2017 BDO TAX OUTLOOK SURVEY

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The BDO Tax Outlook Survey of Tax Executives *is a national telephone survey conducted by Market Measurement, Inc., an independent market research consulting firm, whose executive interviewers spoke directly to 100 tax executives, or those with tax director responsibilities, at public companies with revenues of over $1 billion using a survey conducted within a scientifically developed pure random sample.*

Tax Executives Primed for Potential Federal Reforms

With the implications of the 2016 General Election beginning to come into focus, tax executives are looking closely at the new administration to gauge how potential tax reform might impact their financial reporting strategies, cash taxes and ultimately their bottom lines.

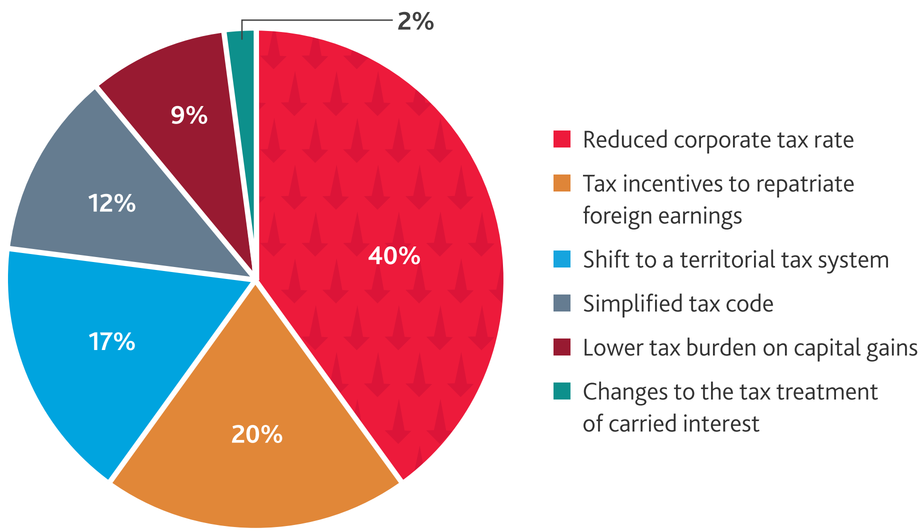
Last year, BDO's annual Tax Outlook Survey found that 77 percent of tax executives believed that significant tax reform would occur if a Republican won the presidency, and post-election, this belief continues to hold strong. All the tax executives surveyed in 2017 think tax reform is likely to some degree under the Trump administration, with 60 percent noting it to be "very likely," and a just under a third of respondents (32 percent) believing it is "somewhat likely." Only eight percent of respondents believe tax reform is only slightly likely.

While a barrage of executive orders took center stage in the opening weeks of Donald Trump's presidency, the administration has consistently positioned itself as pro-business, which may bode well for tax executives in the long run. The majority (60 percent) of tax executives feel the cost of compliance within the tax and financial regulatory environment has increased in the past year, and many will be looking to the Trump administration to reverse that trend.

Reforms aimed at driving growth of American business top tax executives' reform wish list, with 40 percent hoping for a reduction of the 35-percent corporate tax rate. One in five (20 percent) of respondents point to tax incentives to repatriate foreign earnings as a top interest, while 17 percent cite a shift to a territorial tax code. The portion of executives interested in lowering the tax burden of capital gains was nine percent, up from two percent in 2016. And just two percent cited changes to the tax treatment of carried interest, discussed by both candidates throughout the campaign, as their primary ask.

