PRIORITY

BUTLER | SNOW

Name of Client: Butler Snow
Publication: The Straits Times
URL: Print
Date: 23 March 2018
Pages: 1 of 4

THE STRAITS TIMES
OPINION
PREMIUM

Speaking Of Asia

Getting snagged in new US tax net

Ravi Velloor
Associate Editor

With the first of the deadlines approaching, how ready Asia is for the full impact of the new US tax systems is open to question.

Something changed in the United States late last December with the new tax laws that amount to a wholly fresh approach to the way that it approaches companies and individuals. It's a transition so fundamental, and yet it is not clear if its wider implications have been fully appreciated in Asia.

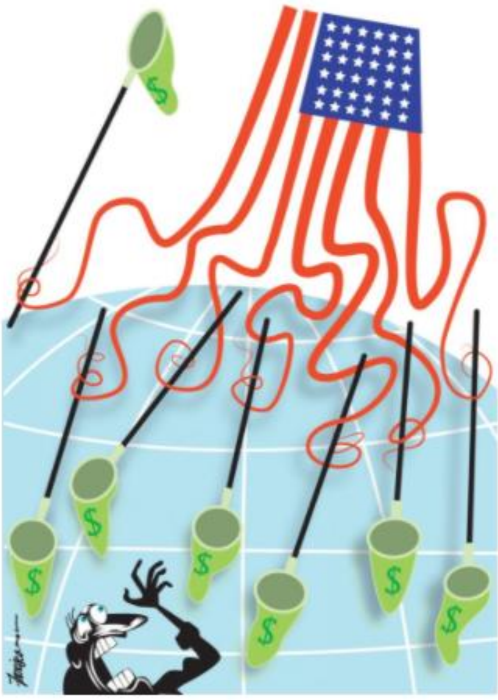
The headlines outside the US have focused largely on two elements of the Tax Cuts and Jobs Act. The dramatic cut in the corporate income tax rate from a top 35 per cent to a flat 21 per cent has got the most attention. To a lesser extent, so too has the change from a worldwide tax system to a so-called territorial one.

Buried in the noise are the complications that arise from new provisions with ominous-sounding acronyms such as GILTI - short for Global Intangible Low-Taxed Income - and the vexing challenges of complying with a plethora of new regulations, a lot of which require drudge paperwork to meet proper compliance.

With April 15 marking the first of the approaching deadlines for some aspects of compliance, and for American shareholders of non-US companies to pay the first of eight instalments of a "deemed repatriation" tax, it is useful to step back and see how Asia, and Asians, could be affected by all this.

Perhaps the one area about which Asia could be reasonably sanguine is the effect of the US tax changes from the perspective of the broader economy. The new rules have fetched criticism in some quarters that the company tax cut underscores a race to the bottom. At 21 per cent, the current US rate indeed is dramatically lower than before - a full 14 percentage points.

But many do feel that a moderation of those high rates was long overdue. The new flat rate of 21 per cent actually puts the US closer to the mean and perhaps just a shade lower, if at all. Average European corporate tax rates, for instance, are lower than the new US rate, at about 19 per cent. The UK tax base rate, already lower than the US', is set to go further south in 2020.



ST ILLUSTRATION : MANNY FRANCISCO

As for Asia, while some of the bigger markets like Indonesia, Malaysia and Thailand tax companies at a higher rate, there are tax jurisdictions such as Taiwan, Hong Kong and Singapore, where the corporate tax is lower than the US rate - 17 per cent in Singapore and Taiwan, for instance, and a half-percentage point lower in Hong Kong.

Could this lead to capital flight from Asia? Not very likely. The fundamental need to be entrenched in the midst of the world's most dynamic region will probably mean the lower home tax will be something to eye, but not to act upon.

"A lot of US companies in the region are currently doing cost-benefit analysis to determine if they should be restructuring their operations," Mr Daniel Joe, who heads KPMG's Asia law practice from Singapore, told me recently. "This is not a simple task. But at the moment they are in that mode, although from where I am sitting, I have not seen a lot of restructuring from the perspective of tax reform."

As DBS Research's Taimur Baig said in a note to clients in late December, the new US tax regime is probably a bigger risk for Europe and Latin America than for Asia.

TERRITORIAL ISSUES

The problems begin when the new tax system gets to be applied to companies and individuals. And this is where it is not clear that people in Asia, especially those with US citizenship or a US green card, have fully grasped the implications.

