tax issues that affect your company and prioritized which are most important and need answering most quickly?

Interim measures for taxing the digital economy allow time for global consensus

Global consensus may be derailed by proliferating interim measures

How to tax the digital economy is one of the difficult questions to be tackled under the Organisation for Economic Cooperation and Development's base erosion and profit shifting (BEPS) project. As countries worldwide work to adopt OECD proposals on most items under the Action Plan on BEPS, global consensus remains elusive on whether and how to tax businesses with a substantial digital business footprint but no physical presence in a jurisdiction — new business models that create what many countries see as a mismatch between taxation and value creation for digital activities.

In March 2018, the OECD released an interim report on digitization's tax challenges, building on an earlier BEPS report under Action 1. Endorsed by the 113 countries in the Inclusive Framework, the report analyzes the characteristics of digitalized business models, including their remote presence, reliance on intangibles and data, and heavy user participation. The report delays making any recommendations as the OECD works toward finding long-term, consensus-based solutions for taxing the digital economy, which it intends to deliver by 2020.

As part of that long-term work, the report notes that the OECD will review the impact of digitization on the economy on two key aspects of the international tax system, namely the nexus for taxation and the methodology for allocating profit to that nexus. For the short term, the OECD note that no consensus was reached on the need for interim measures, with a number of countries expressing concern that such measures could run counter to international consensus as it develops and may be difficult to undo.

Nevertheless, recognizing that other countries believed it would be necessary to introduce interim measures to shore up their tax bases more quickly, the report lists common principles that those countries believed should be followed to minimize the negative consequences of such measures.

? Questions to consider

— Does your business have digital economy attributes, such as significant online scale without physical mass, reliance on intangible property or high user activity?

— If enacted, would the 3 percent digital services tax apply to your business's online activities in EU countries, starting in 2020?

— Do you have business concerns about the debate over the digital economy that your KPMG advisers can help raise with policymakers?

Indeed, many countries are already acting unilaterally to address taxation of digital economy businesses. For example:

— Countries like Israel and India have introduced significant economic presence tests for creating permanent establishments.

— Specific tax regimes for multinational enterprises have been introduced, for example, by the UK and Australia with diverted profits taxes and by the US with its base erosion and anti-abuse tax.

— Turnover taxes have been introduced for targeted sectors, such as Hungary's tax on digital advertising and Italy's levy on digital transactions.

More recently, the European Union's (EU) digital tax strategy proposes both interim measures and a long-term solution. The European Council has stated its preference for a coordinated tax policy response to the challenges raised by the digitalization of the economy at the global level. However, the EC also believes interim measures are needed due to the lack of consensus and the limited progress made at the OECD level in implementing a global standard.

Under the interim measure, the EU's proposed new 3 percent digital service tax would apply as of 1 January 2020 to revenue from certain services, including selling online advertising space, creating certain online marketplaces, and transmitting collected user data. There is far from consensus in the EU that this is the right approach with many arguing that (1) a global consensus is first needed and (2) "digital" should be treated the same as other businesses.

Passing these proposals will require unanimity from all EU member states, which is by no means certain. Some member states have already expressed concerns about the DST (Digital Services Tax). For example:

— The DST is a revenue tax, so it must be paid even when the company is loss making.

— For the same reason, companies would pay the same level of tax regardless of whether they have high or low margins.

— The DST is not a profits tax, so double tax could arise since no offsetting foreign tax credit would be allowed in the company's home country.

The other major question is how the United States will react to these proposals. The EC estimates the new rules would apply to 120–150 companies, about half in the United States and a third in the EU. During the G20 leaders' meeting in March 2018, the United States already expressed concerns and could decide to introduce countermeasures if the EU were to adopt these proposals.

It is possible that the EU will adopt the digital service tax in the short term, if only to forestall the further enactment of other, disparate interim measures by its member states. In turn, this may spur more non-EU countries to respond with their own unilateral interim measures.

Longer term, the prospects seem dim for achieving consensus among EU member states on the EU solution, or among countries more broadly on an as-yet-unknown OECD solution:

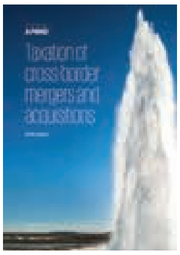
- Some countries believe the previously agreed BEPS solutions are enough to address the challenges of digitalization.
- Other countries want to put focus on where value is created and try to adapt agreed concepts of value creation to the digital environment.
- Still others want to change the balance of source versus revenue taxation, focusing on where value is created but even more so where revenues are generated.

If a long-term global solution is out of reach, there is a risk that the proliferating interim measures will become permanent, leaving us with even more complexity and potential for double taxation and disputes.

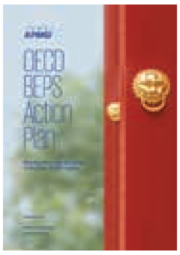
Achieving consensus will require careful consideration, openness and collaboration on all sides — but worth the considerable effort. A uniform global approach is likely to offer better outcomes for both governments and businesses in the long run.

Further information

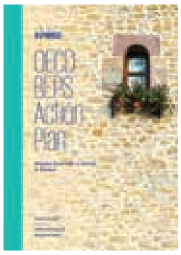
For further information and resources, please explore these links or visit kpmg.com/tax. You might also consider attending an upcoming webcast or event designed to address issues of interest to tax leaders. As always, please feel free to contact a KPMG professional to discuss these strategies and tools or to speak about the tax issues you face today.



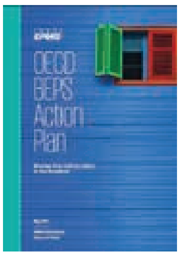
Taxation of Cross-Border Mergers and Acquisitions



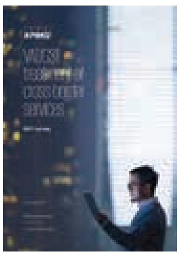
OECD BEPS Action Plan: Moving from talk to action in the Asia Pacific region



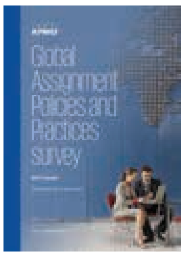
OECD BEPS Action Plan: Moving from talk to action in Europe



OECD BEPS Action Plan: Moving from talk to action in the Americas

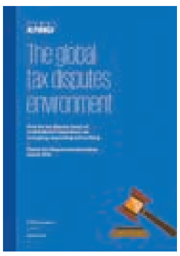


VAT/GST treatment of cross-border services

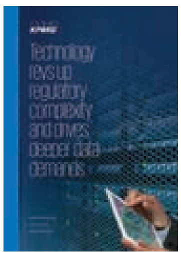


Global assignment policies and practices survey

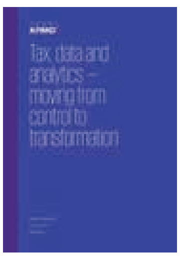
Global tax department benchmarking survey: Summary report



Global tax department benchmarking survey: Disputes special report



Technology revs up regulatory complexity and drives deeper data demands



Tax, data and analytics — moving from control to transformation

Global tax department benchmarking survey: Latin America special report

Outlook for US Tax Reform web site

For ongoing KPMG insights on the outlook for US tax reform.

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