KPMG

Jnet newsletter

U.S. business update for Japanese companies

Issue 3 - 2017

ENGLISH EDITION

KPMG's U.S. Japanese Practice

Contents

Subscribe

Published since 1997, Jnet is issued quarterly to update you on audit, accounting, tax, and other business issues relevant to Japanese companies operating in the United States.

To subscribe to this Newsletter or to receive further information on any of the matters discussed, please contact your local Japanese Practice professional, or email us at us-kpmg-jp@kpmg.com.

KPMG

Jnet newsletter

U.S. business update for Japanese companies

U.S. CEO Outlook 2017: Disrupt and Grow

KPMG's U.S. CEO Outlook 2017 of 400 U.S. chief executives reveals rising confidence among chief executives about business prospects, the U.S. economy and the positive potential of disruption. Results show that most have a positive outlook on economic growth over the next three years, and possess far greater confidence in the United States and in their companies than last year.

An increasing number of CEOs are getting more comfortable with rapid, technology-driven change, appreciating the value of disruption and the vast potential that accompanies it. In fact, six out of 10 CEOs now view technology as an opportunity, not a threat.

Nearly three quarters of CEOs surveyed say they are actively pursuing disruption in their own sectors, rather than waiting for competitors to do it. That's a marked contrast from a year ago when two-thirds of CEOs in our 2016 survey admitted concern that their organizations were not disrupting business models in their industry.

Key findings

CEOs confident, see opportunity amidst disruption

— 46 percent are 'highly confident' about their growth prospects in the next three years, up from 32 percent in 2016

— 72 percent say rather than waiting to be disrupted by competitors, their organizations are actively disrupting their own sectors; in 2016, two-thirds of CEOs were concerned their organizations were not disrupting business models in their industry

— 60 percent see technological disruption as more of an opportunity than threat

Digital & sensory concerns

— 57 percent say their organizations do not have the sensory capabilities and innovative processes to respond to rapid disruption

— 61 percent are concerned about integrating cognitive processes and artificial intelligence

— 45 percent say they are not leveraging digital as a means to connect to their customers effectively

Integrity of data questioned

— 49 percent are concerned about the integrity of the data they base decisions on

— 32 percent say the depth of their customer insight is hindered by a lack of quality customer data

Speed-to-market tops priorities

— Improving speed-to-market, digitizing business, becoming more data-driven and building public trust are their top strategic priorities

Customer focus dims a bit

— A stronger client focus ranked 10th in strategic priorities; in the 2016 study it ranked first

— 48 percent say they have a growing responsibility to represent the best interests of their customers

— 56 percent say that their organizations can confidently articulate how they create value for customers

Cybersecurity spend has its rewards

— Three-quarters see investment in cybersecurity as an opportunity to find new revenue streams and innovate

— CEOs expect significant investments in cyber, digital infrastructure, regulatory compliance and emerging technology over next three years

Trust, values and culture keys to future

— 81 percent believe their organization is placing greater importance on trust, values and culture in order to sustain its long-term future

— 69 percent say a culture of short-termism has had a negative impact on long term strategic objectives

CEOs become more U.S.-centric

— 92 percent view U.S. as top market for new growth; last year U.S. CEOs viewed India (44 percent) as top market for growth followed by U.S. (37 percent) and China (36 percent)

— U.S. CEOs more confident than non-U.S. peers on global economy

— To achieve growth, 44 percent of CEOs intend to increase penetration into existing markets

— 54 percent are reassessing their global footprint

Recruiting budgets target cognitive, risk specialists

— While overall hiring is expected to be lower, 80 percent of CEOs are increasing budgets for recruiting

— A third of CEOs are 'significantly' increasing headcount because of impact of emerging technologies, especially in middle and senior management, R&D and HR

— 77 percent recruiting new skills/specialists to help better understand geopolitical risks

Read KPMG's U.S. CEO Outlook 2017 for new CEO perspectives that indicate an uptick of positive trends emerging across a range of issues and industries.

For more information, download the full report below.

Download Now
US CEO Outlook 2017 > (PDF/2.08MB)

https://assets.kpmg.com/content/dam/kpmg/us/pdf/2017/06/us-ceo-outlook-survey-2017.pdf

Questions?
If you have any questions about this article please reach out to your KPMG engagement team or email us at us-kpmg-jp@kpmg.com.

KPMG

Jnet newsletter

U.S. business update for Japanese companies

Chief Tax Officer Insights (June edition)

Never before has the tax department played such an integral role in the success of the business. Chief tax officers (CTOs) are expected to align tax with business goals, drive strategic value, increase transparency, and improve the efficiency of tax operations. CTO Insights from KPMG LLP is designed to highlight top-of-mind issues for tax executives and ways CTOs are addressing these opportunities and challenges.

Tax departments continue to play a key role in the overall success of the business. In the June edition of Chief Tax Officer (CTO) Insights we discuss recent developments on U.S. corporate tax reform, including steps CTOs are taking to prepare and how they are communicating internally and externally around reform. Also in this edition, we highlight the growing significance of robotic process automation and how it is coming into play in the tax function.

