

Morgan Lewis

TAX DEVELOPMENTS AND THEIR IMPACT ON THE AUTOMOTIVE INDUSTRY

May 1, 2019

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Alex Reid
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Greg Hartker**

Morgan Lewis Automotive Hour Webinar Series

Series of automotive industry focused webinars led by members of the Morgan Lewis global automotive team. The 10-part 2019 program is designed to provide a comprehensive overview on a variety of topics related to clients in the automotive industry. Upcoming sessions:

MAY 29 | IP Issues with Emerging Automotive and Mobility Technologies

JUNE 12 | Distribution of Vehicles in the United States and the Impact of State Law

SEPTEMBER 18 | Venture Investing in the Automotive and Mobility Space

OCTOBER 16 | Labor and Employment Issues in the Automotive and Mobility Space

NOVEMBER 13 | Joint Ventures and Alliance Issues in the Automotive Space

DECEMBER 11 | Privacy Considerations and the Use of Collected Data

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SECTION 01

INTRODUCTIONS



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Morgan Lewis

Alexander L. Reid advises tax-exempt organizations in planning, structuring, and transactional matters. He also represents taxpayers under audit, and helps organizations improve their governance and enhance their tax compliance. Alexander counsels taxpayers seeking administrative guidance from the Internal Revenue Service (IRS) and US Department of the Treasury, as well as on legislative matters with the US Congress. His tax-exempt clients include charities, foundations, colleges and universities, museums, and other nonprofit organizations.

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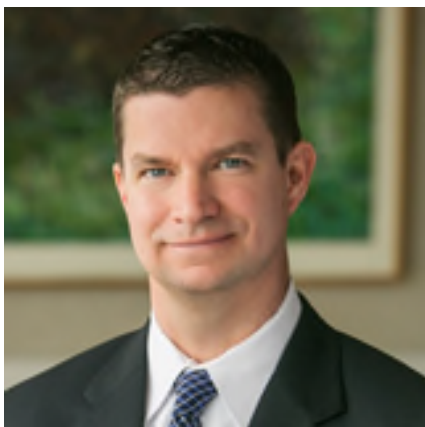


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Michael Liu advises and counsels multinational corporations with domestic and international tax planning. His clients span a variety of industries, including those in the high technology, semiconductor, software, pharmaceuticals, and biotechnology sectors. Michael advises public and private companies on a wide range of issues, including tax planning involving the use, transfer, and deployment of intangibles and intellectual property; supply chain and distribution planning; cross-border transfer pricing issues; foreign tax credit planning; redomiciliations and redomestications of both US and foreign corporations; tax-efficient cash repatriation strategies; post-acquisition integration planning and implementation; cross-border merger and acquisition transactions; and loss utilization planning.

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Gregory Hartker focuses his practice on domestic and international corporate and partnership tax issues, as well as on investment fund structuring and representing investors in such funds. Gregory represents clients in both taxable and tax-deferred mergers and acquisitions, public and private issuances of debt instruments, and partnership and LLC structuring and operating issues. Additionally, his international tax background includes matters involving Subpart F, PFIC, foreign tax credits, withholding, treaty issues, cost sharing, and cross-border transfer pricing.

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- Alex Sadler helps clients prepare and defend claims for the R&D tax credit, a valuable corporate tax incentive. He authored the treatise *Legal Guide to the Research Credit* published by Thomson Reuters® and chair an R&D credit symposium every year. He has litigated several leading research credit cases and helped many clients resolve R&D credit issues with the IRS.
- Alex was previously a Trial Attorney with the U.S. Department of Justice, Tax Division, where he received the Attorney General's Distinguished Service Award and the Tax Division's Outstanding Attorney Award for high-profile tax trials.
- Alex also served as chair and vice chair of the DC Bar's Tax Audits and Litigation Committee and has been listed in Chambers USA, Washingtonian Top Lawyers Guide, and Washington DC Super Lawyers.

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Cosimo advises corporations, partnerships, and individuals on state and local tax controversy, planning, and transactional matters. Cosimo routinely represents clients in high-stakes state and local tax audits, appeals, and litigations in matters throughout the United States, including defending clients in state False Claims Act cases and sales and use tax, individual residency, withholding tax, corporate income tax, and real estate transfer tax audits and disputes. He also advises clients on developing state and local tax planning strategies for corporate acquisitions, dispositions, restructurings, and mergers.

