MAYER • BROWN

WITA Intensive Trade Seminar

International Tax and Competitiveness

Warren S. Payne
Senior Tax and Trade Policy Advisor
wpayne@mayerbrown.com

May 13

Basics of International Tax

- Worldwide Taxation: Right to tax income regardless of where it is earned.
- Territorial Taxation: Right to tax income only to the extent it is earned in the country levying the tax.
  - Most OECD countries have gone to a territorial form of taxation.
- U.S. system is effectively a hybrid of the two.
  - Applies worldwide taxation,
  - Tax liability is deferred until the income is brought back or "repatriated" to the U.S.,
  - Tax liability is reduced by the application of credits for taxes paid in foreign jurisdictions.

Basics of International Tax - Example

- UK firm earns income from operations in the U.S.
- UK firm pays tax in the U.S. on U.S.-connected income.
- After (U.S.) tax income repatriated to UK without being subject to UK income tax (rate of 20%)

- U.S. firm earns income from operations in UK.
- U.S. firms pays tax in UK on UK-connected income.
- After (UK) tax income repatriated to U.S. and subject to 35% tax less credit for taxes paid in UK.
- U.S. rate higher than UK rate so U.S. firm pays residual tax of 15%.

International Developments in Tax Policy - BEPS

- OECD Base Erosion and Profit Shifting (BEPS) project.
  - OECD serves as clearing house for setting norms of international tax policy, e.g. OECD "models" for transfer pricing and tax treaties.
  - Historically efforts focused on avoiding "double taxation" or the circumstance where two countries claim the right to tax the same income.
  - BEPS project flips the focus to avoiding "double non-taxation" or the situation where no country taxes the income. New premise is that all income should be subject to an unspecified minimum amount of tax and failure to tax in one country frees up another country to tax it.
  - U.S. world-wide system with deferral, creates lots of income that is not being <u>currently</u> taxed – so other countries are trying to tax it.

International Developments in Tax Policy – EU State Aid Investigations

- EU Treaty obligations prohibit EU governments from providing subsidies to companies.
- EU State Aid investigations represent efforts by EU Commission to target certain tax regimes as providing illegal subsidies.
- The bulk of the targeted companies are U.S. headquartered companies, e.g. Apple, Starbucks, McDonalds.
- Has led U.S. policy makers, Senators Hatch, Wyden, Portman and Schumer and Treasury Sec. Lew to raise concerns about discrimination against U.S. firms.

International Developments in Tax Policy – LuxLeaks & Panama Papers

- Part of a larger narrative around international tax that focuses on large companies and wealthy individuals not paying any or enough taxes.
- Motivates pundits and some policy makers to pursue increasingly aggressive efforts on tax collection and public dissemination of tax information.
- An example of the fall out includes new calls for information in Country by Country (CbC) reports required under OECD BEPS to be made public – effectively disclosing confidential taxpayer information.

International Developments in Tax Policy – More Tax Reform in Other Countries

- Many countries continuously reviewing, reforming tax regime in response to international developments.
- Examples,
  - Adoption of patent box regimes (preferential tax for income associated with sale of goods with a lot of IPR),
  - Imposition of new minimum taxes on foreign firms, and
  - Continued lowering of corporate tax rates.
- U.S. slower to react, but not completely standing still,
  - PATH Act in December 2015 – many key expiring tax policies made permanent.
- However, pressure will increase on U.S. companies and policy makers.

International Developments in Tax Policy – Targeting U.S. firms

- Some of the biggest changes in international tax policy arguably target U.S. based firms:
  - BEPS,
  - State Aid Investigations,
  - Minimum or diverted profits taxes.
- Question: Are these actions discriminatory?
- Question: If they are discriminatory, could they conflict with international trade obligations?