Questions to consider:

- When do you think the earliest effective date for tax reform will be?
- How have you evaluated how specific tax reform proposals affect your company?
- What message regarding tax reform are you communicating to your leadership?
- Do you believe robotic process automation will offer value to your tax function?

For more information, download the full report below.

Download Now
Chief Tax Officer Insights (June edition) > (PDF/3.37MB)

https://assets.kpmg.com/content/dam/kpmg/us/pdf/2017/09/us-cto-Insights-june2017.pdf

Questions?
If you have any questions about this article please reach out to your KPMG engagement team or email us at us-kpmg-jp@kpmg.com.

KPMG

Jnet newsletter

U.S. business update for Japanese companies

Rise of the Humans

The convergence of artificial intelligence, robotic process automation (RPA), machine learning and cognitive platforms are the forefront of the Fourth Industrial Revolution. As organizations seek to streamline process and reduce operating costs, cognitive technologies are creating a new class of digital labor.

While the debate continues whether digital labor will remove or add jobs, KPMG professionals explore how digital and human labor can integrate. This paper delves into the potential transformation to the shape, size and functions of organizations.

In brief

— Despite doom and gloom scenarios for massive unemployment, cognitive technologies can spur new jobs and enhance human skills and expertise.

— The kind of jobs will likely change, however, especially middle-income routine jobs that are likely to be replaced by cognitive platforms.

— The challenge for leaders is to integrate and make the most of both kinds of labor.

— A five-stage process of inquiry can help leaders systematically think through how the shape and size of their workforce should change.

— Arguments range as to whether digital labor will remove or grow jobs, and in truth the jury is still out.

Read the paper to discover five steps organizations can take to better understand how digital labor will affect their workforce, including a case study on the changing Human Resources organization.

For more information, download the full report below.

Download Now

Rise of the Humans > (PDF/1.07MB)

https://assets.kpmg.com/content/dam/kpmg/us/pdf/2017/09/us-rise-of-the-humans.pdf

Questions?

If you have any questions about this article please reach out to your KPMG engagement team or email us at us-kpmg-jp@kpmg.com.

KPMG

Jnet newsletter

U.S. business update for Japanese companies

Auditing & Accounting Update

In this section, we provide brief updates on regulatory developments in auditing and accounting that may impact Japanese companies in the United States. Further discussion of the issues can be found in KPMG's Department of Professional Practice's Defining Issues
http://search.kpmginstitutes.com/?bigi=1&q=Defining+Issues&x=0&y=0

SEC expands nonpublic reviews of registration statements

Defining Issues 17-14 reports on the SEC's decision to allow most companies to confidentially file registration statements for nonpublic review. The decision means that many documents will not be available for public review until closer to the time that the securities offering occurs.

Go to Defining Issues 17-14 >
https://frv.kpmg.us/content/dam/kpmg-frv/pdf/2017/defining-issues-17-14-sec-nonpublic-reviews.pdf

FASB changes accounting and EPS for certain instruments with down round features

Defining Issues 17-15 reports on ASU 2017-11, under which down round features will not cause certain instruments to be accounted for as derivatives. This means that fewer free-standing equity-linked instruments with down round features will be accounted for as liabilities and fewer features with down round features will be bifurcated from the host contract than under current accounting.

Go to Defining Issues 17-15 (PDF) >
https://frv.kpmg.us/content/dam/kpmg-frv/pdf/2017/defining-issues-17-15-down-round.pdf

IFRS Perspectives (May edition)

The May 2017 edition provides an update on IFRS issues in the US, including no-GAAP financial measures, Brexit, carve-out financials and IFRS 15 implementation.

Non-GAAP financial measures are thriving

Despite increased scrutiny from the SEC and other regulators, the use of non-GAAP financial measures continues to grow. The IASB is looking at options to incorporate alternative performance measures, such as EBIT or EBITDA, into IFRS as part of its project on primary financial statements.1 These activities, as well as IOSCO's Statement on Non-GAAP Financial Measures issued in 2016, evidence the challenge of enhancing communication around financial performance without misleading the reader or diluting the importance of the GAAP measures.

Read more:
http://www.kpmg-institutes.com/institutes/ifrs-institute/articles/2017/05/ifrs-1-non-gaap-financial-measures-thriving.html

Brexit: IFRS considerations for US companies

Among other things, Brexit brings regulatory uncertainty and market volatility, possibly affecting the financial statements of US companies with significant UK operations. Impairment, foreign currency translation, income tax and risk disclosures are a few examples. A robust and continuous monitoring of political and regulatory developments in the UK is essential to getting financial reporting right.

Read more:
http://www.kpmg-institutes.com/institutes/ifrs-institute/articles/2017/05/ifrs-2-brexit-ifrs-considerations-us-companies.html

IFRS 15: Our five tips for a successful implementation

In less than seven months, IFRS 15 will go live. The modified retrospective approach is gaining in popularity, while estimating variable consideration, assessing performance obligations and compiling disclosures are top concerns for preparers. A proactive holistic assessment is key to a successful implementation. Read our five tips and speed up your IFRS 15 project.