Despite positive signs for the likelihood of tax reform, the process will undoubtedly be complex, and tax executives are concerned about the uncertainty of how the developments will unfold. More than one in three respondents (34 percent) highlight planning for federal tax reform as their primary tax concern in 2017, up from 21 percent in 2016. Given talk from both the GOP and the president on reforms ranging from cutting investment income taxes to enacting a border adjustment tax, businesses will undoubtedly be adjusting to a changing landscape throughout the coming year. Tax reform, however, is subject to an often slow-moving legislative process and will require compromise on the part of both the president and Congress. More than half of tax executives (51 percent) believe congressional gridlock will be the primary obstacle to tax reform over the next four years. Others point to conflicting legislative priorities (19 percent), public opposition to proposed reforms (13 percent) and international actions related to multinationals (12 percent) as potential roadblocks. Just five percent believe the outcome of the 2018 midterm election will stall reform efforts.

TOP TAX POLICY CHANGES ON TAX EXECUTIVES' WISH LISTS



"Despite the widely-debated initiatives discussed during President Trump's first months in office, federal tax reform is more like an aircraft carrier than a speedboat; it takes time and effort to change course. Any changes that do come to pass may look significantly different than what's being proposed today. Businesses should stay abreast of how the potential outcomes could impact their bottom line and remain ready to pivot their tax planning strategies when important developments arise."

Matthew Becker, partner in the national Tax practice at BDO

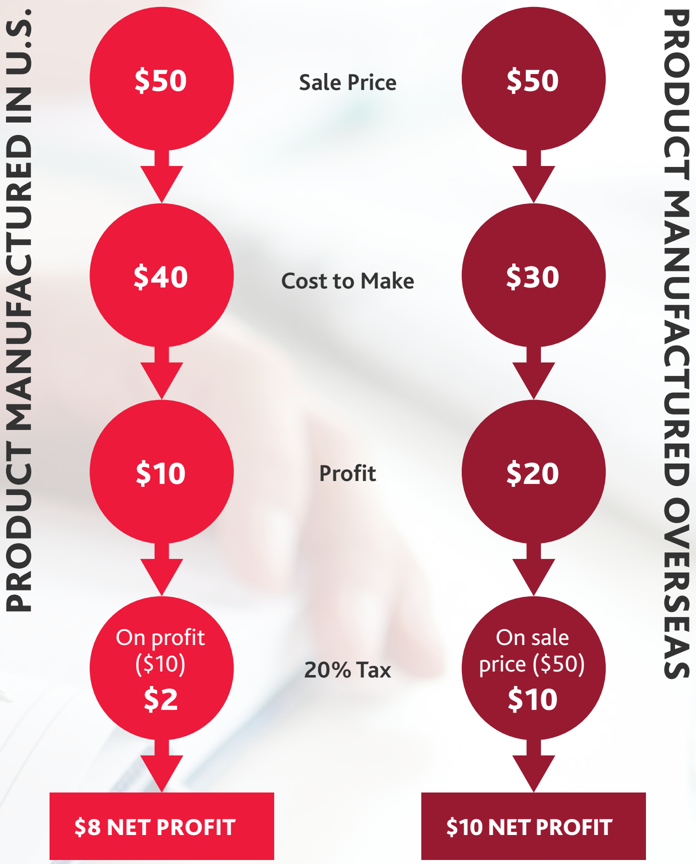
Spotlight: The GOP border tax-adjustment proposal

Currently, U.S. public companies are subject to a 35-percent tax rate on worldwide income, and to the extent that taxes are paid in foreign jurisdictions, they are allowed a foreign tax credit to avoid having the same income taxed twice.

Both the president and GOP leaders in Congress have said they would like to change this system, and both have embraced to varying degrees the notion of a destination-basis tax system, also known as the border adjustment tax.

While subject to change as the administration further develops its tax reform policies, the border adjustment tax proposal, if passed as it is being proposed, would tax companies on their sales to U.S. customers while excluding foreign sales from U.S. tax entirely. This means sales of imported goods would be fully taxable while the sales of exported products would be exempt from tax.

Take a look at the graphic to the right for an illustration of the border adjustment concept.



Assuming the value of the USD remains constant.

