Taxation of Foreign Source Income Under New Tax Law

THURSDAY, MAY 10, 2018, 1:00-2:50 pm Eastern

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Stanley C. Ruchelman, Chairman
Ruchelman, New York
ruchelman@ruchelaw.com

Galia Antebi, Partner
Ruchelman, New York
antebi@ruchelaw.com
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U.S. TAXATION OF FOREIGN SOURCE INCOME
IMPACT OF THE TAX REFORM

Galia Antebi
antebi@ruchelaw.com

Stanley C. Ruchelman
ruchelman@ruchelaw.com

Ruchelman P.L.L.C.
New York, NY | 212.755.3333

Strafford Seminar
Agenda

• U.S. Tax Reform: A (Very) Brief Overview
• Dividend Received Deduction
• Treatment of Sale of C.F.C. Stock
• Hybrid Transactions
• Transition Tax
• Changes to the Subpart F rules
• G.I.L.T.I. and F.D.I.I.
• Planning Techniques
• Putting It Together
U.S. TAX REFORM

Brief Review of Prior Law v. New Law
U.S. Tax Reform

Prior Law v. New Law

• At 35%, the U.S. corporate tax rate in effect until the tax reform was one of the highest among O.E.C.D. countries; provided incentive to shift profits outside the U.S. and defer the tax

• Deferral was subject to limitations under the C.F.C. and P.F.I.C. regimes; those remain in effect; C.F.C. rules were expanded to apply to more foreign corporations and to more U.S. shareholders

• New law introduced a partial territorial corporate system, \textit{i.e.}, intercompany dividends are exempt

• New law introduced G.I.L.T.I., a new type of foreign income which will be subject to the C.F.C. immediate tax rules

• Transition tax was imposed to repatriate deferred foreign earnings prior to the imposition of the territorial system
U.S. Tax Reform

Prior Law v. New Law

• Tax reform permanently reduced the corporate rate to 21%
  • Effective for tax years beginning after December 31, 2017
  • Special rule applies to fiscal year corporations; blended rate

• New law introduced a deduction for foreign derived intangible income

• The reduced corporate rate, the deduction available to F.D.I.I., the expanded C.F.C. rules and the introduction of G.I.L.T.I. eliminated the incentive for shifting income to foreign jurisdictions; that and certain bonus depreciation rules introduced by the new law result in encouragement of locating PP&E in the U.S.
Territorial System – Dividend Received Deduction
The New "Territorial" System
Dividends Received Deduction

• Section 245A provides a 100% dividends received deduction for the foreign source portion of a dividend paid by a “specified foreign corporation”

• A specified foreign corporation is a foreign corporation that has at least one 10% U.S. shareholder that is a corporation
  • Doesn’t apply to foreign corporations which are P.F.I.C.'s but not C.F.C.'s
  • The 10% ownership requirement is directly, indirectly or constructively

• The foreign source portion of a dividend is the undistributed foreign earnings that are not attributable to:
  • E.C.I., or
  • Dividends from U.S. corporations the stock of which the foreign corporation owns at least 80%
The New "Territorial" System
Dividends Received Deduction

• The D.R.D. applies to corporate U.S. shareholders
  • Only C corporations
  • S corporations, R.I.C.'s and R.E.I.T.'s don’t qualify
  • C corporation that is a partner in a partnership may be able to benefit (awaiting regulations)
• Requires a 1-year holding period

• No foreign tax credits allowed, including withholding taxes
  • Withholding taxes imposed on distributions of P.T.I. from C.F.C. to corporate U.S. Shareholder should continue to be creditable under Section 901
• Disallowed for hybrid dividends
• Effective date: distributions made after December 31, 2017
The New "Territorial" System
Dividends Received Deduction