SECTION 02

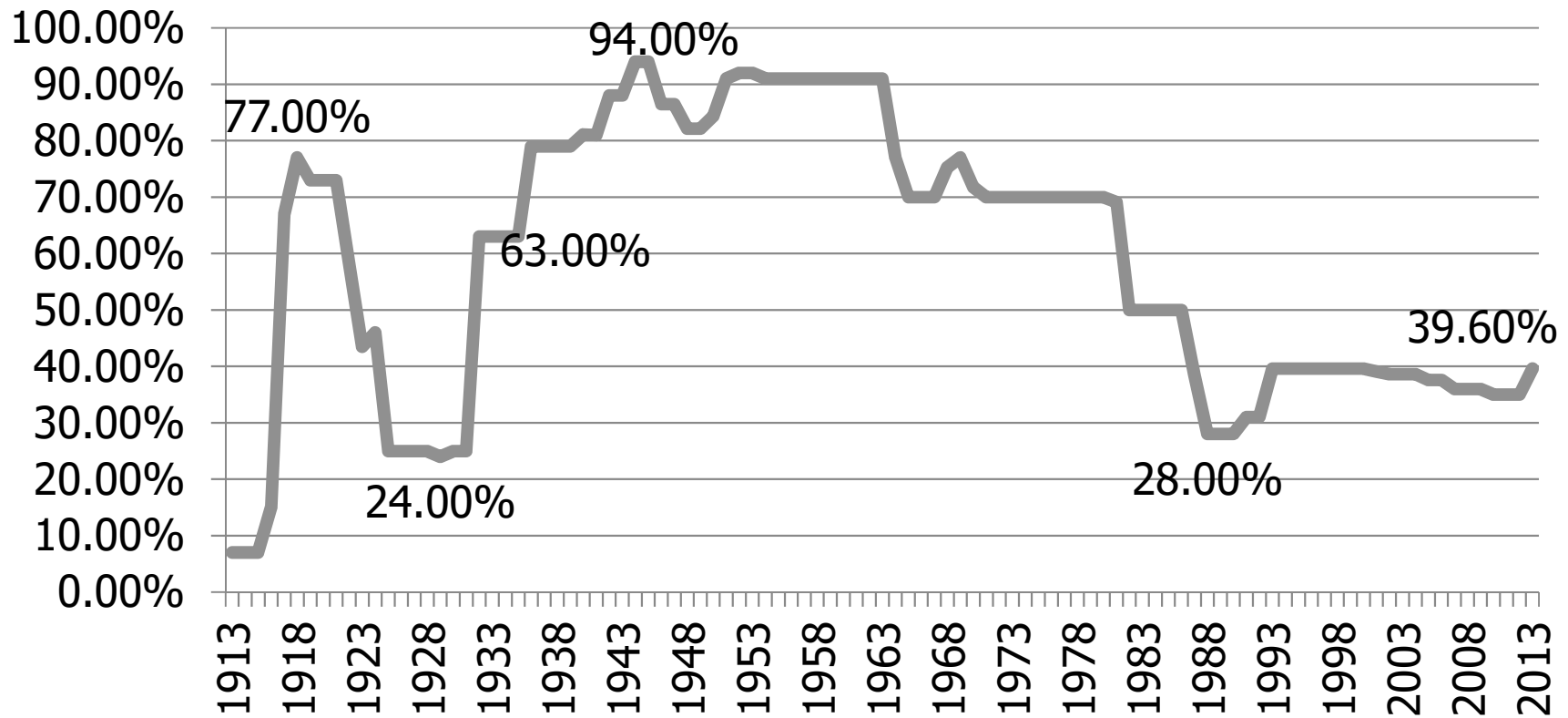
TAX REFORM: WHAT HAPPENED? WHAT'S NEXT?