The objective of a border adjustment tax is ultimately geared to reverse the U.S. trade imbalance. The impact it will have on individual businesses, however, will vary. The best gauge for its impact is a company's business model: Does its reliance on imported goods overshadow sales revenue from global markets or the other way around?

BEPS Gains Steam Causing Tax Planning Concerns

While domestic tax reform continues to dominate headlines, major efforts on the international stage also remain a source of anxiety for tax executives. Unsurprisingly, 82 percent of the companies surveyed conduct operations outside of North America, and over half (54 percent) plan to enter or expand into international markets this year.

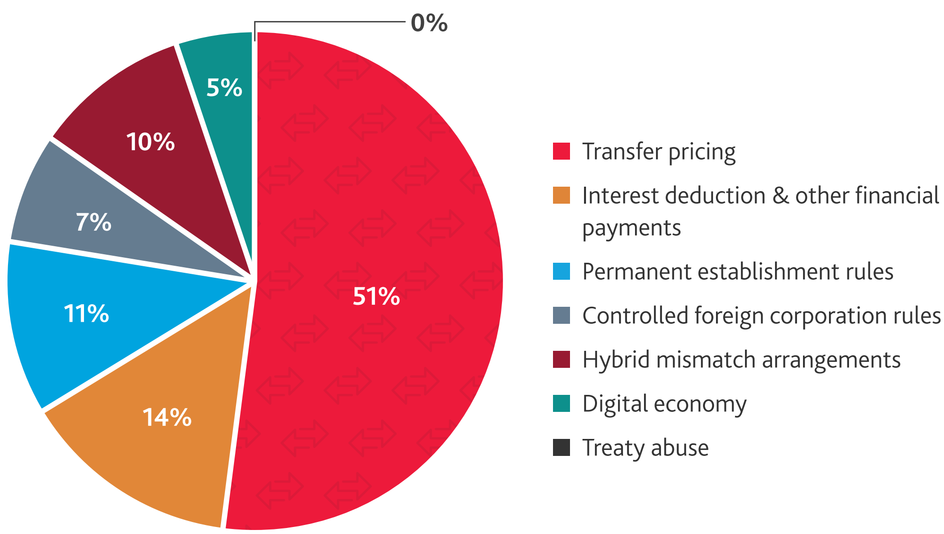
As tax executives look to optimize global growth, international tax planning is top of mind. But navigating the waters of international regulations is never a simple task, especially following the publication of the Organisation for Economic Co-operation and Development (OECD)'s action plan designed to address tax base erosion and profit shifting (BEPS) in 2015. The highest portion of those surveyed (35 percent) say international tax planning, including BEPS, is their primary tax issue for 2017.

In keeping with last year's survey, BEPS recommendations around transfer pricing (Action Items 8, 9, 10 and 13) generate the greatest concern among tax executives, cited by 51 percent of respondents. Their concern is a valid one, as 76 percent of tax executives surveyed currently include transfer pricing mechanisms in their tax strategy.

While BEPS remains a critical issue for tax executives, strategies for responding to the initiative vary. A majority (57 percent) of respondents say they are proactively taking steps toward implementation based on the Action Item drafts. More than a third (35 percent), however, plan to wait for individual countries to implement BEPS measures before acting. Given recent criticism from China and other nations that the rules may not be appropriately tailored to the developing world, it remains to be seen how global implementation will shake out.