Read more:
http://www.kpmg-institutes.com/institutes/ifrs-institute/articles/2017/05/ifrs-3-ifrs-15-our-five-tips-successful-implementation.html

IFRS combined and/or carve-out financial statements

Capital market transactions, private placements and M&A deals frequently require the preparation of IFRS combined and/or carve-out financial statements. While IFRS does not contain guidance in this area, the preparation of combined and/or carve-out financial statements in compliance with IFRS is possible when those financial statements are 'fit for purpose'.

Read more:
http://www.kpmg-institutes.com/institutes/ifrs-institute/articles/2017/05/ifrs-4-ifrs-combined-carve-out-financial-statements.html

IFRS vs. US GAAP: Liability/equity classification

There is no concept of 'temporary equity' under IFRS. Many instruments classified as a financial liability under IFRS could be classified as equity or temporary equity under US GAAP; and certain instruments that are equity under IFRS could be classified outside equity under US GAAP.

Read more:
http://www.kpmg-institutes.com/institutes/ifrs-institute/articles/2017/05/ifrs-5-ifrs-vsus-gaapliability-equity-classification.html

Contacts

Michael Maekawa
Partner, Audit
KPMG LLP
E: tmaekawa@kpmg.com

Questions?
If you have any questions about this article please reach out to your KPMG engagement team or the contact listed with this article.

KPMG

Jnet newsletter

U.S. business update for Japanese companies

Tax Update

In this section of Jnet, we provide brief updates on legislative, judicial, and administrative developments in tax that may impact Japanese companies operating in the United States.

July 2017

"Documentation regulations" under Reg. section 1.385-2 delayed by one year

On July 28, the IRS today released an advance version of Notice 2017-36 that delays the application of the "documentation regulations" under Reg. section 1.385-2 by one year. The documentation regulations will apply only to interests issued or deemed issued on or after January 1, 2019.

Today's IRS notice states that in response to a concern raised by taxpayers about application of the "documentation regulations" to interests issued on or after January 1, 2018, and in light of further actions concerning the final and temporary regulations under section 385 in connection with the review of those regulations, the IRS and Treasury Department have decided to delay the application of the "documentation regulations" by 12 months.

Accordingly, the IRS and Treasury Department have stated they intend to amend the "documentation regulations" to apply only to interests issued or deemed issued on or after January 1, 2019. Pending the issuance of those regulations, taxpayers may rely on the delay in application of the "documentation regulations" as provided in today's notice.

The IRS has requested comments concerning whether the proposed amendment and delay of the application of the "documentation regulations" provides adequate time for taxpayers to develop any necessary systems or processes to comply with the documentation regulations. Comments are to be submitted no later than Friday, September 1, 2017.

Administration and congressional Republican leaders release statement on tax reform

The "Big Six"—House Speaker Paul Ryan (R-WI), House Ways and Means Committee Chair Kevin Brady (R-TX), Senate Majority Leader Mitch McConnell (R-KY), Senate Finance Committee Chair Orrin Hatch (R-UT), National Economic Council Chair Gary Cohn, and Treasury Secretary Steve Mnuchin—released on July 27 a joint statement on Republican tax reform efforts.

The joint statement (as posted on Treasury's website) indicates that the Big Six are "confident that a shared vision for tax reform exists" and are prepared for the House Ways and Means and Senate Finance committees to "take the lead and begin producing legislation for the President to sign."

It also expressly states that a decision has been made to set aside border adjustability in order to advance tax reform.

Areas of consensus; process

Areas of consensus

The statement highlights lower tax rates for families and businesses (small and large), "unprecedented capital expensing," and bringing back "profits trapped overseas." More specifically, the statement says:

> *Above all, the mission of the committees is to protect American jobs and make taxes simpler, fairer, and lower for hard-working American families. We have always been in agreement that tax relief for American families should be at the heart of our plan. We also believe there should be a lower tax rate for small businesses so they can compete with larger ones, and lower rates for all American businesses so they can compete with foreign ones. The goal is a plan that reduces tax rates as much as possible, allows unprecedented capital expensing, places a priority on permanence, and creates a system that encourages American companies to bring back jobs and profits trapped overseas. And we are now confident that, without transitioning to a new domestic consumption-based tax system, there is a viable approach for ensuring a level playing field between American and foreign companies and workers, while protecting American jobs and the U.S. tax base. While we have debated the pro-growth benefits of border adjustability, we appreciate that there are many unknowns associated with it and have decided to set this policy aside in order to advance tax reform.*

Process

The statement indicates that the tax reform process will follow "regular order" in which the Ways and Means Committee and Finance Committee will be responsible for drafting legislation. Specifically, the statement says:

> *Given our shared sense of purpose, the time has arrived for the two tax-writing committees to develop and draft legislation that will result in the first comprehensive tax reform in a generation. It will be the responsibility of the members of those committees to produce legislation that achieves the goals shared broadly within Congress, the Administration, and by citizens who have been burdened for too long by an outdated tax system. Our expectation is for this legislation to move through the committees this fall, under regular order, followed by consideration on the House and Senate floors. As the committees work toward this end, our hope is that our friends on the other side of the aisle will participate in this effort. The President fully supports these principles and is committed to this approach. American families are counting on us to deliver historic tax reform. And we will.*

KPMG observation

Today's joint statement appears intended to build momentum for tax reform; to show that there are areas of consensus between congressional Republicans and the administration and that progress is being made; and to assure members of Congress that the process will follow regular order (rather than being a "top down" process in which congressional leadership largely dictates the substance of the legislation). It also appears designed to send a clear message that border adjustability has been set aside.