ALEX REID (DC)



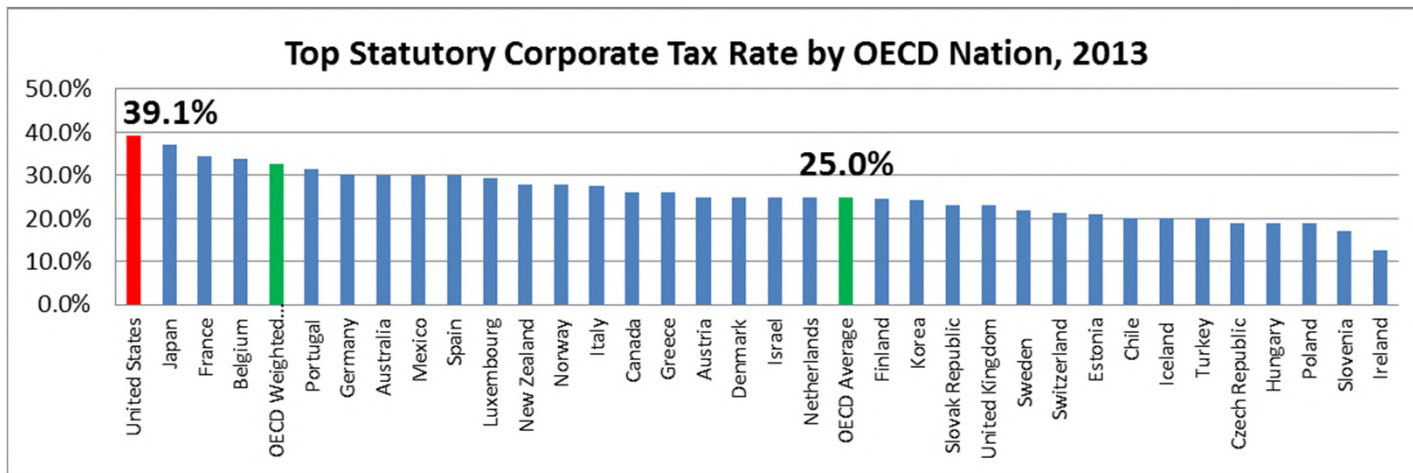
WHAT IS TAX REFORM?