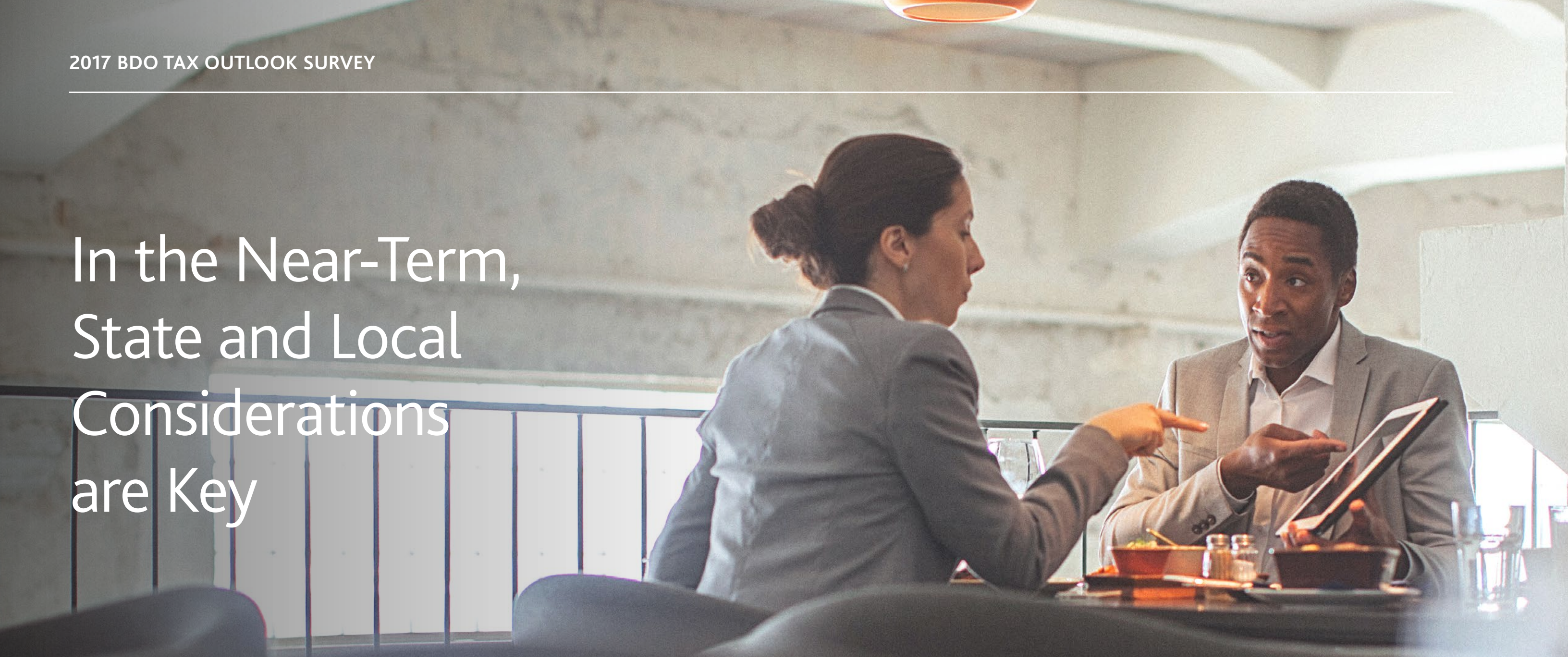
Despite implementation uncertainty, some BEPS reporting rules are already coming into play, with country-by-country reporting rules beginning for tax years starting on or after Jan. 1, 2017. Nine out of 10 (91%) tax executives anticipate meeting the initial country-by-country reporting deadline at the end of this year.

WHICH BEPS ACTION ITEMS GENERATE THE MOST CONCERN?



"When the OECD first released the BEPS Action Plan, implementation seemed far off in the future for most multinationals. Now that the country-by-country reporting deadline is looming, businesses need to take steps to proactively adjust their financial reporting practices and prepare for future changes related to transfer pricing mechanisms."

