Tax Alert

ISSUE 12 | **APRIL 2018**

U.S. Tax Reform - Implications for Singaporean Corporate Taxpayers with U.S. Investments or Business Operations

After a long pursuit for U.S. tax reform, President Trump signed a bill on 22 December 2017, overhauling the U.S. tax system which has been in place since 1986. This article highlights some of the significant provisions that could impact the U.S. taxation of Singaporean companies with investments or business operations in the U.S.

Overview of the U.S. Tax Reform

Tax Reform aims to increase the attractiveness of increasing investment and activities in the U.S. At the same time, the new tax law establishes measures to prevent base erosion from the U.S. To achieve these goals, the reform adds significant complexity to the existing U.S. tax system.

The significant provisions that may be relevant to Singapore companies include, but are not limited to:

- The permanent reduction in the corporate income tax rate to 21%;
- U.S. investment incentives including temporary (5-year) 100% expensing on certain qualified capital expenditures;
- The limitation on the deductibility of net business interest expense to 30% of adjusted taxable income (generally EBITDA for years before 2022 and EBIT thereafter);
- The minimum tax on certain deductible payments made to a non-U.S. affiliate (referred to as the "base erosion anti-abuse tax" or "BEAT"); and
- The taxation of gain from the disposition of interests in a partnership engaged in a U.S. trade or business.

The remaining provisions, including the new export rules, 80% limitations on net operation loss deductions, and changes affecting individuals, will not be discussed in this article.

Overview of the Significant Provisions

Reduction in the Corporate Tax Rate

Possibly the most significant change for corporate taxpayers is the reduction of the federal corporate income tax rate to a flat 21%, effective for tax years beginning after 2017.

Prior to this change, the U.S. had one of the highest corporate income tax rates (i.e., a 35% marginal rate) among OECD countries, even before taking into account the U.S. state and local income tax rates.

The rate reduction is expected to make the U.S. a more attractive destination for foreign investments. At the same time, however, the new law eliminates or restricts some tax benefits that drove down the effective corporate tax rate for certain corporations before the new law change.

Singaporean companies should therefore, carefully review their U.S. tax strategies to get the most out of the reduced tax rate and to examine whether the deductions they have been taking are eliminated or restricted under the new tax law as highlighted below.

Net Business Interest Expense Limitation

The new law generally disallows taxpayer's deductions for net business interest expense exceeding 30% of a business's adjusted taxable income, which is generally EBITDA for taxable years beginning after 31 December 2017, but before 1 January 2022, and EBIT thereafter. Any disallowed interest expense may be carried forward indefinitely.

The new limitation rules do not provide for the grandfathering of pre-existing debt, but do not apply to certain taxpayers. For example, taxpayers with average annual gross receipts not exceeding USD 25 million are generally exempt from the limitation. Additionally, real estate businesses may elect out of the limitation, although those electing out of this provision are required to use an alternative depreciation system to depreciate certain property.

Singaporean companies should re-evaluate their debt financing plans for U.S. operations and acquisitions under the new rule. They should also review their existing U.S. group capital structures and engage in modelling for optimal global debt placement, to minimize the impact of the new limitations.

Immediate Expensing of Certain Qualified Properties

The new law allows immediate expensing for certain "qualified properties" acquired and placed in service from 27 September 2017 and before 1 January 2023.

In other words, a U.S. taxpayer may treat the cost incurred in acquiring those properties and placing them in service as an operating cost rather than a capital investment, thereby deducting the amount immediately instead of depreciating it over an extended period of time. This provision, along with new, preferential export tax rules, are key Tax Reform investment features.

Immediate expensing will phase down yearly in increments of 20% for qualified properties placed in service from 2023 to 2026.

In general, "qualified property" is tangible property depreciable over 20 years or less. The immediate expensing provisions apply to both new and used properties if it is the taxpayer's first use. This provision does not apply to properties used in any business not subject to the new net business interest expense limitation, such as certain electing real estate businesses.

As the immediate expensing provisions will phase out by 2026, Singaporean companies may consider the timing of acquisitions of qualified properties as well as structuring more U.S. taxable acquisitions as asset purchases, particularly for asset-intensive targets, before 2026.

Base Erosion Anti-Abuse Tax (BEAT)

The new law imposes a minimum tax applicable to certain large U.S. corporation groups that reduce their U.S. tax liabilities below a certain threshold by making certain deductible payments (e.g., interest and royalties) to related non-U.S. entities. If applicable, a BEAT liability will be imposed in addition to the regular income tax liability.

A two prong test applies to determine if a BEAT liability applies - whether the U.S. corporation (i) is part of a group with at least $500 million of U.S. gross receipts on average over a three-year period, and (ii) has a "base erosion percentage" of 3% (2% for certain financial institutions).

The base erosion percentage is generally the ratio of (i) certain deductible payments, or the "base erosion deductions," made to non-U.S. affiliates, to (ii) the total amount of the corporation's deductions for the year. The base erosion deductions include most deductible payments to non-U.S. affiliates including interest, royalties and valuable services fees, and in respect of depreciation expense attributable to property purchased from a non-U.S. affiliate. Cost of goods sold and fees for certain low value services are generally not treated as base erosion deductions.

Corporations that satisfy both prongs of the test are required to compute their BEAT liability as if they had not made any base erosion payments (and disregarding most credits), and then apply the applicable BEAT rate to such modified taxable income. A taxpayer will generally have a BEAT liability to the extent the calculated amount exceeds the taxpayer's regular tax liability computed including credits.

The BEAT rate is generally 5% for taxable years beginning in 2018, 10% for years beginning between 2019 and 2025, and 12.5% thereafter. The BEAT rate is 1% higher for banks and registered securities dealers.

Singaporean companies with U.S. operations should consider possible supply chain modifications, such as transacting with unrelated parties, and should determine whether additional items can qualify as cost of goods.

Tax gain on the sale of a non-U.S. partner's partnership interest on look-through basis

The new law codifies the longstanding U.S. Internal Revenue Service (IRS) position that a non-U.S. partner's gain from a sale of an interest in a partnership that is engaged in a U.S. trade or business, will be taxed as "effectively connected income" (ECI) to the extent that a sale of assets by the partnership would have resulted in ECI for the non-U.S. partner. This provision overrules a 2017 Tax Court case that had rejected the IRS position.

In addition, the new law imposes a new 10% withholding obligation on buyers of such partnership interests, unless the seller certifies that it is a U.S. person. The rule includes a backstop – if the buyer does not properly withhold, the partnership recaptures the amount required to be withheld, plus interest, from future distributions to the buyer.

The U.S. Treasury Department has temporarily suspended application of the withholding provisions to publicly traded partnerships until further guidance is issued. The substantive tax provision applies to transfers occurring on or after 27 November 2017; however, the withholding obligation applies only to transfers occurring after 31 December 2017.

Singaporean companies should consider revising their partnership agreements to address the new law, the potential for partnership level withholding, and the creation of indemnification rights for withholding liability exposure.

How we can help

As a committed tax advisor to our clients, we welcome any opportunity to discuss the relevance of the above matters to your business.

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