US Top Marginal Tax Rates: 1913-2013

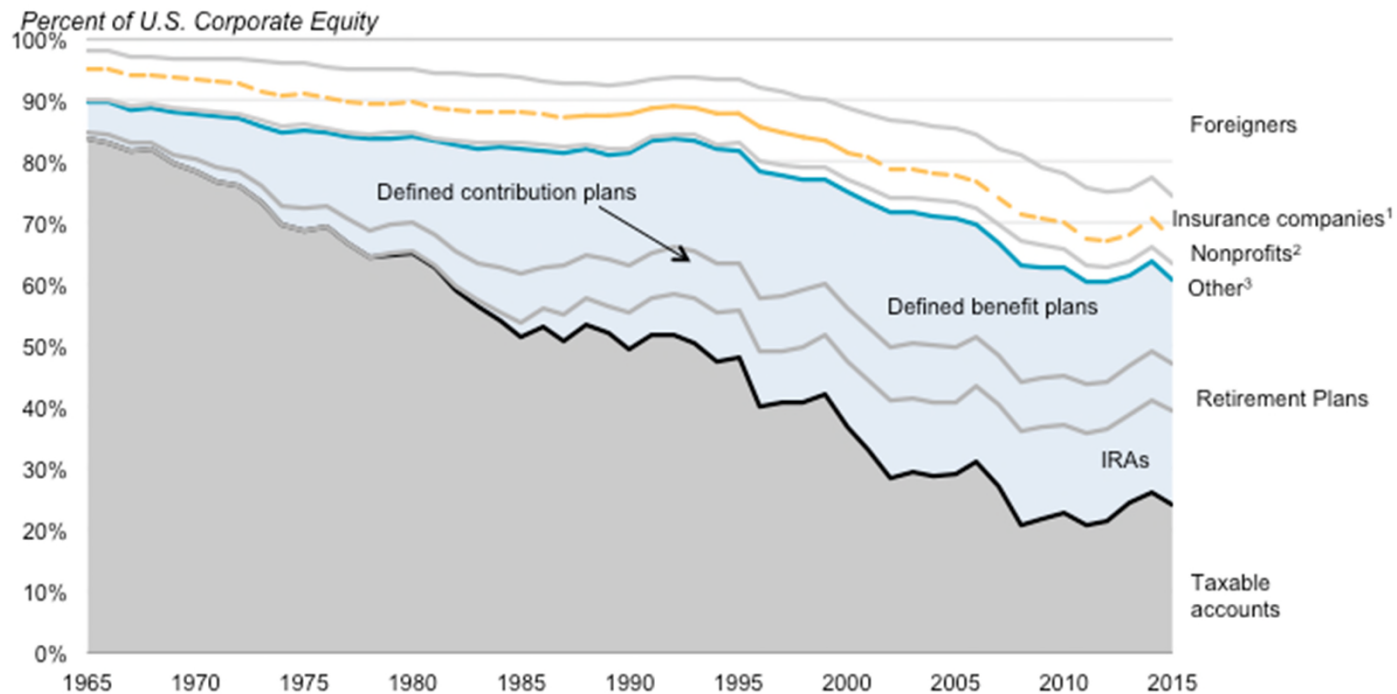


Case for Corporate Tax Reform

- High US statutory corporate tax rate relative to other OECD countries
- Double taxation of corporate earnings at entity and shareholder levels
- Deductibility of interest and non-deductibility of dividends creates incentive to finance corporations with debt rather than equity



...but only 25% of US Corporate Stock is held in taxable accounts



Source: Rosenthal & Austin, The Dwindling Taxable Share of U.S. Corporate Stock (Urban-Brookings Tax Policy Center, May 16, 2016)

What is tax reform?

- Not all tax legislation is “tax reform”
- Tax reform is:
 - Revenue neutral (government share of revenue is the same as before)
 - Distributionally neutral (those with more pay more than those with less)
 - Horizontally neutral (similarly situated taxpayers pay the same)
 - Efficient (does not distort economic transactions)
 - Achieved by broadening tax base and lowering tax rates (eliminate “tax expenditures”)

I would do anything for tax reform ...

- 1986 Act:
 - Multi-year effort with sustained engagement from Treasury,
 - 100 base broadening measures,
 - lowered top individual income tax rate from 50% to 28%,
 - lowered corporate tax rate from 46% to 34%,
 - achieved parity of tax rate on capital and ordinary income
- Tax Reform Act of 2014 (Camp Draft)
 - Individual rates reduced from 39.6 to 35%, corporate rate to 25%, territorial system
- Tax Reform Blueprint of 2016
 - Destination based cash-flow tax with border adjustment (BAT)
 - Individual tax rates to 33%,
 - corporate tax rate to 20% with 25% passthrough rate

...(but I won't do BAT)

Joint Statement on Tax Reform (July 27, 2017)

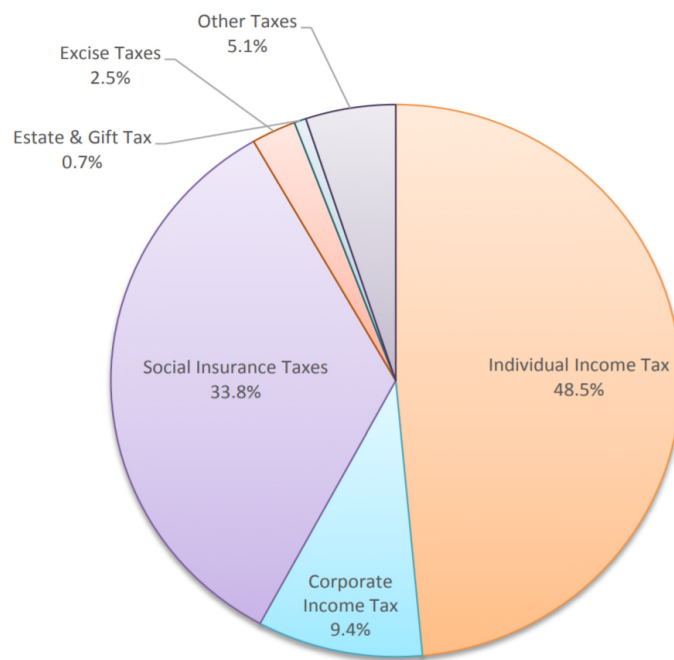
“[W]e are now confident that, without transitioning to a new domestic consumption-based tax system, there is a viable approach for ensuring a level playing field between American and foreign companies and workers, while protecting American jobs and the U.S. tax base.