Paul Heiselmann, national managing partner of Specialized Tax Services at BDO

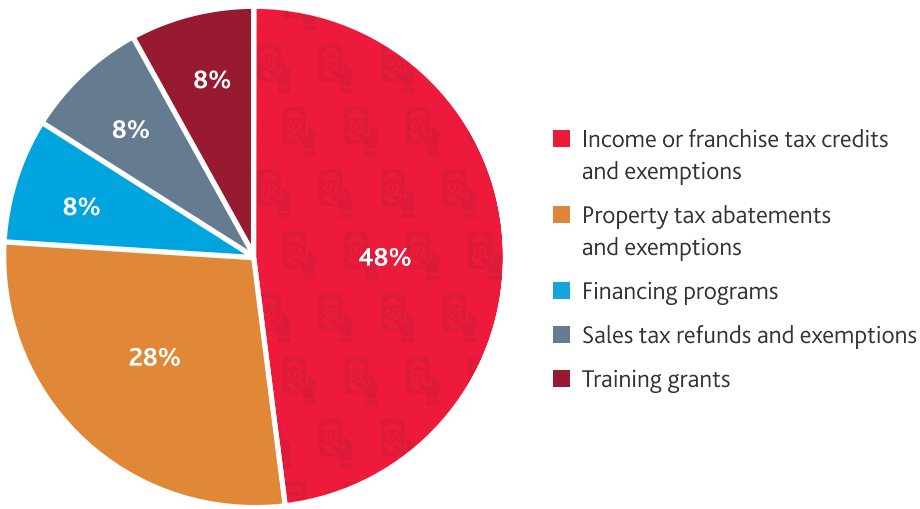


In the Near-Term, State and Local Considerations are Key

Looking beyond slow-moving federal and international tax reforms, tax executives turn to state and local incentives to reduce their tax burden, as states themselves try to balance gathering revenue with attracting growth. When asked what programs they take advantage of in the U.S. market, 91 percent of respondents cited income or franchise tax credits and exemptions. Eighty-eight percent use sales tax refunds and exemptions, and 86 percent rely on property tax abatements and exemptions. Just over half (52 percent) benefit from training grants, and 37 percent take advantage of financing programs.

The new administration espouses policies that promise to put "America first," and following the General Election, that sentiment of reinvestment in America has spread. Five states lowered their corporate income tax rates for 2017, and states like North Carolina and Arizona are contemplating rate-reducing reforms. Tax executives too are increasing their concentration on national expansion, with just under a third (32 percent) stating they will likely enter new geographic areas in the United States in 2017, up from 24 percent of respondents last year. For those planning domestic expansions, 48 percent cite income or franchise tax credits and exemptions as having the greatest impact on their decision to enter new markets. Over a quarter (28 percent) look to available property tax programs, and just eight percent prioritize financing programs, sales tax refunds and exemptions, and training grants.

GREATEST MOTIVATOR FOR DOMESTIC EXPANSION



"State governments are constantly working to balance the need to grow revenue while inspiring economic growth within their borders. Companies looking to expand within the U.S. should not undervalue the impact of state and local tax regulations and incentives when developing their tax strategies."

Rocky Cummings, tax partner and head of National Multistate Tax Services at BDO

The PATH Act One Year Later: Public Companies Taking Advantage of R&D Tax Credits

The passage of the Protecting Americans from Tax Hikes Act of 2015 (PATH Act) put an end to the tumultuous history of the federal research and development (R&D) tax credit after decades of repeated expirations and renewals at the eleventh hour or even later. The PATH Act permanently extended the credit while expanding it to benefit startups and small business. This allowed tax executives to include the credit in their long-term business planning without concerns about expiration.

