Leverage the Changing Tax Landscape

Restructuring creates options for increased profitability

The scope and rarity of the 2017 U.S. tax law reform offers corporations an unprecedented opportunity to focus on core business functions and to increase profitability. A dramatic reduction in top-line tax rates means most corporations will increase profits for their shareholders without even trying. However, playing it safe invites risk. This overhaul provides a once-in-a-lifetime chance to create transformative organizational change.

Leveraging the benefits of the tax law first requires ensuring that the data input into analysis and assessment is clean. Data integrity is an absolute necessity to comply with the tax law, re-assess entity structures and position an organization for accelerating profits and market leadership.

Since Congress authorized the creation of the federal income tax in 1913, the tax code has been comprehensively overhauled only twice: once in 1986 and again in 2017. You're not likely to see another overhaul, especially one as favorable as this, in your working lifetime.

Because there are so many provisions that impact corporations, there are a multitude of opportunities to leverage tax code changes. In such a target-rich environment, what portions of the tax law do corporations focus on first? Your tax and legal teams are front and center in terms of untangling the implications of the tax law. As partners in decoding, complying with and understanding the implications of the law, the collaboration between tax and legal teams is critical.

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5% to 10.5% boost in S&P 500 2018 earnings, analysts predict [i]

Collaboration across your organization will position your company proactively to maximize profitability. This path may involve corporate restructuring. That's because current structures were built with the previous tax law in mind. In addition, acquisitions, divestitures and international expansion may have created outdated, inefficient business structures. A fresh examination of your organizational structure can accelerate your competitive positioning to gain and maintain market leadership in your vertical diagramming to empower your organization to better understand potential options and outcomes.

Your tax and legal teams are best positioned to consult on the opportunities. In all likelihood, they are already analyzing the provisions in the context of your industry and how the law will evolve over time. Building a framework that encompasses opportunities within the law, as well as corporate goals and current corporate structure, creates a basis from which to formulate a relevant and realistic restructuring plan.

The U.S. tax changes throw down the gauntlet to other developed nations' tax codes, setting the United States up as a preferred jurisdiction for corporate headquarters, operational locations and overall U.S.-based investment. Economists expect that this is just the beginning of a global tax realignment that will challenge corporate executives and boards to keep pace.

Major New U.S. Tax Law Provisions

There are two sides to the U.S. tax law restructuring: corporate and individual. While most executives and boards are focused on the corporate provisions, the collective changes are expected to increase employment, raise corporate profitability and increase economic growth. Based on an analysis by the Tax Foundation[ii], the law is expected to:

- **Increase GDP by 1.7% over the long term**
- **Boost wages by 1.5%**
- **Add 339,000 full-time jobs**

The biggest change for corporations is the reduction in the corporate tax rate from 35% to 21%. While many corporations didn't pay the full 35% rate, the reduction is significant and promises increased profits and investment going forward. Individual rates have also been reduced. However, while the corporate tax rate change is permanent, the individual tax rate cuts are temporary, and are set to expire in 2025.

0.44% higher GDP growth in 2018 from tax law over baseline projections [iii]

Full Expensing. The removal of limits on capital expensing—known as full expensing—means that companies can write off their entire investment on new and used equipment immediately. Assets acquired between Sept. 27, 2017, and Dec. 31, 2023, are eligible. Mergers and acquisitions benefit from a reduction on taxes for deals structured as asset purchases, which include partnerships and, potentially, other pass-through entities.

Debt Financing Disadvantaged. Congress dropped the hammer on debt-fueled financial engineering, which prompts rethinking of corporate financing and corporate structures moving forward. Previously, corporations could deduct all of their net interest expense. Under the new law, that deduction is unchanged for the smallest companies, those with revenue at or under $25 million a year. However, companies with revenue in excess of $25 million a year can only deduct 30% of that interest.

Net Interest Expense Tax Provisions

Debt Financing Loses its Appeal

	$25M	>$25M
2017 and earlier	No limits	No limits
2018–2021	No limits	30% EBITDA limit
2022 and later	No limits	30% EBIT limit

Source: Thomson Reuters [iv]

The days of fueling acquisitions, share buy-backs, dividends, pension obligations and acquisitions with cheap debt are over. Not only has the tax law disadvantaged corporate debt through decreasing the net interest expense deduction, but rising rates also create even less incentive to borrow.