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. ...

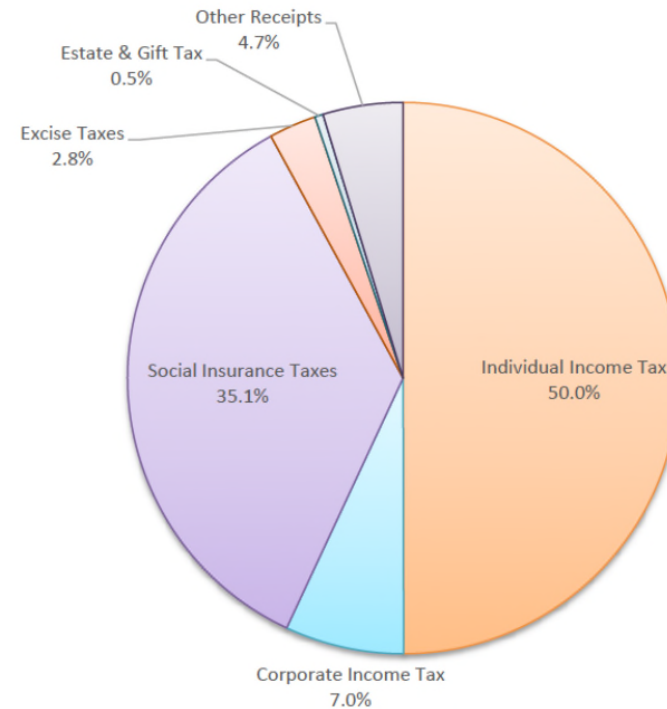
Our expectation is for this legislation to move through the committees this fall, under regular order, followed by consideration on the House and Senate floors.”

WAS THAT TAX REFORM?

Sources of ~\$3.3 trillion tax revenue: Shift of tax burden from corporations to individuals

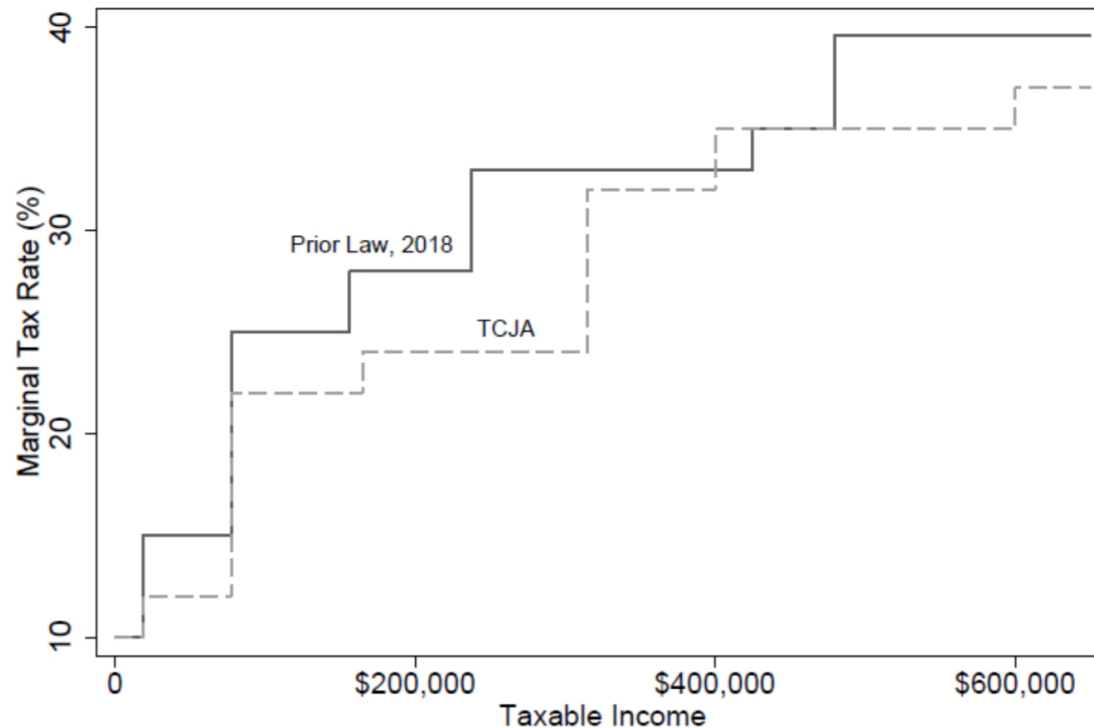


2017



2019

Effect of Tax Cuts and Jobs Act on individual tax rates



Source: Alex Brill and Derrick Choe, Charitable Giving and the Tax Cuts and Jobs Act (American Enterprise Institute, June 2018)

What was Public Law 115-97?