The statement does not include technical details regarding the issues on which there is consensus (including details as to how much individual and business rates might be cut). Nonetheless, based on the language of the statement, the general areas of consensus appear to include:

- Lower individual rates
- Lower rates for passthrough entities
- Lower C corporation rates
- Some form of capital expensing
- Some permanent provisions
- Repatriation of existing foreign earnings
- No border adjustability, but an unspecified approach to "ensure a level playing field between American and foreign companies and workers, while protecting American jobs and the U.S. tax base"

The statement does not address possible revenue offsets, including the deductibility of interest and the deductibility of state and local taxes. Nevertheless, the fact that priority is being placed on permanence suggests that some revenue offsets might be on the table. Very generally, this is because if tax reform is moved through budget reconciliation procedures, the revenue costs outside the "budget window" would have to be offset.

Notably, today's statement also does not explicitly address a variety of other tax proposals that have been raised, such as repealing the estate tax or territorial international taxation.

First round of NAFTA negotiations scheduled for August 2017

On July 19, the Office of the U.S. Trade Representative today announced arrangements for the first round of negotiations for the North American Free Trade Agreement (NAFTA).

The first round of the negotiations involving the United States, Canada, and Mexico will take place in Washington, D.C., from August 16 - 20, 2017. According to a USTR release, John Melle, Assistant U.S. Trade Representative for the Western Hemisphere, will serve as the chief negotiator for the NAFTA negotiations.

Regulations: Return due dates, extended due date amendments

On July 18, the U.S. Treasury Department and IRS released for publication in the Federal Register final and temporary regulations (T.D. 9821), and by cross-reference, proposed regulations (REG-128483-15) that update existing provisions to reflect the due dates and extensions of time to file certain tax returns and information returns.

The temporary regulations [PDF 398 KB] and proposed regulations [PDF 270 KB] update existing rules to reflect statutory requirements of legislation enacted in 2015 that revised the due date for filing income tax returns of C corporations and partnerships.

The regulations provide:

- Income tax returns of C corporations—except for a C corporation that has a tax year that ends on June 30—the last date for filing is the 15th day of the fourth month following the close of the tax year
- A seven-month automatic extension of time to file the income tax return of any C corporation with a tax year that ends on June 30 and before January 1, 2026 (a six-month automatic extension of time to file a return applies for all other corporations)
- A rule for the extension of time for the return for a short period that ends on any day in June, that treats the period as if it ended on June 30
- Income tax returns of partnerships due by the 15th day of the third month following the close of the tax year (March 15 for calendar year partnerships)
- A six-month automatic extension to file Form 1065 by partnerships
- An extension of time for estates and trusts to file Form 1041 of five and one-half months (September 30 for calendar year filers)
- A six-month automatic extension of time to file certain returns (Form 990 series) by exempt organizations

The preamble to the regulations explains what items are not addressed, such as the time for filing the FBAR (FinCEN Report 114, Report of Foreign Bank and Financial Accounts).

Interim list of Treasury regulations, responding to reduce tax burden

The IRS released on July 7 an advance version of Notice 2017-38 that contains a list of eight tax regulations that have been identified as either imposing an undue financial burden on taxpayers, or adding excessive complexity to the tax system. This list is in response to an April 2017 executive order, and the IRS release notes that the U.S. Treasury Department has identified eight regulations that satisfy the criteria of the executive order—including regulations issued under sections 385, 987, and 367.

Background

President Trump on April 21, 2017, signed an executive order (Executive Order 13789) directing U.S. Treasury to examine recent tax regulations to determine whether any of the regulatory projects: (1) imposed an undue financial burden on U.S. taxpayers; (2) added undue complexity to the federal tax laws; or (3) exceeded the statutory authority of the IRS.

Treasury was directed to review "significant tax regulations" issued on or after January 1, 2016, and to issue an interim report no later than 60 days after April 21. Treasury was then directed to submit a report to the president recommending specific actions to mitigate the burden imposed by regulations identified in the interim report. The final report to the president is due by September 18, 2017.

According to the executive order, Treasury was to take "appropriate steps" to delay or suspend the effective date of the identified regulations, and to modify or rescind the regulations, through notice and comment rulemaking.

Notice 2017-38

Today's IRS notice explains that for the period from January 1, 2016, through April 21, 2017:

- There were 105 final, temporary, and proposed regulations issued.
- Of these, 53 regulations were "minor or technical in nature."
- The 52 remaining regulations were treated as "potentially significant" and were re-examined for the purpose of the interim report.
- Of these, eight (8) have been identified as meeting one of the first two criteria of the executive order and qualify as "significant."