36% increase in U.S. corporate debt from 2008-17 [v]

Large corporations are already pulling back their plans to issue debt in 2018. Others plan to refinance debt or pay down debt with the proceeds from cash repatriation. The rise in debt issuance by large corporates was fueled, at least in part, by what is known as synthetic repatriation. Synthetic repatriation involves issuing domestic debt to avoid paying a high tax rate on cash that is held overseas. Now that taxes have been imposed on overseas cash and assets, there is no need to resort to this tactic because corporations will have access to those funds.

Territorial Tax-Related Provisions. The tension between globalization and protecting national interests is highlighted in several new tax provisions. These are designed to ensure that multinational firms pay U.S. taxes on profits from U.S. operations, rather than moving profits to countries with extremely low tax rates.

This mindset shift is displayed in three specific provisions:

1. **Repatriation Discount:** Corporations that hoarded more than $3.1 trillion overseas[vi] are required by the tax law to pay tax on cash and illiquid earnings accrued offshore since 1986. Taxes are due regardless of whether cash or assets are actually repatriated. The favorable repatriation rate is 15.5% on cash and cash equivalents and 8% on illiquid assets, such as property, plants, equipment and intellectual property.

$223.6 billion projected savings in taxes on foreign profits

2. **Related Company Payments:** The base-erosion and anti-abuse tax (BEAT) applies to multinational companies that earn more than $500 million in annual revenue in the U.S. and that engage in a significant number of cross-border transactions with related entities. The provision dictates that a minimum amount of tax must be paid on U.S. profits. The tax starts at 5% in 2018, increases to 10% in 2019 and then bumps up to 12.5% in 2026.
3. **Foreign Income Tax:** The global intangible low-taxed income tax attempts to ensure that multinational firms pay a minimum of tax on their profits, especially on intangible assets. If a company fails to pay at least 10.5% in taxes on foreign income, based on a percentage of foreign tangible assets, that company must pay the difference to the IRS.

Top U.S. Tax Reform Provisions

- ✓ 35% -> 21% tax rate cut
- ✓ 15.5% rate on overseas cash
- ✓ 8% rate on overseas illiquid assets
- ✓ 30% limitation on net interest expense
- ✓ Full expensing of new and used assets
- ✓ 15 -> 39-year recovery for real property
- ✓ 21% discount on asset purchases
- ✓ 5% BEAT tax

Data Sets the Stage for Transformation

It's impossible to overestimate how important data is to not only taking advantage of the tax law, but also complying with it. As soon as the tax law was signed on Dec. 22, 2017, corporate accountants canceled their holiday vacations and dug into the law's provisions.

Generally Accepted Accounting Principles (GAAP) require companies to reflect the impact of the tax law on their finances in the quarter in which it was signed into law. Many companies that follow a calendar year reporting schedule will have to report updated financial information 60 days after the beginning of this year.

In order for finance, tax and legal to comply accurately with the tax law, they must source clean data from a trusted chain of custody. Accurately assessing tax liabilities on offshore cash and deferred tax items is also contingent upon data integrity. In fact, data integrity affects every aspect of an organization, including the legal and tax functions.

The concept of data integrity includes data custody, governance and cleanliness. To ensure data accuracy, organizations must establish where and how data is maintained (custody); the standards by which data is sourced, gathered and maintained (governance); and the systems that audit and reconcile data to verify the fact that it is clean.

It's not possible for finance, tax and legal to assess their tax liabilities on offshore cash and deferred-tax items without knowing exactly what those are. Accountants, attorneys and finance executives geared up to excavate records going back to the last tax overhaul in 1986 and to examine finances in their subsidiaries around the world to calculate liabilities under the new rules.

Clean data is critical to effective, efficient and accurate tax reporting. Multinational corporations with thousands of entities in hundreds of jurisdictions must ensure that the data they use for compliance and tax reporting flows through their reporting systems quickly, transparently and correctly.

Changing Global Tax Landscape

Cutting tax rates is a surefire way to attract investment. Ireland cut its corporate tax rate to 12.5% in 2003. Today, more than 155,000 people are directly employed in Ireland by more than 700 firms with U.S. headquarters, which accounts for $387 billion in direct foreign investment[vii]. Economic growth is a stated goal of the U.S. tax cut, which is designed to make the U.S. a more attractive destination for corporate investment, cutting into the advantages of jurisdictions such as Ireland.

37% reduction in global weighted corporate tax rates since 1980[vii]

Overall, corporate tax rates have fallen significantly since 1980. The United States, until the most recent tax cut, was one of a few jurisdictions to resist tax reform. Tax overhauls don't happen every day. However, once one country makes a change, it's difficult for others to keep the status quo. In fact, global tax experts predict tax reform will spread as other countries seek to realign their tax rates to make them more competitive with those of the United States.