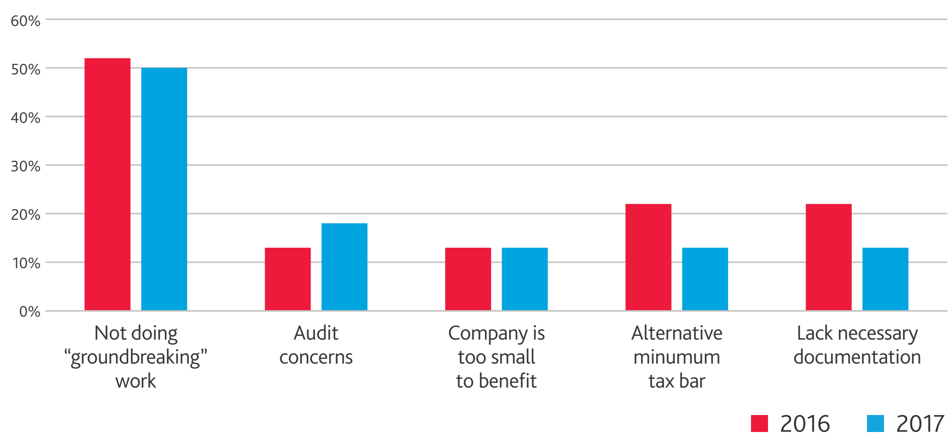
In the year following the implementation of the PATH Act, the survey found that use of the credit grew. Eighty-two percent of tax executives surveyed make use of some form of R&D credit, up from 75 percent in 2016. The majority (64 percent) use both federal and state credits, while one in three (33 percent) claim only the federal credit.

For the 18 percent of those surveyed who said they do not use any form of R&D credit, half believe they are not doing "groundbreaking" work. It is important to note that the credit doesn't require activity to be groundbreaking to qualify, or even that the activity succeed. Instead, in general, it requires only that the activity attempt to develop or improve the functionality or performance of a product, process, software, or other component.

Interestingly, concerns over the cost to pursue the credit dropped significantly, from nearly half of respondents (44 percent) in 2016, to just 13 percent. This drop may be attributable to an increased level of comfort in annually claiming the now-permanent federal credit.

Despite the increasing number of R&D credit claims, more executives this year say they are not reporting them due to audit concerns (18 percent), up from 13 percent last year. Worry over the alternative minimum tax bar and documentation requirements both dropped to 13 percent, compared to 22 percent each in 2016.

WHY TAX EXECUTIVES AREN'T CLAIMING R&D CREDITS



"Now that the PATH Act has been in effect for a full year, we're seeing more businesses work the permanent federal R&D credit into their tax planning strategies. A lot of startups and smaller businesses are using the credit to offset up to $250,000 of their payroll taxes or against their AMT; and with the potential to save up to 15 percent of qualified spending, companies of all sizes are using the credit to increase their cash flow. If your company is financing attempts to develop better, faster, cheaper or greener products, processes, software or other components, they would be well advised to look at the federal R&D credit and the myriad of related state and local credits and incentives designed to promote such investments, to ensure they're not leaving money on the table."

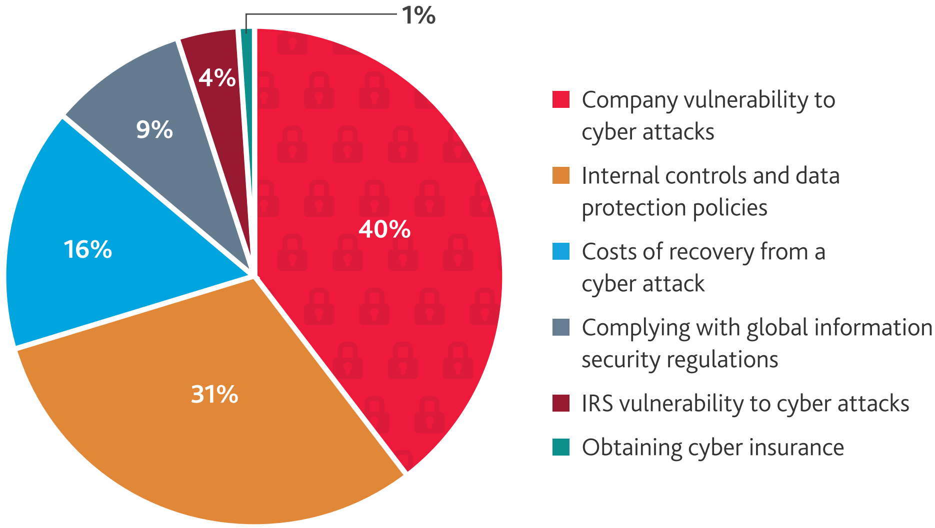
Chris Bard, national leader for Specialized Tax Services, Research and Development at BDO