One of the eight regulatory projects is final and temporary regulations (T.D. 9790) under section 385 on the treatment of certain interests in corporations as stock or indebtedness. The notice indicates that both aspects of the regulations—the documentation requirement (contained in Reg. section 1.385-2), as well as the transaction rules that treat as stock certain debt that is issued by a corporation to a controlling shareholder in a distribution or in another related-party transaction that achieves an economically similar result, (generally contained in Reg. section 1.385-3)—are under review.

Comments are requested about whether these eight regulations need to be rescinded or modified, and if modified, how this is to be done to reduce burdens and complexity. Comments are due by August 7, 2017.

Comments are also requested as to whether any existing regulations warrant "a broader review." These comments are due by July 31, 2017.

June 2017

Hatch's statement on tax reform: Revenue offsets "on the table"

On June 7, U.S. Senate Finance Committee Chairman Orrin Hatch (R-UT) discussed current efforts of the Congress and the administration to unite behind a tax overhaul plan "…that will strengthen the economy, spur new job growth, and promote better opportunity for all Americans."

Chairman Hatch's remarks were delivered at a conference in Washington, D.C., and are available on the Finance Committee's website.

Among the issues addressed in Hatch's speech were:

- Revenue offsets and revenue neutrality
- Reducing tax rates and shifting to a territorial system
- Putting aside partisanship

Revenue offsets and revenue objectives

Chairman Hatch stated that "virtually any potential offset for reduced tax rates should be on the table." He also indicated that this includes the border adjustment tax (BAT) proposal in the House tax reform blueprint, explaining that:

> *I don't think I'm making any news when I say that, given the small margin of error we have in the Senate and the number of senators who oppose the very concept of a BAT, the proposal will have a difficult time becoming law. That said, I want to see the specifics of the proposal and find out if it works like its proponents say it will. Until then, I'm not going to publicly rule anything out.*

Chairman Hatch also indicated that some Republicans may have a difficult time supporting a package that adds to the deficit and that he would have to "see where the votes are." Nonetheless, Hatch expressed his personal view that he does not "see a problem with a tax reform proposal that loses revenue in the short-term if we can show that it will help put the economy on a better growth path."

Rate reductions and international reforms

The Finance Committee chairman also indicated that Republicans in the Senate, the House, and the White House were largely in agreement on "roughly 80 percent" of the key issues in tax reform, including, for example:

- The need to bring down tax rates on businesses (both corporations and passthroughs) to create jobs and grow the economy
- The need to fix the U.S. international tax system to make the United States more competitive while preventing base erosion

With respect to rate reduction, Chairman Hatch indicated that, although the general goal is to get rates as low as possible under the circumstances, he is not committed to any specific rate targets. Hatch explained that:

> *Until we perform the surgery and start eliminating preferences and credits in order to bring down rates—and get official feedback from the Joint Committee on Taxation—we can't speak definitively on the rate targets. And, of course, we have to see just where our members are going to object to the removal of certain tax provisions because, once again, our margin of error with regard to the vote total is very slim.*

With respect to changing the international tax system, Chairman Hatch noted the need to convert to a territorial system with safeguards to prevent base erosion.

Finding the "sweet spot"

Chairman Hatch concluded his remarks by noting, that while "we all have our wish lists for what we'd like to see in tax reform," any bill or proposal that can't get 51 votes in the Senate and 218 votes in the House is "a waste of time." Thus, he said that:

My goal in tax reform is to find the proverbial "sweet spot," that will maximize the growth potential of the final package without jeopardizing its prospects for passage. To that end, I am in constant contact with the administration and the leaders in the House, as well as the Senate leadership, in an ongoing effort to find that balance

Finance Chairman Hatch requests ideas, feedback on tax reform

On June 16, U.S. Senate Finance Committee Chairman Orrin Hatch (R-UT) requested from tax stakeholders ideas, proposals, and feedback on improving the U.S. tax system.

In a Finance Committee release, Chairman Hatch is seeking recommendations about how to:

- Provide tax relief to middle-class individuals and families through reforms to the individual income tax system
- Strengthen businesses—both large and small—by lowering tax rates and broadening the relevant tax base in order to put the economy on a better growth path and create jobs
- Remove impediments and disincentives for savings and investment that exist in the current tax system
- Update the U.S. international tax system in order to make the United States more competitive in the global economy and preserve the U.S. tax base

Submissions, which will be kept confidential, are due by July 17, 2017

House Speaker Ryan's "first major speech on tax reform"

On June 20, U.S. House Speaker Paul Ryan (R-WI) addressed tax reform in what was described as his "first major speech on tax reform," and presented at the 2017 manufacturing summit convened by the National Association of Manufacturers.

Tax reform for individual taxpayers

Speaker Ryan indicated that lawmakers would:

- Eliminate the estate tax and the alternative minimum tax (AMT)
- "Clear out special interest carve outs and excessive deductions, and focus on keeping those that make the most sense: home ownership, charitable giving, and retirement savings"
- Consolidate the existing seven brackets into three
- Double the standard deduction
- "Simplify things to the point that you can do your taxes on a form the size of a postcard"
- Use the savings from eliminating loopholes to lower tax rates

Business tax reform

Speaker Ryan also indicated that "if we are going to truly fix our tax code, we have to fix all of it—both for individuals and businesses." Among other things, he noted the large number of passthrough businesses that pay taxes as individuals. While he did not explicitly call for a "border adjustment tax," he alluded to the House Republican "blueprint" for tax reform, stating that:

Today, U.S. companies are leaving to become foreign companies, when it should be the other way around. We want foreign companies to become U.S. companies.