You can't make plans based on potential tax changes. The priority is to evaluate and implement considered changes related to the U.S. tax code. For both U.S.-based companies and multinationals with U.S. operations, opportunities for improving profitability and overall tax positioning and investment are numerous.

In the coming years, other jurisdictions are likely to make moves to become more competitive. Ensuring that your organization can quickly evaluate and respond to these opportunities will help you maintain your competitive position in the marketplace.

2017 OECD Corporate Tax Rates[ix]

Country	Rate
United States	35%
France	34.43%
Belgium	33%
Mexico	30%
Australia	30%
Greece	29%
Portugal	28%
New Zealand	28%
Spain	25%
Netherlands	25%
Chile	25%
Austria	25%
Norway	24%
Italy	24%
Israel	24%
Japan	23.4%
Sweden	22%
Korea	22%
Denmark	22%
Slovak Republic	21%
Luxembourg	20.33%
Turkey	20%
Iceland	20%
Finland	20%
Estonia	20%
United Kingdom	19%
Slovenia	19%
Czech Republic	19%
Germany	15.825%
Poland	15%
Latvia	15%
Canada	15%
Ireland	12.5%
Hungary	9%
Switzerland	8.5%

Corporate Restructuring Benefits

Many organizational structures have evolved haphazardly over time. Tax regulations, accounting rules and jurisdictional requirements of a specific era dictated those structures, which may no longer serve your organization's business goals.

With that in mind, put your current organizational structure under a microscope. Don't stop there—take a step back and consider what your optimal organizational structure would look like if you had a blank slate.

First, assess the status of your organization today. Like many corporations, you may have hundreds—if not thousands— of entities located all over the globe. These entities may exist in a variety of corporate structures, depending on the function of the business unit and the jurisdiction in which it is located.

Base an organizational assessment upon accurate and clean organizational data about business units, employees, directors, structures and bottom-line contributions.

Technology facilitates the data-gathering processes, ensuring that you have accurate information for smarter decision-making. Once you have the organizational assessment in hand, your board and executives can use that as a jumping-off point to consider how best to align your corporate structure with your overall business goals.

Your organizational structure must serve your goals and drive profitability. All too often, organizational structures aren't optimized for organizational profitability, the current tax landscape and the current, optimal legal structures. If that isn't the case for your global entity, the U.S. tax law provides the perfect opportunity to change the equation.

If increasing profitability and creating transparency aren't enough reasons to at least investigate altering your corporate structures, then risk should be. Leveraging the latest technology, governance and data integrity systems for organizational change also supports strong, independent governance.

Organizational Restructuring Checklist

- ✓ Assess current organizational structure
- ✓ Determine optimal structure
- ✓ Align structure with business goals
- ✓ Drive profitability
- ✓ Increase transparency
- ✓ Reduce governance risk

Envision Corporate Restructuring

Planning is all well and good, but creating transformational change requires vision. Vision demands collaboration, a future-oriented focus and visualization of the data at your disposal and the plan you have in mind. You can't afford to make mistakes, but you don't want to let caution rule.

Data visualization, driven by entity management charting tools, marries your plans with your vision. Think about the data behind the scenes and how tax and legal can use the data to envision an organizational structure that leverages opportunities and efficiencies to create the most effective structure possible. Organizational charting effectively conveys the narrative behind the re-envisioning of your corporate structure to reveal the impact of potential change. Use data visualization to translate potentially complex changes in business structure to show the impact of those changes before actual implementation.

Business objectives must drive organizational structures, not the other way around. Data visualization moves your organization toward an optimized solution designed to leverage the impact of the U.S. tax law changes.

The tax law is so far reaching, with provisions phasing in and out over the next decade, that stakeholders across the organization—especially tax and legal—must be involved in any re-visioning of corporate structures. Break down geographical, departmental, gender, racial, business line and administrative silos so that all relevant teams have a voice.

You can't afford to sideline legal, tax, finance, treasury or compliance, because these functions are so integral to interpreting the nuances of the tax law and implementing organizational change. Strong governance and ongoing compliance responsibilities translate into a seat at organization decision-making tables for your tax, legal, finance and compliance teams.