- For U.S. Co 1 the new law applies: U.S. Co 1 is eligible for D.R.D. No F.T.C. allowed
- For U.S. Co 2 and for the U.S. Individual, the new law doesn’t apply; dividend is subject to tax; No indirect F.T.C. for the individual; possible F.T.C. under Section 960 for U.S. Co 2
- If dividend sourced from E.C.I., U.S. Co 1 would not be eligible for D.R.D. under Section 245A, but under prior law may deduct 50% of the dividend (Section 245)
SECTIONS 1248 AND 245A

Sale of C.F.C. Stock
Sale of C.F.C. Stock

• Gain on the sale of C.F.C. stock by a U.S. Shareholder is subject to tax

• Section 1248 remains in effect and recharacterize all or portion of the gain as dividend income to the extent of the E&P of the C.F.C. attributable to the selling shareholder

• Under Section 1248(j) such dividend amount qualifies for the 100% D.R.D. provided by Section 245A to a Corporate U.S. Shareholder

• The balance of the gain is subject to 21% corporate tax rate

• Gain recognized by a C.F.C. on the sale of stock in a lower tier C.F.C. is treated under Section 964(e) in whole or in part as dividends

• Such dividend is treated as Subpart F income notwithstanding any other provision but a D.R.D. under Section 245A is available to corporate U.S. Shareholder

• D.R.D. dividends reduce basis for purposes of determining losses

• Planning point: Disregarded a C.F.C. prior to its sale to treat sale as sale of assets used in trade or business. Gain may be subject to tax as G.I.L.T.I. rather than 21%
SECTIONS 245A & 267A

Hybrid Transactions
Hybrid Dividends – Sections 245A(d) & (e)

- Hybrid Dividends paid to U.S. shareholder
  - No Section 245A deduction allowed
  - Do not carry F.T.C.'s

- C.F.C.-to-C.F.C. Hybrid Dividends
  - Treated as Subpart F income – cannot be reduced by other expenses or the Section 952(c) limitations
  - Do not carry F.T.C.'s

Hybrid Dividend = (i) dividend from a C.F.C. that otherwise would generate a Section 245A deduction and (ii) for which the payor C.F.C. received a deduction (or other tax benefit) with respect to any foreign income tax

- What is an example of an "other tax benefit"?
Other Hybrid Transactions – Section 267A

• Disallowance of deductions for certain related party interest and royalty expense payments by U.S. taxpayers and C.F.C.’s

• No deduction allowed for any disqualified related party amount paid or accrued pursuant to a hybrid transaction or by, or to, a hybrid entity

• Disqualified related party amount means interest or royalties paid or accrued to a related party if:
  • Such amount is not included in the income of the related party under the tax law of its country of tax residence, or
  • Such related party is allowed a deduction with respect to such amount under its local country tax law

• A hybrid transaction is any transaction, instrument or agreement for which one or more payments is treated as interest or royalties for U.S. tax purposes but which is not so treated for purposes of the tax law of the recipient's country of residence

• A hybrid entity is an entity treated as fiscally transparent in one jurisdiction, but not the other, where one of the jurisdictions is the United States
Section 267A

- Broad regulatory authority to expand the scope of Section 267A to:
  - Deny deductions for conduit arrangements that involve a hybrid transaction or hybrid entity
  - Apply the provision to foreign branches
  - Apply the provision to "certain structured transactions"
  - Treat as an exclusion a tax preference that has the effect of reducing the headline rate by 25% or more
  - Deny all or a portion of a deduction claimed for interest or royalties paid that are subject to certain preferential tax regimes or a participation exemption
  - Determine the tax residence of a foreign entity
  - Identify exceptions to the general rule
SECTION 965

Transition Tax
Move to "Territorial" System

Transition Tax

• The transition tax applies to a "U.S. Shareholder" of a "Specified Foreign Corporation" with respect to the corporation’s last taxable year beginning before January 1, 2018

• A specified foreign corporation includes:
  • A C.F.C. and
  • A foreign corporation with at least one U.S. shareholder that is a U.S. domestic corporation

