US Territorial tax

What is the issue?

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- US is likely to enact new corporate tax reforms.
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- The territorial tax will have some impact on emerging markets like India.
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What is the present US corporate taxation rule?

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- The territorial method of taxing profits from the overseas subsidiaries of US corporations essentially aligns US tax methods with those of most developed jurisdictions.
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- For example, if Apple had repatriated profits from its subsidiary in Ireland, which charges a competitive 12 per cent rate, it would have had to pay 23 per cent tax.
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- It is then free to reinvest the after-tax profits in Ireland, in financial securities, or in operating businesses anywhere in the world except the US.
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- If the foreign subsidiary's parent company brings the after-tax profits back to the US, it must pay the current US corporate tax rate of 35 per cent.
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- The tax is collected on its original pre-tax Irish profits, with a credit for the 12 per cent that it has already paid.
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- US companies generally choose not to repatriate the profits of their foreign subsidiaries as there is 23 per cent penalty on repatriation.
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What is US new tax reform?

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- US is likely to adopt the “territorial” method of taxing the profits of US corporations’ foreign subsidiaries.
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- This will reduce the present a 35 per cent statutory tax rate on corporate profits to 15- 20 per cent.
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- Under the territorial method, US corporations will be able to repatriate their foreign subsidiaries’ after-tax profits with little or no extra tax.
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- It is also likely to enact a “deemed repatriation tax” on the $2.5 trillion of profits that have been accumulated abroad but never subject to US tax.
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- The basic idea of deemed repatriation tax would be to levy a tax of about 10 per cent on the untaxed overseas profits, to be paid over a period of years.
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- Companies in abroad will have an incentive to shift their headquarters to the US, without incurring the current tax penalty.
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- All these provisions, plus the sharp reduction in the domestic corporate tax rate to 20 per cent in the Bill, are designed to encourage US corporations to reinvest in the American economy and generate jobs.
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What are the expected impacts of this tax reform?

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- US Corporationswill simply stash the profits in high-yielding financial instruments or use them for buybacks and dividend distribution.
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- The benign nature of the territorial tax may encourage USA Inc to invest overseas more freely without the attendant hassle of tax planning.
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- At the same time tax on outgoing investment may simply encourage more US corporations to expand their dependence on offshoring.
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- Due to the relatively high wages and low productivity of American labour and this looks like a plausible scenario.
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- Predicting corporate behaviour is notoriously difficult and in the case of US

corporations, as it is more dependent on its mutable immigration and trade policies.
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- US is not a signatory to notorious practice of base erosion and profit shifting, which suggesting that US corporations may still indulge in treaty shopping.
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Source: Business Standard

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