We must think differently, so that once again we make things here and export them around the world. There are a number of ways to achieve this—we in the House have our own idea—and that is one of the things that we are discussing with the administration.

But the bottom line here is this: We cannot accept a system that perpetuates the drain of American businesses overseas.

In terms of the substance of business tax reform, Speaker Ryan expressed support for:

- Moving to a territorial system that enables businesses to bring back cash stranded overseas without being taxed
- "Slashing" the corporate tax rate as low as possible
- Eliminating special-interest carve-outs and replacing them with lower tax rates for all businesses
- Creating a new, lower tax, specifically for small businesses
- Making tax cuts permanent

Process and timing

Speaker Ryan indicated that the House and the Senate currently are working with the president to turn the administration's "core principles" for tax reform into a "transformational tax reform plan." He also expressed optimism about achieving transformational tax reform this year, stating that:

We are going to get this done in 2017. We need to get this done in 2017.

KPMG observation

Enacting tax reform is inherently difficult and can take time. Further, the Senate generally requires 60 votes to approve legislation, unless special "budget reconciliation" rules can be used that provide a process for passing legislation with a simple majority of the Senate. Given that there are only 52 Senate Republicans, achieving 60 votes to move tax reform through the Senate would require some Democratic support unless these budget reconciliation rules were used. Using the budget reconciliation process to pass tax reform with only Republican votes, however, may raise its own set of issues.

As just one example, the reconciliation rules include a requirement that any title of legislation generally cannot increase the federal long-term deficit in any year beyond the "budget window." Thus, as a very general matter, if Republican leaders want to be able to pass a tax bill in the Senate with fewer than 60 votes, that legislation may need to be drafted so as to not contain a net tax cut in years outside the budget window (which, in recent years, has been 10 years but could possibly be modified to a different timeframe). Thus, using budget reconciliation to move tax reform with just Republican votes could make enacting permanent tax reform even more challenging.

North Carolina: Veto override, additional tax rate reductions enacted

The North Carolina legislature voted on June 28 to override the governor's veto of an appropriations bill that includes reductions in the rates of the state's corporate income tax and individual income tax.

Senate Bill 257, the Appropriations Act of 2017, was vetoed by Governor Roy Cooper on June 27, 2017. In his veto message [PDF 436 KB], the governor said that the budget "prioritizes tax breaks for the wealthy and corporations" and "lacks structural integrity by failing to account for population growth, inflation and looming federal reductions." The legislature on June 28, 2017, voted to override the veto.

Corporate income tax rate reduction

North Carolina's corporate tax rate has been reduced several times over the last few years. Senate Bill 257 adopts an additional corporate income tax rate reduction.

The corporate income tax rate of 3% that applies for tax years beginning on or after January 1, 2017, will be further reduced to 2.5% effective for tax years beginning on or after January 1, 2019. This rate reduction is automatic and is not contingent on state revenue collections meeting or exceeding certain thresholds.

Senate Bill 257 also reduces the franchise tax for S corporations by essentially exempting the first $1 million of tax base.

- The first $1 million of an S corporation's tax base will be subject to the minimum tax of $200.
- The amount of the tax base that exceeds $1 million will be subject to the regular rate of $1.50 per $1,000 of tax base.
- This change is effective for tax years beginning on or after January 1, 2019, and applies to the franchise tax reported on an S corporation's tax returns for 2018 and later years.

Individual income tax rate reduction

Concerning the state's individual (personal) income tax, the tax rate is reduced from 5.499% to 5.25% effective for tax years beginning on or after January 1, 2019. The standard deduction for individuals is increased.

Sales and use tax changes

Senate Bill 257 also makes various sales and use tax changes.

- The 1% privilege tax on mill machinery and mill machinery parts and accessories is repealed, effective July 1, 2018, and there are new sales and use tax exemptions created for such sales.
- The legislation also directs the Revenue Laws Study Committee to study ways as to how to clarify the scope of the sales and use tax exemption for mill machinery (as enacted by Senate Bill 257), by modernizing and further defining the statutory language and by incorporating existing administrative interpretations of the Department of Revenue, to the extent the General Assembly desires to maintain those interpretations.

May 2017

Oregon: Draft of proposed commercial activity tax

In Oregon: a joint committee on tax reform has proposed a "commercial activity tax."

Background

In 2017, there has been an increased interest in gross receipts taxes or commercial activity taxes at the state-level. Both governors of Louisiana and West Virginia have proposed the adoption of gross receipts taxes in part to address current budget deficits. A bill introduced in Oklahoma would adopt a commercial activity tax that would be imposed in addition to the state's corporate income tax.

Most recently, lawmakers in Oregon released a draft gross receipts tax proposal that had been weeks in the making.