• U.S. Shareholder for taxable years beginning before 1/1/2018 is a U.S. person that owns 10% or more of the foreign corporation’s voting power
  • U.S. person includes an individual and a pass-through entity
  • In the case of a pass-through entity, the inclusion amount is determined at the pass-through entity’s level; pass-through entity owners are subject to tax on their share of the amount regardless of whether such owners are also U.S. Shareholders with respect to the foreign corporation
Move to "Territorial" System

Transition Tax

- The tax applies only with respect to foreign corporations which have positive deferred earnings

- Two measuring dates for the deferred E&P: 2/11/2017 and 31/12/2017, the higher of the two applies

- Earnings effectively connected to a U.S. business and previously taxed income (P.T.I.) are excluded from the base

- Distributions made in the inclusion year are added to increase the base for the tax, unless made to another deferred income corporation

- Deficit as of November 2, 2017 can reduce the inclusion amount. Deficit allocated among deferred income corporations
Move to "Territorial" System

Transition Tax

- A deduction is allowed to reduce the tax rate applicable to the deemed repatriated amount.

- The deduction is represented as an equivalent percentages to assure that the applicable rate is the same for all corporations no matter whether their tax year is a calendar year or a fiscal year.

- The deduction applies to individuals as well, however the deduction is calculated using the corporate rate and therefore results in higher effective rate for certain individuals in the top tax brackets.
Move to "Territorial" System

Transition Tax

- Effectively, after the deduction, two tax rates apply:
  - 15.5% to the aggregate earnings attributable to cash and to cash equivalent assets ("cash position"), and
  - 8% to all other earnings

- The "cash position" of any specified foreign corporation is the sum of:
  - cash held by such corporation,
  - the net accounts receivables of such corporation, with a term of less than one year, and
  - the FMV of certain assets, including actively traded property for which there is an established financial market, commercial paper, certificates of deposit, governmental body securities, foreign currency, short term obligations having a term of less than one year, and any assets described by the I.R.S. as economically equivalent
• The cash position is the aggregate of the shareholder’s share of the specified foreign corporation’s cash position as of:
  • The close of the last taxable year that begins before 1/1/2018 (i.e., 12/31/2017) or, if higher
  • The average of the close of the two years preceding the last taxable year (i.e., the average of 12/31/2016 and 12/31/2015)

• In Notice 2018-26 the I.R.S. clarifies the measurement dates that are taken into account in calculating a U.S. Shareholder’s aggregate cash position when the shareholder’s shares in the foreign corporation were disposed of between two measurement dates or when the foreign corporation ceased to exist between such dates. While it clarifies the relevant dates, it doesn’t clarify against what base of E&P it is applied
Move to "Territorial" System

Transition Tax

• A corporate U.S. Shareholder may account for a portion of the foreign tax paid under Section 960 to reduce the transition tax inclusion

• The F.T.C. is reduced by a percentage that intends to reduce the value of the credit by the same percentage that the former tax rate was reduced to the applicable transition tax rate

• Individual are not eligible for this F.T.C. reduction unless they elect to be treated as a corporation for purposes of Subpart F
Transition Tax

Payment of the Tax

• The tax may be paid over eight installments with 40% payable in equal installments during first 5 years and 60% payable in the final three years in incremental installments; S-Corp may defer payment indefinitely or until the business is winded down or the S-Corp is liquidated

• The tax liability crystalizes for the U.S. Shareholder in the year of inclusion (2017 with respect to calendar year taxpayers and 2018 with respect to fiscal year) and the deferral does not affect the liability
Transition Tax

Anti Avoidance Rules

• Notice 2018-26 provides that regulations will disallow the following:
  • Change in accounting method
  • Entity classification election filed on or after November 2, 2017
  • Transactions that reduces the tax liability or the cash position
  • Transactions that increases the amount of F.T.C. allowed under Section 960
  • Transactions that are undertaken with the principal purpose of reducing the transition tax
  • Certain distributions to U.S. shareholders and to foreign related persons

• Transactions taken in the ordinary course of business will not be disregarded
SECTIONS 951 AND 958