- It was not the “Tax Cuts and Jobs Act” because **reconciliation**
- More short-term **stimulus** than tax reform:
 - Reduces tax revenue by **\$1.8 trillion** over 10 years, raises deficit by \$2.3T
 - Cut max corporate income tax rate to **21 percent**
 - Redesigned international tax rules (**GILTI, BEAT, FDII, repatriation**)
 - New deduction for **pass-through income**
 - **Expensing** of equipment investment
 - Eliminates **corporate alternative minimum tax**, personal and dependent exemptions, tax on failure to obtain adequate health insurance coverage
 - Increases **standard deduction**, the estate tax exemption, and the individual alternative minimum tax exemption
- Corporate provisions **permanent**
- Individual and estate tax provisions **expire after 2025**

Negative Consequences of Tax Cuts and Jobs Act

- SALT cap
 - Deduction for state and local taxes limited to \$10,000
 - High tax states have democratic delegations (NY, CT, NJ, IL, WI, CA, MD)
 - 10th Amendment concerns
- BEAT
 - Base erosion anti-abuse tax establishes minimum tax on cross border related-party transactions involving payment of royalties, interest, rent, and high-margin service payments
- Limits on corporate interest deductions
 - Corporations cannot deduct more than 30% of taxable income computed without regard to interest and depreciation)
 - In 2022 depreciation add back goes away
 - Increased after-tax cost of leveraged structures

Negative Consequences of Tax Cuts and Jobs Act (cont'd)

- CFC attribution rules
 - US shareholders owning 10% of controlled foreign corporations must pay tax on Subpart F income
 - New upstream attribution rule significantly increases number of CFCs and changes international tax planning
- Mortgage Interest Deduction
 - Reduced maximum mortgage from \$1.1 million to \$750,000 and doubled standard deduction
 - 20.9 million taxpayers will be unable to claim a mortgage interest deduction
- Charitable Deduction
 - Charities are expected to lose \$17.2 billion in donations in 2018 alone due to effect of doubled standard deduction and estate tax exemption
 - 21 million taxpayers will lose ability to claim a deduction, deduction limited to top 9%

Negative Consequences of Tax Cuts and Jobs Act (cont'd)

- GILTI
 - Significant uncertainty remains in global intangible low-taxed income (GILTI) rules
 - The special low tax rate of 10% creates incentives to plan **into** GILTI
 - GILTI applies to companies without intangible assets
 - Application of GILTI against depreciated basis of tangible assets creates distortions
- Deduction for passthrough income is difficult to apply and prone to abuse
- Error in bonus depreciation rule excluded “qualified improvement property”

Negative Consequences of Tax Cuts and Jobs Act (cont'd)

- NOLs
 - Net operating loss deduction limited to 80% of business's net income in a given year
 - Losses can be carried forward indefinitely, but **not backward** (no more 2 back and 20 forward) which makes income smoothing more difficult
 - Can't use net operating loss in one business to offset income from other sources
 - Effective dates are confused: law says NOL carrybacks eliminated effective for NOLs arising in tax years **ending** after 12/31/17 but conference report says it is effective for tax years **beginning** after 12/31/17. Fiscal year taxpayers with tax years beginning in 2017 and ending in 2018 can't carryback NOLs without a change.
- And many, many more...

TAX REFORM 2.0?