Companies Look Inward to Cybersecurity Liabilities

While tax executives are mulling over how they will need to shift tax planning strategies to accommodate domestic and international change, cybersecurity issues remain a critical business concern. With high-profile cyber-attacks on organizations ranging from the Democratic National Committee to Dropbox to Yahoo! to the IRS itself taking place in 2016, executives across all sectors are looking to their own cybersecurity as a potential risk. And tax executives are no different. Furthermore, as the BEPS country-by-country reporting draws near, businesses face obligations to securely transfer sensitive tax data.

When asked about their primary concern related to cybersecurity, 40 percent of tax executives point to company vulnerability, and 31 percent cite internal controls and data protection policies. The cost of recovery from a cyber-attack was cited by 16 percent, followed by complying with global information security regulations (9 percent), IRS vulnerability (4 percent) and obtaining cyber insurance (1 percent).

TAX DIRECTORS' CYBERSECURITY CONCERNS



"Cybersecurity isn't just an IT issue—it's an everyone issue, from the board of directors to the most junior employee. Tax executives are no exception: They deal with sensitive financial and transactional data that, in the hands of a sophisticated hacker, is the proverbial golden goose. Moreover, tax professionals are increasingly relying on tax and accounting software, which can serve as a gateway to the broader corporate network. As reporting and data demands increase, the more vulnerable all stakeholders touching that data are to attack."

Shahryar Shaghaghi, national leader of Technology Advisory Services and head of International Cybersecurity at BDO

Spotlight on Industry

CONSUMER BUSINESS CFOS WEIGH BORDER-ADJUSTED TAX PROPOSAL

In January, **78%** of retail CFOs said they were not familiar with the border-adjustment tax proposal

Of retailers who are aware of the proposal, **53%** believed it would have a negative impact on retailers who important goods, **20%** thought it would be positive, and **27%** believed it would have no impact

Coming March 2017

NATURAL RESOURCES CFOS FACE TAX ISSUES DURING INDUSTRY TURNAROUND

Intangible drilling costs are the most cited tax issue for oil & gas CFOs

32% cite percentage depreciation as their primary concern

See more: 2017 Energy Outlook Survey

PRIVATE EQUITY UNCONCERNED WITH TAX BURDEN

Just 5% of PE fund managers say the impact of tax burdens, including the proposed tax increase on carried interest, is the biggest challenges facing the industry

See more: PErspective Eighth Annual Private Equity Study

TECHNOLOGY LOOKS TO TAX REFORM FOR GROWTH, BUT REMAINS CAUTIOUS ABOUT UNCERTAINTY

1 IN 4 TECH CFOS think tax changes will be the biggest challenge to their business in 2017

61% say lowering the corporate tax rate is their top priority for tax reform

See more: 2017 BDO Technology Outlook Survey

MANUFACTURING MISSING OUT ON TAX INCENTIVES

Just 17% of manufacturers say they are planning to claim tax credits and incentives for their investments in the Internet of Things (IoT).

For those not planning to claim credits and incentives for IoT investments, **nearly half** (45%) say the reason is a lack of documentation, while **only 11%** of respondents cite concern about the associated costs.

See more: The MPI Internet of Things Study

BIOTECH FEVER DRIVES BOOM IN R&D SPENDING

Average R&D expenditures for biotech companies **increased 18%** in 2014, reaching **$55.6 million**, up from $47.1 million in 2013.

Small biotechs with less than $50 million in revenue saw the biggest hike in R&D spending, reporting an increase of **28%** to $52.6 million, compared to a **20%** growth rate in 2013.

See more: Biotech Briefing

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