Changes to Subpart F
Changes to Subpart F
Changes to the U.S. Shareholder Definition

- Under prior law, a U.S. shareholders meant a U.S. person owning 10% or more of a foreign corporation, measured by vote only

- Under new law, the definition of a U.S. Shareholder was expanded to include U.S. persons owning 10% or more of the vote or the value of the foreign corporation

- The change is effective for taxable years of foreign corporations beginning after December 31, 2017
Changes to Subpart F

30-Day Rule Eliminated

• Under prior law, a U.S. shareholder would include Subpart F income of a C.F.C. in its taxable income for the year only if the foreign corporation was a C.F.C. for an uninterrupted period of 30 days or more.

• Under new law, Subpart F rules applies to U.S. Shareholders of C.F.C.'s if the corporation was a C.F.C. at any time during the taxable year.

• Effective for taxable years of foreign corporations beginning after December 31, 2017.

• As a result, all years in which a foreign corporation is a C.F.C. — even for 1 day — would trigger Subpart F inclusion. Planning that resulted in avoidance of inclusion are no longer effective.
30-Day Rule Eliminated Planning Alternatives?

- C.T.B. for the foreign corporations solved the problem of the U.S. beneficiaries who inherited this structure post death

- With the elimination of the 30 day rule post death C.T.B. would trigger Subpart F income on the deemed liquidation

- Consider multi-tier structures
Changes to Subpart F
Changes to the Attribution Rules

• The ownership rule for determining whether a foreign corporation is a C.F.C. looks to U.S. Shareholders owning 10% of the foreign corporation. For these purposes, ownership includes constructive ownership under Section 958(b) which incorporates attribution under Section 318.

• Under Section 318(a)(3) "downward attribution" applies:
  • A partnership is treated as owning all of the shares owned by its partners. No threshold applies.
  • A trust is treated as owning all of the shares owned by its beneficiaries, unless such beneficiary's interest is a remote contingent interest.
  • A corporation is treated as owning all of the shares owned by a shareholder who owns 50% or more of the stock of the corporation.

• Under prior law, Section 958(b)(4) provided that downward attribution to entities would not apply to attribute ownership from a foreign person to a U.S. person.

• Under the new law, this rule was eliminated and downward attribution from a foreign person applies to treat a U.S. person as a U.S. Shareholder.

• Effective for the last taxable year of foreign corporations beginning before January 1, 2018.
Because Foreign Parent owns “50% or more” of U.S. Sub, U.S. Sub is attributed all of FP’s holdings, i.e., its 100% of F Sub

F Sub will be treated as a C.F.C.

Under Notice 2018-13 the IRS intends the instructions for Form 5471 to provide an exception from filing the form if no U.S. Shareholder owns stock in such C.F.C., and the foreign corporation is a C.F.C. solely because of attribution from a foreign person.
• Because FP owns 50% or more of US Sub, US Sub is attributed all of FP’s other holdings, *i.e.*, 90% of F Sub

• F Sub is a C.F.C.

• U.S.I. will be subject to Section 965 and will begin to include Subpart F income
Changes to Attribution

Illustration C

- U.S. / F Person (100%)
  - U.S. Sub
- U.S. Individual (1%)
  - F / U.S. Partnership
  - F Sub (10%)
  - FP (90%)
Changes to Attribution
Illustration C

- The partnership, will be treated as owning 100% of U.S. Sub from its 1% partner and 10% of F Sub from its 10% partner.

- Because the partnership constructively owns “50% or more” of U.S. Sub, U.S. Sub will be attributed the partnership’s other holdings, i.e., 10% of F Sub.

- By applying the downward attribution rule from a 1% partner, F Sub will be a Specified Foreign Corporation and U.S.I. will have include the transition tax, but U.S.I. may not even know that F Sub is a foreign corporation to which the transition tax applies.