Political Dynamics

- Tax Cuts and Jobs Act was the major legislative victory for Republicans
 - Republicans reluctant to criticize it publicly
 - Yet “Tax Reform 2.0” suggests an iterative process, that the first cut was imperfect
 - Also Republicans in blue states like New Jersey and California have constituents adversely affected by SALT cap
- Legislation was passed without support from Democrats
 - Democrats willing to fix the bill, but not willing to waive PayGo rules to do so
 - Revenue may not be difficult to find given new appetite for increasing marginal tax rates
 - Eliminating the SALT cap is a key priority

“Tax Reform 2.0”

- Tax Reform 2.0 legislation introduced in 115th Congress
 - Makes expiring provisions permanent, including individual tax rate reductions, deduction for pass through income, child tax credit modification, estate tax exclusion, etc.
 - Additional incentive for cash gifts to charities
 - Retirement saving incentives for small businesses,
 - Incentives for new businesses to write off start up costs without limiting access to research and development (R&D) tax credit
 - Does not address technical corrections
 - Total cost of three bills: \$657 billion

JCT Bluebook on the TCJA

- The Joint Committee on Taxation published a comprehensive technical explanation of the Tax Cuts and Jobs Act (Bluebook) on December 20, 2018
- The explanation clarifies certain ambiguities in the text and flags the need for technical corrections in more than 75 places.
- The Bluebook is nonbinding but instructive to Treasury when writing implementing regulations and is often cited in legal opinions.
- Ambiguities that can't be clarified through technical explanations may be added to the list of technical corrections for inclusion in future tax legislation.
- Technical corrections require agreement by and among majority and minority staff of the House and Senate tax writing committees as well as the tax policy staff of the Treasury Department.

Tax Clerical and Technical Corrections Bill

- At the end of the 115th Congress, the House passed H.R. 88, the “Tax Technical and Clerical Corrections Act” which included \$54 billion of tax policy modifications as well as technical corrections, which have no cost because they are considered part of the original legislation.
- The bill was made up of two component pieces of tax legislation that are likely to be considered in the 116th Congress as well:
 - Retirement, Savings, and Other Tax Relief Act of 2018, which included certain tax extenders and technical corrections
 - Taxpayer First Act of 2018, which addresses IRS restructuring and modernization

House Committee on Ways and Means Leadership

- Rep. Richard E. Neal (D-MA) replaces Rep. Kevin Brady (R-TX) as Chair of Ways and Means Committee in the 116th Congress.
- New members of the committee include: Gwen Moore (D-WI), Dan Kildee (D-MI), Brendan Boyle (D-PA), Don Beyer (D-VA), Dwight Evans (D-PA), Brad Schneider (D-IL), Tom Suozzi (D-NY), Jimmy Panetta (D-CA), Stephanie Murphy (D-FL), Jimmy Gomez (D-CA), Steven Horsford (D-NV), Drew Ferguson (R-GA), Jodey Arrington (R-TX) and Ron Estes (R-KS).
- Andrew Grossman, formerly legislation counsel with Joint Committee on Taxation, joins Ways and Means majority staff as chief tax counsel.

Senate Finance Committee Leadership

- Senator Chuck Grassley (R-IA) replaces retired Senator Orrin Hatch (R-UT) as Chairman of the Senate Finance Committee.
- In addition to Senator Grassley, the Republican majority includes: Mike Crapo (ID), Pat Roberts (KS), Mike Enzi (WY), John Cornyn (TX), John Thune (SD), Richard Burr (NC), Johnny Isakson (GA), Rob Portman (OH), Pat Toomey (PA), Tim Scott (SC), Bill Cassidy (LA), and three new members: James Lankford (OK), Steve Daines (MT), Todd Young (IN)
- Democrats include Ranking Member Ron Wyden (OR), Debbie Stabenow (MI), Maria Cantwell (WA), Bob Menendez (NJ), Tom Carper (DE), Ben Cardin (MD), Sherrod Brown (OH), Michael Bennet (CO), Bob Casey (PA), Mark Warner (VA), Sheldon Whitehouse (RI), Maggie Hassan (NH), and one new member: Catherine Cortez Masto (NV)

Senate Finance Committee Leadership (cont'd)

- Mark Warren has been appointed chief tax counsel for the Finance Committee majority staff.
 - He previously served as senior tax counsel to Senator John Thune and as tax counsel to Ways and Means under Chairman Dave Camp (sponsor of the Tax Reform Act of 2014)
- DeLisa Ragsdale will serve as Chief Investigative Counsel, and Joshua Flynn-Brown as Senior Investigative Counsel for the Finance Committee majority staff.
- John Schoenecker joins the Finance Committee staff as senior investigative counsel covering tax. John was previously with the majority staff of House Ways and Means.