Finally, any change must involve the most appropriate technological solution to leverage smart decision-making and organizational goals. A technology platform that can deliver clean data that acts as an organizational source of truth fuels systematic processes and streamlined procedures. Integration with your other operating systems avoids errors, wasting time and operational inefficiencies.

Execute Corporate Restructuring

Any large project involves implementation risk. Too many organizations underestimate appropriate costs, timelines and human capital requirements when moving from the planning to the execution stage of a project. This is the mother of all projects, so creating an executable plan, crafting an ambitious, but realistic, schedule and allocating sufficient resources is the key to success.

"Execution is a specific set of behaviors and techniques that companies need to master in order to have competitive advantage. It's a discipline of its own."[x]

— Larry Bossidy, Ram Charan, Charles Burck, Execution: The Discipline of Getting Things Done

Obviously, tax, legal and compliance personnel are key members of the implementation team. Their expertise supports the goals of any tax overhaul-based corporate restructuring. Bringing in project managers from these areas and key operational verticals is also critical.

Effective restructuring leverages technology. Such technology ensures that you know where you stand when you start and possess the robust solution that will not only get you where you want to go, but also support your organizational growth in the future.

Maximize Your Tax Law Response

The 2017 U.S. tax law change is an opportunity for organizations to restructure for the future, leaving legacy structures, organization and technology behind. With savings from the tax rate in hand, prudent investments in technology and partnerships can successfully position your organization for change.

Any restructuring must maximize corporate efficiency and elevate profits, competitive position and market leadership. Retroactive provisions encourage organizations to act quickly to acquire targets, break ground on new facilities and purchase equipment. Tax-law restructuring is truly a marathon, rather than a sprint. Still, don't let your competitors set the terms—leverage the law for your ongoing competitive advantage, rather than reacting to others.

Tax Law Gives to and Takes from Foreign Firms

While 2017 U.S. tax law reform offers a clear victory for U.S.-based companies, the verdict is much more mixed for European firms with U.S. affiliates. Lower overall tax rates and immediate expensing of investment costs make investment more attractive, while base-erosion and anti-abuse tax provisions (BEAT) possess the potential to offset gains from more favorable provisions.

> *"The stimulus to investment in the United States provided by a lower corporate tax rate and full investment expensing might lead to higher inward investment in the United States, and possibly to further re-shoring of manufacturing activity."*[xi]

Acquiring assets in the United States immediately becomes more attractive for foreign firms, which has the potential to increase a variety of activities, including:

- **Acquisition of U.S.-based assets**
- **Acquisitions of U.S.-based companies**
- **Investment in U.S.-based operations**
- **Expansion or upgrades of U.S.-based operations**

However, how much benefit a foreign firm can extract from the new tax regime depends on a foreign firm's structure, industry, debt load and propensity for inter-company transactions. The base-erosion and anti-abuse tax provisions are expected to adversely impact foreign companies that engage in strategies designed to lower taxable income in the U.S. These include inter-company transactions, including interest and payments for software and pharmaceutical sales rights.

For example, companies that engaged in inversions by switching their headquarters from the United States to overseas initially benefited through lower tax rates and specific deductions. Now, BEAT provisions are likely to curtail these benefits, increasing their effective tax rates.

BEAT provisions are part of a switch to a territorial taxing system. U.S. Treasury officials have not yet issued guidance on how these provisions will be interpreted and enforced, so their ultimate impact on individual companies is uncertain at this point in time.

Executives need to weigh a number of factors when deciding on strategies to deal with the tax law, including their individual lines of business, where their subsidiaries are located and how individual provisions in the tax law will affect those operations.

About Diligent Entities

Diligent Entities is our web-based entity management, governance and compliance solution, allowing users to access and manage their corporate compliance data 24/7, anytime, anywhere. With thousands of Users worldwide, across every conceivable industry, our client-base features many of the largest companies in the world such as Microsoft, Exxon, Chevron, Disney, TimeWarner, General Motors, as well as large clients in Europe, Africa, the East, Far East and Australasia. We have dedicated sales and support offices in the UK (HQ), US (Stratford, CT), Australia (Sydney), the UAE (Dubai) and Hong Kong. We are also a multi-site Microsoft Gold Partner with both the ISV and Hosting competencies.

Our commitment to providing a suite of highly secure and integrated solutions is the reason why many FTSE100, FORTUNE 500, EURONEXT 100, ASX 200, government organizations and public bodies trust us to manage their corporate information to deliver good governance.

We have a 98% client retention rate, the highest client retention rate in our industry, achieved by providing superior customer service and support.

Notes

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