Winter 2018

Happy 2018!

As you likely noticed, two things dominated the U.S. headlines this holiday season: the popularity of Fingerlings - toy monkeys, unicorns, and sloths that cling to your finger and react to touch and sound - and the passage of "The Tax Cuts and Job Act of 2017." The first drove parents to pay many times the retail price in order to make sure their kids were smiling on Christmas day. The second is helping to drive the global markets steadily higher.

We lack the expertise to explain the lure of robotic finger puppets (though it's likely similar to what drove the Cabbage Patch Kid craze). However, we have a lot to say about the other.

The change in the top U.S. corporate tax rate from 35%, one of the highest in the world, to 21% will lessen the need for companies to find ways (corporate inversions and stand-alone corporations outside the U.S.) to keep money from being taxed here at home.

The Act changes the U.S. from a global to a territorial system with respect to corporate income tax. Instead of a corporation paying the U.S. tax rate (35%) for income earned in any country (less a credit for taxes paid to that country), each subsidiary would pay the tax rate of the country in which it was legally established. For example, under the old tax law, if a U.S. company earned $1 million in a Canadian subsidiary, they pay 15% in Canada and an additional 20% in the U.S. Under the new tax law, that same company would only pay the Canadian tax rate. If they choose to bring the cash home, an addition 6% tax would be owed the U.S. In other words, under a territorial tax system, the corporation saves the difference between the generally higher U.S. tax rate and the rate of the country in which the subsidiary was legally established.

In theory, the law reduces the incentive for tax inversion, used to obtain the benefits of a territorial tax system by moving U.S. corporate headquarters to other countries. This allows companies to freely move profits anywhere in the world without fear of the higher U.S. tax rates, and invest where most efficient and profitable.

The Act also would allow a one-time repatriation tax of profits in overseas subsidiaries of 8%, 15.5% for cash. U.S. multinationals have accumulated nearly $3 trillion offshore, much of it in tax-haven subsidiaries. The Act will likely encourage companies to bring the money home over time, at much lower rates.

Today, Apple Inc. said it will bring hundreds of billions of overseas dollars back to the U.S., pay about $38 billion in taxes on the money and spend tens of billions on domestic jobs, manufacturing and data centers in the coming years. On the day the tax bill was signed into law, Amgen Inc said it expected to incur tax expenses of $6 billion to $6.5 billion over time as it repatriates cash it has accumulated around the world because of the new U.S. tax law. Approximately $39 billion of Amgen's $41.4 billion in cash holdings came from overseas earnings. Others will follow.

Some of you may remember 2004, the last time the U.S. allowed companies to repatriate cash with a low interest rate. (And something called the Nintendo DS was the hottest selling Christmas toy.) Back then, most of the cash companies expatriated went to shareholders as dividend and share buybacks, leaving little room for expansion of plants and new hiring. But the 2017 Act is not a one-time tax holiday. This is a true reduction in rates. Companies can plan long-term goals, not focus on allocating a one-time gift from the government.

We'd be remiss not to mention the Act also includes, of course, individual tax cuts. But there's a reason it's not our *Folio*'s lede paragraph. While most will see a lower burden, it won't be the panacea some had hoped for. With the cut to tax rates come cuts to many deductions, making the overall reduction less impactful. For example, standard deductions are nearly doubled while the ability to deduct things like mortgage interest and state and local taxes are reduced (NOT eliminated, as some report). The estate tax limit on the amount an individual that can pass on without tax did jump from $5.6 million to $11.2 million. These individual tax filer changes expire in 2025, so we aren't done yet with this tax bill.

That said, the overall global economy is strong. Employment continues to grow at a healthy pace, exceeding expectations in countries like Canada. Interest rates, while moving higher, are still relatively low and manageable for expansion. The U.S. administration implemented a "2-for-1 policy," mandating that for every new regulation added, two must be removed - a positive effect on small and large business. Some U.S. companies are raising wages and giving bonuses with their newfound profits from lower tax rates. (This may merely be for show, but it still puts additional cash in folks' pockets.) And, as the holiday season, and peoples' desire to pay $50-$500 for colorful, chirping finger-monkeys showed, consumers' optimism is high.

So is ours. While expecting the usual bumps in the road, we don't see a reason for pessimism in the new year.