- Notice 2018-26 provides that regulations will require 5% threshold for the application of the downward attribution rule but that the 5% would be measured by applying attribution rules.
NEW SECTIONS 951A AND 250

Rules Related to Passive & Mobile Income
(Otherwise Known as G.I.L.T.I.)
Global Intangible Low-Tax Income (G.I.L.T.I.)

• New Section 951A is a Subpart F type of inclusion for a U.S. Shareholder’s "G.I.L.T.I." pleasures – i.e., a C.F.C.'s low-taxed income deemed attributable to intangibles

• G.I.L.T.I. is the excess of the U.S. shareholder's aggregate net tested income over a routine return of 10% on its aggregate pro-rata share of the depreciable tangible property of the C.F.C.'s.
  • Tested income does not include E.C.I., Subpart F, foreign oil and gas income, high taxed exception income if elected (18.9%) and related party dividends
  • 10% routine return applied to the average of the aggregate adjusted basis of depreciable tangible property (using S.L. method) used in a trade or business to produce tested income as of the end of each quarter.

• G.I.L.T.I. is included in gross income in same manner as Subpart F (basis, P.T.I., etc.) and is allocated among shareholders in proportion to their share of the G.I.L.T.I.
Deduction for G.I.L.T.I.

- New Section 250 provides a deduction for G.I.L.T.I. and Foreign-Derived Intangible Income of a Domestic Corporation (not a R.I.C., R.E.I.T. or S Corp.) – *It does not apply to individuals*

- Conceptually, provides a 10.5% minimum rate on G.I.L.T.I.

- Mechanics – deduction equal 50% of G.I.L.T.I. (*limited to taxable income*)

- For G.I.L.T.I. – Since 80% F.T.C. allowed, if foreign tax rate is higher than 13.125%, generally no residual U.S. tax (potentially subject to expense allocation)
Deduction for G.I.L.T.I.

• Foreign tax credit claimed triggers a gross up to the G.I.L.T.I. inclusion under Section 78

• Foreign tax credit is allowed with respect to foreign taxes attributable to G.I.L.T.I., determined by multiplying the total C.F.C. foreign taxes by the proportion of the G.I.L.T.I. compared to the C.F.C. tested income

• Excess FTC attributable to G.I.L.T.I. is not allowed for carryback or carryforward

• Foreign tax credit under Section 960 doesn’t apply to individuals

• Section 250 deduction doesn’t apply to individuals

• As a result while for corporations G.I.L.T.I. is viewed as a minimum residual tax on low taxed foreign income, for individuals, G.I.L.T.I. is more akin a new Subpart F category
Deduction for F.D.I.I.

- Provided under new Section 250

- Available only to a U.S. C Corp that exploits foreign markets with goods and services that will be used or consumed abroad
  - The F.D.I.I. deduction is not available to a U.S. C Corp that is a R.I.C. or a R.E.I.T.
  - It is capped at taxable income so that it cannot create a loss

- Applies to a foreign corporation’s income derived from property sold to foreign persons or for foreign use or from services provided to any person or with respect to property not located in the U.S., excluding Subpart F income, G.I.L.T.I. Income, financial services income, dividends from C.F.C., domestic O.G.E.I. and foreign branch income

- Eligible income is reduced by a 10% fixed return on qualified business assets
Deduction for F.D.I.I.

- Conceptually, provides a 13.125% rate on foreign derived income from intangibles held in the U.S.

- Mechanics - Deduction of 37.5% until 2026 of foreign-derived intangible income

- F.D.I.I. is part of an array of financial reasons to locate PP&E in the U.S.
  - 21% tax rate
  - Bonus depreciation allowing an immediate write-off for property having a ≤20-year recovery period, computer software, water utility, a film or television production, or a qualified live theatrical production
  - Expensing of up to $1.0 million for equipment each year, phasing out when total property placed in service exceeds $2.5 million
  - Single factor apportionment rules based on place of delivery can yield intentional double no-taxation result at state level
  - State industrial development programs for major facilities are extensive – New Jersey, Florida, Nevada, Massachusetts have exceed $100MM in benefits over time
SECTION 962