For all the talk that the US has moved to a territorial tax system, which would mostly exclude foreign-earned income from US taxation, the facts remain that the "territorial" aspects of the new law apply only to corporations, and US individuals remain fully taxable in the US on their global income. The US will still pursue individuals worldwide if they have not paid their dues, and with ever-more reliable sources of information.

From FATCA, the Foreign Account Tax Compliance Act, to the OECD's Common Reporting Standards and corollaries like Automatic Exchange of Information, we are in an era where information will be exchanged between governments about both corporates and individuals. The days of sticking your head in the sand are over.

When the proposals were sent to Congress, the administration explained that the framework plan was to prevent US companies from shifting their profits to tax havens. It would do so with rules to protect the US tax base by offering a reduced rate as well as go "on a global basis" for the profits earned abroad by US multinationals.

"Even if you concede that the US has moved to a territorial tax system for corporations, exceptions abound in the new law that capture US corporations' non-US sourced income," says Mr Kurt Rademacher, a partner at the Hong Kong and Singapore offices of US law firm Butler Snow, which focuses on tax and estate planning advice to high net wealth families and family-controlled businesses in South-east Asia with US connections.

For instance, he says, many laymen - presumably most members of Congress too - believed that the GILTI rules would capture only "intangible" income that was actively manipulated to achieve a very low, or zero, tax rate.

This would happen, for instance, when a US company places its trademarks or other intellectual property in a tax haven entity that then licenses that intellectual property back to the US parent company in exchange for a fee, thus extracting income from the US tax net. The theory behind the GILTI rule was that Congress needed a backstop to prevent this sort of manipulation. However, the GILTI rules were hastily drafted, and they actually catch many types of non-US sourced income that are not necessarily related to intellectual property.

Mr Rademacher says every US multinational will need to look at its overseas subsidiaries to determine whether they are subject to numerous sets of taxes on their local sourced income. "Given the GILTI rules and the new BEAT tax (also aimed at multinational companies' attempts to shift income outside of the US tax net), the idea that the US has moved to a truly territorial corporate tax regime is not defensible. At best, the new regime is "quasi-territorial", which creates substantial complexity for taxpayers doing their best to comply," he adds.

TANGLED FAMILY TIES

Tax experts think it could get more troubling as it moves to the level of smaller businesses and individual families.

Complexity is one thing for a multinational corporation with a professional in-house tax department. It is quite another for a family that is subject to the repatriation tax and may not even realise it.

Because large numbers of second-and third-generation family-controlled businesses in Asia have American citizens or green card holders in the family, partly because in the past many of their progeny went to the US to study, stayed back and worked there, or sunk roots after marrying American spouses with the children automatically becoming US citizens, the new rules are hitting home in Asia.

"A US citizen or green card holder who is a shareholder of a controlled non-US company is liable to pay the US a repatriation tax at up to 17.5 per cent on his or her share of that company's accumulated profits for the past 30 years. While you can elect to pay in eight annual instalments or in one go, the deadline to make that choice, not to speak of the first instalment payment itself, is due on April 15, 2018 and that is less than one month from today," says Mr Rademacher.

How does this work? Let's say you live in Jakarta or Manila and you own or run a hardware store through a local company and you have US nationality. All of a sudden, you find that you are liable to pay a 17.5 per cent US tax on the store's accumulated earnings since 1986! And that isn't funny.

As it goes fishing for funds parked overseas, the US has cast a wide net. Under the new rules, if five or fewer "US shareholders" own more than 50 per cent of the vote or value of a non-US company, it is treated as a "controlled foreign corporation" and subject to the repatriation tax.

Special attribution rules create deemed percentage ownership when parties related to the US person own shares. Even if one owns less than 50 per cent of the value of the company in question, he or she could also have US tax liability if he or she controls the majority vote.

If you thought all this is complicated enough, here is worse. People who belong to territories or states, such as Taiwan, the Philippines and Indonesia, that have matrimonial property regimes are particularly vulnerable here. Under the laws that apply in matrimonial property regimes, a person is deemed to be equal owner of his spouse's assets.

So, if one of the spouses is American, he or she is considered equal owner even if no assets are specifically titled in that person's name.

"Having a US spouse in a place where there is matrimonial property regime substantially complicates your life," says Mr John Shoemaker, an attorney at Butler Snow. "We always recommend that you never marry an American, but no one follows that advice."

Talk about holy acrimony! Make no mistake, the new tax code is going to be a headache for a whole bunch of Asians.

ST ILLUSTRATION : MANNY FRANCISCO

A version of this article appeared in the print edition of The Straits Times on March 23, 2018, with the headline 'Getting snagged in new US tax net'. Print Edition | Subscribe