Oregon proposal

The 111-page draft proposal [PDF 286 KB] which, according to state Senator Mark Hass, is a "shell" to be "updated and replaced…or not" provides details on the proposed gross receipts tax. Certain Oregon lawmakers believe the proposed measure is the answer to filling the estimated $1.4 billion shortfall in the budget for the 2017-2019 biennium. It is expected that the proposal will be the subject of much debate and discussion in the coming weeks, as Oregon's legislative session starts to wind down. The legislature is scheduled to adjourn on July 10, 2017.

Details of the draft are summarized as follows.

- A new "corporate activities tax" would replace the corporate excise tax as of January 1, 2018.
- The new tax would be based on gross receipts sitused to Oregon, and would apply to all types of business entities, with the exception of certain specifically excluded entities (generally various non-profits).
- Financial institutions would be subject to the new tax.
- There are numerous exclusions from the definition of "gross receipts."
- Market-based situsing rules would apply to determine Oregon-sitused receipts. In addition to rules governing certain receipts from intangibles, receipts from the sale of tangible personal property would be sitused to Oregon if the destination of the property is Oregon, and receipts from services would be sitused to Oregon based on the proportion of the "purchaser's benefit" received in Oregon. Businesses with less than $3 million in Oregon-sitused sales would pay a flat $250 tax. Businesses with $3 million or more in Oregon-sitused sales would pay the new tax at rates that vary by industry.

- The draft bill does not include rates, but a summary [PDF 100 KB] of the draft plan does provide details on the proposed rates—a 0.85% rate for service businesses, a 0.35% rate for retail, a 0.25% for wholesale and warehousing, and a 0.48% for all others.
- It appears that unitary groups would continue to file as such and would be treated as a single taxpayer with an exclusion from gross receipts for receipts from transactions between unitary group members.
- The draft also includes certain individual (personal) income tax changes and the estimated net revenue impact of the draft proposal is $954 million for the 2017-2019 biennium cycle and $1.4 billion by the 2021-2023 biennium.

Trump Administration releases budget proposals

The Trump Administration released on May 23 its fiscal year (FY) 2018 budget, entitled "A New Foundation for American Greatness." The budget contains the administration's recommendations to Congress for spending and taxation for the fiscal year that begins on October 1, 2017.

Read more about the FY 2018 budget on the White House website.

KPMG observation

In recent fiscal years, the Treasury Department has released an explanation of the tax proposals in the budget (known as the "Green Book") the same day an administration transmitted its budget to Congress. The Treasury Department has not released a Green Book with respect to the Trump Administration's FY 2018 budget proposals.

Tax reform

The budget states the Trump Administration's commitment to tax reform and simplification. It indicates that the administration has articulated several "core principles that will guide its discussions with taxpayers, businesses, Members of Congress, and other stakeholders." It further indicates that "the President is committed to continuing to work with Congress and other stakeholders to carefully and deliberatively build on these principles."

The budget "assumes deficit neutral tax reform" and indicates that the administration will work closely with the Congress on such reform.

Individual tax reform

The budget states that tax relief for U.S. families, especially middle-income families, must do the following:

- Lower individual income tax rates
- Expand the standard deduction and "help families struggling with child and dependent care expenses"
- Protect homeownership, charitable giving, and retirement saving
- End the alternative minimum tax (AMT)
- Repeal the 3.8% net investment income tax
- Repeal the estate tax

Business tax reform

The budget expresses the administration's belief that business tax reform must do the following:

- Reduce the tax rate on U.S. businesses
- Eliminate most "special interest" tax breaks
- Transition to a territorial system of taxation, enabling businesses to repatriate newly earned overseas profits without incurring additional taxes
- Provide a one-time repatriation tax on already accumulated overseas earnings

KPMG observation

The budget does not include additional technical details on the administration's tax reform proposals beyond what Treasury Secretary Mnuchin and National Economic Council (NEC) Director Cohn previously announced at a White House press conference on April 26, 2107.

Treasury Secretary Mnuchin is scheduled to testify before the House Ways and Means Committee on May 24, 2017, and before the Senate Finance Committee on May 25, 2017, about the administration's budget, including its tax proposals.

Tennessee: Legislature passes bill prohibiting enforcement of economic nexus rule

Last year, the Tennessee Department of Revenue approved a rule (Rule 129) that adopted an economic nexus standard for sales and use tax purposes. The rule applied to out-of-state dealers that engaged in regular or systematic solicitation of Tennessee consumers by any means. Under the rule, if such dealers made sales exceeding $500,000 to Tennessee consumers during the calendar year, they were considered to have substantial nexus with the state. By March, 1, 2017, out-of-state dealers meeting these tests were required register with the Department of Revenue, and they were required to begin collecting and remitting sales and use taxes by July 1, 2017.

On March 30, 2017, the American Catalog Mailer's Association and NetChoice (the plaintiffs), filed a suit challenging the constitutionality of the rule. Shortly thereafter, the plaintiffs and the Department submitted a joint motion to the court to prevent the Department from enforcing the rule pending a final judgment in the lawsuit. Most recently, the General Assembly approved a bill (House Bill 261) that prohibits the Department from collecting any sales or use taxes authorized under Rule 129 or permitted under any court ruling until the court's ruling has been fully reviewed and Rule 129 has been approved by the General Assembly. It has been reported that Governor Haslam will likely sign the legislation.