Planning Techniques
Planning Technique
Election under Section 962

- Section 962 allows a U.S. individual to elect to be taxed as a corporation for purposes of subpart F inclusions. The Act provides that a Section 962 election may be made for G.I.L.T.I. and for the transition tax

- Consequences of section 962 election:
  - Tax imposed is generally an amount equal to the tax which would be imposed under section 11 if such amounts were received by a domestic corporation
  - Electing shareholder entitled to a deemed paid credit for foreign income taxes under Section 960 as if shareholder were a domestic corporation, subject to limitations

- Actual distribution of earnings and profits previously taxed under Subpart F are taxed as a hypothetical distribution from the U.S. corporation to the individual who made the election. The applicable rate is unclear
Planning Technique

Election under Section 962

• Under Notice 2018-26, for individuals holding interest in specified foreign corporations through partnership, the election is allowed only if such individuals directly or indirectly own 10% or more of the shares of the foreign corporations.

• Under Notice 2018-26 it is clear that the deduction for the transition tax applies to individuals whether or not they make the 962 election; However, it remains unclear whether a section 962 election would allow an individual to claim the benefit of the G.I.L.T.I. deduction available to corporations under Section 250.

• If the election is suboptimal, consider transferring shares of C.F.C. to a U.S. corporation.
PUTTING IT TOGETHER
Transition Tax
Fact Pattern

• U.S. based group

• Manufacturing and marketing I.P. acquired by I.P. Co. in consideration of the issuance of a Contingent Preferred Equity Certificate many years ago

• License fees paid to I.P. Co. which retains funds for use in Europe

• License fees and trademark fees meet an exception from Foreign Personal Holding Company Income and were not taxed to U.S. Shareholders

• Country E I.P. Co. highly profitable, all others are marginally profitable except for Country B DistribCo, which has losses

• All C.F.C.’s have a calendar taxable year
Transition Tax Analysis

- Determine accumulated post-1986 earnings for each C.F.C. on November 2, 2017 and December 31, 2017 (excluding E.C.I. and P.T.I.), pick the higher

- Determine the aggregate foreign E&P deficit on November 2, 2017

- Allocate deficit of Country B DistribCo among profitable C.F.C.'s on a pro rata basis by reference to positive earnings

- Eliminate double counting from intercompany receivables pursuant to Notice 2018-7

- From balance sheet, determine higher cash position of each C.F.C.
  - At 12/31/17
  - The average of 12/31/16 and 12/31/15

- Use cash position that produces greater amount for U.S. Shareholder and aggregate all cash positions

- Reduce the aggregate cash position to identify the pool attributable to all other assets
Transition Tax Analysis

- For cash pool:
  - Multiply the balance by 0.443 (15.5 ÷ 35) to determine tax base after the rate equivalent deduction that allows the effective rate of tax to drop to 15.5%
  - Apply tax rate of 35%
  - Net tax rate for U.S. Co. is 15.5% on this pool

- For other pool:
  - Multiply the balance by 0.229 (8 ÷ 35) to determine tax base after the rate equivalent deduction that allows the effective rate of tax to drop to 8%
  - Apply tax rate of 35%
  - Net tax rate for U.S. Co. is 8%

- For a U.S. corporation, an indirect foreign tax credit is allowed, with a haircut

- The haircut is the foreign tax attributable to the rate equivalent deduction. The disallowed percentage is calculated by multiplying the percentage of the cash pool by \([1 − (15.5 ÷ 35)]\) and the percentage of the other pool by \([1 − (8 ÷ 35)]\), and adding the two
G.I.L.T.I. Tax
Fact Pattern

U.S. Co.

Country A
ManuCo

Country B
DistribCo

Country C
DistribCo

Country D
DistribCo

Country E
I.P. Co.

