Financial Sector Seen as 'Most Enigmatic' Part of House Tax Plan

by Stephanie Cumings

The financial sector remains the "most enigmatic" part of House Republicans' tax reform blueprint, according to Viva Hammer, legislation counsel for the Joint Committee on Taxation.

The "Better Way" blueprint offers only skeletal information on the treatment of financial activity, and there are still many questions to be answered, Hammer said April 20 at an event in Washington sponsored by the District of Columbia Bar Taxation Section, Jones Day, and Tax Analysts.

The House blueprint doesn't speak to how financial institutions would be treated, saying only that the House Ways and Means Committee would work to develop "special rules" for these taxpayers.

Hammer refused to speculate if or when tax reform could become a reality, but the other panelists agreed that while a watered-down version of the House's plan that lowers the corporate tax rate and expands the tax base was likely, the plan's border adjustment proposal was unlikely to ever pass.

Steven Bunson of Goldman Sachs & Co. said there has been some disagreement over whether the House plan represents a simpler tax system, adding that he believes it just substitutes one form of complexity for another. Given that complexity, Bunson questioned whether Treasury and the IRS have "anywhere near the resources" to implement guidance and engage in enforcement. He said he didn't see how a best-case scenario 2018 effective date for tax reform was practical.

David S. Miller of Proskauer Rose LLP said that much of the complexity stems from the fact that the House's plan is not a pure destination-based cash flow tax (DBCFT) but a hybrid. Under a pure DBCFT, there is no tax on dividend income or interest income for either individuals or businesses. That isn't the case under the House plan, Miller said. He estimated that 95 percent of the tax planning that would arise under the House plan would result from the fact that it's a hybrid, rather than pure, DBCFT.

Viva Hammer

Hammer said that other countries have grappled with a hybrid income tax and consumption tax and found ways to address the taxation of financial institutions, noting that both Turkey and Israel have interesting approaches. "There are examples that they could follow; it's not an unsolvable problem," she said. However, she later argued that studies of how, for example, VATs were implemented in other countries "cannot be compared to what would happen if you do these kinds of changes in the U.S." because the U.S. economy is so unique.

Hammer said that if the financial sector is treated differently than other sectors, there will be "tremendous arbitrage opportunities" similar to what goes on with transfer pricing. For example, U.S. businesses would want banks to designate payments as service fees and not interest, she said.

"The IRS is going to have to have a very good nose for what [financial institutions are] doing domestically and what they're doing for foreign clients and foreign service providers," Hammer said. "And there will be tremendous pressures on

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definitions — which is what [the JCT's] job is — to make the definitions as strong as we can get and not provide the opportunity for arbitrage."

In discussing the various options for how financial institutions could be taxed under the House plan, Miller noted that there was a potential public relations issue with largely exempting financial institutions from taxation. Hammer said it's more than just a public relations problem, it's also a "philosophical problem."

"There's a lot of money in the financial sector, and to completely exempt that from tax would look odd given the sense of justice that we have in the tax system today," Hammer said. "And I don't think it's revolutionary to say that we like the sense of justice in the tax system; otherwise no one wants to participate in it." She added that a consumption tax is "heavily concentrated amongst people who don't have the highest capacity to pay," which creates tension with traditional notions of a tax system that is fair. ■

Senate Tax Counsels Air Concerns About Border Adjustment Tax

by Andrew Velarde

Senate tax counsels from both parties aired their concerns April 20 about what they saw as the biggest unanswered questions regarding the border-adjustable tax in the House GOP's tax reform blueprint.

"The devil's in the details. And right now, while we have a description of the [border-adjustable tax], there is no real detail there," Tiffany Smith, Senate Finance Committee minority chief tax counsel, said at an event in Washington sponsored by the District of Columbia Bar Taxation Section, Jones Day, and Tax Analysts.

Smith provided a list of questions raised by the proposal that would dramatically change business taxation by using border adjustments to exempt exports and tax imports. How the transition rules might work, classification of import and export, and whether other countries might retaliate were all issues that would need to be addressed, she said. The tax's applicability to services — especially those provided both in the United States and abroad — and whether which party paid was relevant to any determination were also important outstanding issues, she said. Another question that had been raised concerned challenges in distinguishing losses from exports in companies that would be in a constant loss position from normal losses, she said, adding that concerns about compliance and administration were also lurking.

"What are the pitfalls for the IRS? Who is going to collect on direct sales? Where is the collection point for these taxes? What are ways to get around the system, monetizing . . . from companies that are in a negative tax position?" Smith asked.

Impact on consumers is of utmost concern, Smith said. And Tony Coughlan, Finance Committee majority tax counsel, added that one of his biggest questions was who would end up paying for the proposal, an answer that might depend in large part on when and to what extent the dollar would make an exchange rate adjustment.

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