Texas: Natural gas temporarily stored in Texas subject to property tax

The Texas Supreme Court recently affirmed an appeals court decision holding that natural gas purchased and temporarily stored in Texas before being sold to out-of-state customers was subject to ad valorem tax. The taxpayer, a Texas-based natural-gas marketer, purchased natural gas from several sources. The gas, which was intermingled at all times with gas owned by other marketers, was stored in a reservoir owned by a related intrastate pipeline for up to several months before it was sold to customers in northern states during the winter months. Under Texas law, all tangible personal property in the state is taxed in proportion to its value if it is located in the state "for longer than a temporary period," unless exempt under federal law. The Harris County Appraisal District (HCAD) assessed ad valorem tax on the value of the taxpayer's gas stored in the reservoir. The taxpayer acknowledged it owned the natural gas stored in the Texas reservoir, but protested the assessment on the basis that the gas was exempt from taxation because it was in interstate commerce. The court of appeals assumed (without deciding) that the gas was in interstate commerce and held that it was permissible for Harris County to assess ad valorem taxes when the gas was stored in a Texas reservoir prior to being sold. The taxpayer appealed. The Texas Supreme Court, perhaps because there was a conflict at the appeals court level over this issue, agreed to review.

At the outset, the Texas Supreme Court held that the taxpayer was precluded from arguing that state law—notably the "longer than a temporary period" statutory requirement—prohibited Harris County from taxing the gas. The taxpayer, the court determined, had procedurally failed to preserve its temporary-period argument. The court subsequently analyzed and concluded that the gas was in interstate commerce. It then determined that a Commerce Clause analysis was required and went on to examine each prong of Complete Auto Transit's four-part test. With respect to the substantial nexus requirement, the court addressed, in a lengthy discourse, whether the natural gas remained in transit when it was stored in Texas. Although related, this was a slightly different inquiry than whether the gas was in "interstate commerce" and was a necessary pre-requisite to a finding that the gas had a "substantial nexus" with Harris County. To resolve this issue, it was necessary to determine whether the stoppage or storage was to facilitate a continuous journey or was to avoid transportation of the gas until a business purpose arose. The court determined that it was the latter the taxpayer stored the natural gas in Texas until the profitable winter season. Thus, the gas being stored in Harris County broke the continuity of transit, and the court concluded that the gas had a substantial nexus to the state such that the first prong of Complete Auto was satisfied. The court also held that the tax was fairly apportioned and did not discriminate against out-of-state taxpayers. Finally, the court rejected the taxpayer's assertion that the benefits provided by the state were provided to the storage facility, and the taxes paid by the storage facility owner covered those services. This position was adopted by another appeals court and the dissenting justice in the court below. However, the court observed that the state provides services to the taxpayer's stored gas as well. "When the fire department arrives to quench an inferno at the pipeline's facility, the fire chief does not instruct her crew to extinguish only the flames that threaten the pipeline's property. Instead, the fire department protects the entirety of the personal property, structures and stored gas alike." The court concluded that the tax was permissible under the Commerce Clause. For more information on ETC Marketing, LTD., v. Harris County Appraisal District.

Contacts

Mie Igarashi
Partner, Tax
KPMG LLP
E: mieigarashi@kpmg.com

Questions?
If you have any questions about this article please reach out to your KPMG engagement team or the contact listed with this article.

KPMG's U.S. Japanese Practice Leadership Contacts

National Leader
Kaz Mori
T: + 1 212-872-5876
E: kazutakamori@kpmg.com

Atlanta
Mie Igarashi
T: + 1 404-222-3212
E: mieigarashi@kpmg.com

Chicago
Yasuko Metcalf
T: + 1 312-665-3409
E: ymetcalf@kpmg.com

Columbus
Masahiro Inomata
T: + 1 614-241-4648
E: minomata@kpmg.com

Dallas
Mario Michaeli
T: + 1 214-840-2193
E: mmichaeli@kpmg.com

Los Angeles
Michael Maekawa
T: + 1 213-955-8331
E: tmaekawa@kpmg.com

Los Angeles
Jeff Tom
T: + 1 213-955-8494
E: jtom@kpmg.com

New York
Kozo Suzuki
T: + 1 212-872-7817
E: ksuzuki@kpmg.com

Silicon Valley
Yukimasa Kitano
T: + 1 650-404-4854
E: ykitano@kpmg.com

Subscribe

Published since 1997, Jnet is issued quarterly to update you on audit, accounting, tax, and other business issues relevant to Japanese companies operating in the United States.

To subscribe to this Newsletter or to receive further information on any of the matters discussed, please contact your local Japanese Practice professional, or email us at us-kpmg.jp@kpmg.com.

About KPMG's U.S. Japanese Practice
KPMG LLP has a Japanese Practice in the United States, comprised of approximately 300 bilingual professionals, dedicated to providing audit, tax and advisory services to help Japanese companies succeed in the United States. We work closely with member firms in Japan and around the world to provide seamless services. Our specialists are able to provide objective advice to help organizations enhance value across their operations.

kpmg.com/socialmedia

kpmg.com/app

Download on the App Store