C.P.E.C.
G.I.L.T.I. Tax

Purpose

• **Purpose (at least on paper)**

  • To protect U.S. tax base after adoption of the foreign D.R.D. rules

  • Prevents mobile intangible income from being used to reduce U.S. taxable income at the same time the group benefits from the D.R.D. with regard to G.I.L.T.I.
G.I.L.T.I. Tax

Basic Approach

- After Subpart F and E.C.I. apply to a C.F.C., a new nontraditional test applies to attack deferral

- All C.F.C. income has two economic drivers – PP&E and I.P.

- Income from PP&E (Qualified Business Asset Investment "Q.B.A.I."), as determined under G.I.L.T.I. rules, is good income and can be deferred

- Income from I.P., which is all income not generated from PP&E, is bad income and deferral is denied

- In determining good and bad income, economic reality plays no role
G.I.L.T.I. Tax

Formula

**Step 1:** From total taxable income of each C.F.C., remove the following items of income and the expenses and assets related to that income

- E.C.I.
- Subpart F income
- High Tax income excluded from Subpart F
- Dividends from related person
- Foreign Oil and Gas Extractions Income

**Step 2:** Determine qualified business assets:

- The adjusted basis for tangible depreciable property used in the trade or business of the C.F.C. is measured on the last day of each quarter
- Longer A.D.R. lives are used in determining basis
- Assets that produce income eliminated in Step 1 are removed from computation
- The basis for the four quarters are averaged
G.I.L.T.I. Tax

Formula

- **Step 3**: Multiply average bases of assets by 10% and reduce the result by C.F.C. interest expense, except for interest expense that reduced income which was eliminated in Step 1.

- **Step 4**: Subtract amount in Step 3 from total taxable income remaining after Step 1.

- **Step 5**: Allocate G.I.L.T.I. to all C.F.C.'s having positive income after Step 4.
  - Foreign taxes are treated as an expense.
  - This affects Section 78 gross-up and F.T.C.
G.I.L.T.I. Tax

Formula

- **Step 6**: Compute tax on G.I.L.T.I. inclusion:
  - Under Section 951A, a U.S. Shareholder of a C.F.C. includes in gross income its G.I.L.T.I. in a manner similar to inclusions of Subpart F income.
  - A U.S. Shareholder that is a corporation may claim a deemed-paid foreign tax credit under Section 960; this includes an individual who makes an election under Section 962 to be taxed as a corporation on G.I.L.T.I.
  - If an indirect F.T.C. is claimed, the foreign taxes of C.F.C.'s with positive G.I.L.T.I. are "grossed-up".
  - The U.S. corporation is entitled to deduct 50% of the G.I.L.T.I. included in income.
  - As a result, a corporate U.S. Shareholder's effective U.S. tax rate on G.I.L.T.I. plus the gross-up will be 10.5%.
  - P.T.I. concept under Section 959 allows G.I.L.T.I. to be distributed without additional tax in most instances.
• **Step 7**: Compute F.T.C. on G.I.L.T.I.
  
  • For each C.F.C., foreign taxes on items of income and loss removed under Step 1 are removed from balance of computations

  • A U.S. Shareholder computes G.I.L.T.I. as a percentage of total income (excluding items removed in Step 1) for all C.F.C.'s

  • The percentage is applied to the foreign taxes of each C.F.C. having positive income after expenses, including taxes, have reduced gross income

  • The result is the foreign tax available for credit on G.I.L.T.I.

  • The full amount of the foreign taxes of C.F.C. available for credit on G.I.L.T.I. is grossed up into income

  • Only 80% of those taxes may be claimed as a credit

  • Unused F.T.C. is permanently lost
G.I.L.T.I. Tax
Asset Mix in the 5-Company Group of C.F.C.'s

- **ManuCo**
  - All dividends from DistribCos and I.P. Co are removed from G.I.L.T.I. computation
  - Likely to have a substantial investment in PP&E, depending on the age of its equipment
  - Also likely to have supplies, work in process, and receivables
  - Likely to be a full taxpayer in Country A
  - Acquisition date of equipment and original cost measured in U.S. Dollars will affect basis
  - Depending on these variables, 35-65 split either way between Q.B.A.I. and G.I.L.T.I. is guestimate
Asset Mix in the 5-Company Group of C.F.C.'s

• Three DistribCos
  • Foreign Base Company Sales Income from cross border sales, if any, should be removed from the analysis along with related portion of depreciable assets
  • Each is likely to have substantial investment in inventory and receivables, assuming the full distributor model applies
  • It is possible that one or more of the C.F.C.'s may have an investment in a warehouse facility
  • If warehouse is owned, a 10-90 split between Q.B.A.I. and G.I.L.T.I. is guestimate
  • If warehouse is not owned, it is likely that all income other than Foreign Base Company Sales Income is G.I.L.T.I.
G.I.L.T.I. Tax
Asset Mix in the 5-Company Group of C.F.C.'s

• I.P. Co.
  • Asset mix likely consists of I.P., cash, loans, other investments, none of which would be considered to be depreciable PP&E
  • Investment income comprising Foreign Personal Holding Company Income should be removed from the analysis
  • It is likely that all remaining income is G.I.L.T.I.
  • It is likely that F.T.C. will be minimal, consistent with typical planning
G.I.L.T.I. Tax  
Planning for G.I.L.T.I.

- The structure that worked well prior to T.C.J.A. now is suboptimal
- Consider operations through branch or hybrid entity structure to take advantage of existing investment in PP&E
- Consider branch rule of Foreign Base Company Sales Income
- Consider construction of new plant with state of the art equipment that can increase the investment in PP&E
- Consider exit tax if location of new plant is in a different jurisdiction
- Consider the effect of a change of ownership of I.P. with location of manufacturing operations
F.D.I.I. New Fact Pattern

U.S. Co. → Country A DistribCo

Country B DistribCo → Country C DistribCo → Country D DistribCo

U.S. E.U.
F.D.I.I.

- Terminology used in F.D.I.I. deduction
  - "D.E.I." means Deduction Eligible Income
  - "D.I.I." means Deemed Intangible Income
  - "F.D.D.E.I." means Foreign Derived Deduction Eligible Income
  - "F.D.I.I." means Foreign Derived Intangible Income
  - "Q.B.A.I." means Qualified Business Asset Income
F.D.I.I. Computation

- **Step 1**: Compute D.E.I. by removing the following items of income, and related expenses and assets:
  - Subpart F Income
  - G.I.L.T.I.
  - Financial services income
  - Dividends received from a C.F.C.
  - Domestic oil and gas extraction income
  - Foreign branch income
**F.D.I.I. Computation**

- **Step 2:** Compute F.D.D.E.I., which is D.E.I. derived in connection with:
  - Sales of property to a foreign person for use, consumption, or sale outside the U.S.
  - Services provided to any person not located in the U.S. or with regard to property not located in the U.S.

- **Operating rules:**
  - Sales to an unrelated person for further manufacturing in the U.S. are not sales of foreign use property
  - Sales to any non-U.S. person for further manufacturing outside the U.S. is a sale of foreign use property
  - Sales to a related party who is not a U.S. person can be a sale of foreign use property if the property is ultimately sold to a foreign person for use outside the U.S. and that fact is demonstrated
  - Services to a related party outside the U.S. must not be of a kind that is provided by the related party to persons within the U.S.
  - Included in the term "sale" are leases, licenses, exchanges, or other dispositions
F.D.I.I. Computation

- **Step 3:** Determine the portion of the D.E.I. that exceeds a base amount
  - The base amount equals 10% of the average basis in depreciable tangible assets used to generate D.E.I.
  - The remainder is D.I.I.

- **Step 4:** Determine the portion of the D.I.I. that is F.D.I.I.
  - Divide the F.D.D.E.I. by the D.E.I. and multiply the resulting percentage against the D.I.I.
Important Notice

This presentation is not intended to be legal advice. Reading these materials does not create an attorney-client relationship. The outcome of each case stands on its own merits.