Senate Finance Committee Priorities

- Senator Grassley's January 9 statement about the priorities of the Finance Committee under his leadership:
 - "I'll continue to hold the IRS accountable for top-quality taxpayer service, respect for taxpayer rights and protection of taxpayer information, and will review the practices and compliance of the tax-exempt sector, ensure tax whistleblowers are treated fairly for exposing tax evasion and abuse, and monitor the Treasury Department's implementation of the recent tax reforms included in the Tax Cuts and Jobs Act to inform legislative efforts to build on the law's success."
- On January 15 he said, "I assume one of the first things we'll try to do on taxes is the extenders."

Prospects for Tax Legislation in the 116th Congress

- Much to be done; no political margin to do it.
- Unfinished business from 115th includes:
 - Technical corrections needed to improve the Tax Cuts and Jobs Act
 - Tax extenders, require retroactive extension
 - Various bipartisan, uncontroversial tax policy, including repeal of the “nonprofit parking tax” (i.e. § 512(a)(7)).
- In the absence of bi-cameral legislative power, House and Senate are likely to use their unilateral power to conduct hearings and investigations

Theatre of the Absurd



"Let's go!"
"We can't."
"Why not?"
"We're waiting for tax reform."

-Samuel Beckett, Waiting for Godot

SECTION 03

**PROPOSED FDII
REGULATIONS AND IMPACT
ON SUPPLY CHAINS AND
EXPORT SALES**

**MIKE LIU (CH / SV) & GREG
HARTKER (SF)**

FDII – Calculation

- **FDII = DII x [FDDEI / DEI]**
 - DII – Deemed Intangible Income
 - DEI – Deduction Eligible Income
 - FDDEI – Foreign Derived Deduction Eligible Income
- **DII = DEI – DTIR**
 - DTIR = Deemed Tangible Income Return
- **DEI = Gross income* - allocable deductions**
 - * Gross income determined without regard to (i) Subpart F income, (ii) GILTI, (iii) financial services income, (iv) dividends from CFCs, (v) domestic oil and gas extraction income, and (vi) foreign branch income
 - Expenses allocation - §§ 1.861-8 through -14T, and -17
 - COGS may be allocated under any reasonable method

FDII – Calculation

- FDDEI– DEI derived
 - Property – sold to a non-U.S. person for foreign use
 - “Sales” include licenses and leases
 - Services – provided to persons or with respect to property located outside the U.S.
- DTIR = 10% x QBAI
 - QBAI – Qualified Business Asset Income
- QBAI = tangible, depreciable property used to generate DEI

FDDEI Transactions

- General Rules
 - Identify transaction as either (i) a sale or (ii) a service
 - If sale => categorize as general property or intangible property
 - If service => categorize proximate, property, transportation, or general service
 - Mixed transactions characterized based on “predominant character”
- General requirements
 1. Do not know (or have reason to know) that transaction does not qualify for FDII
 2. Documentation requirement
 - Do not know or have reason to know documentation unreliable / inaccurate
 - Obtained before Filing Date (due date for U.S. tax return, with extensions)
 - Obtained no earlier than one year before sale or provision of services
- Special rules
 - Losses – Cannot intentionally “flunk” documentation requirements to increase FDDEI

FDDEI Sales – General Property

- General Requirements
 1. Sale to a foreign person
 2. Sale for foreign use
 - a. Not subject to domestic use within 3 years of delivery, or
 - b. Subject to manufacture, assembly, or processing before domestic use
 - Physically and materially changed (facts / circumstances)
 - Incorporated as a component into a second product
 - FMV of component < 20% of FMV of second product
 - Components sold by same seller aggregated
- Special rules
 - Fungible goods / mass – may rely on market research, statistical sampling, etc.

FDDEI Sales – General Property

- Documentation requirements
 1. Sale to a foreign person
 - Written statement
 - In the case of entities, organizational documents
 - In the case of individuals, valid government identification
 - Government filings (e.g., SEC reporting)
 2. Foreign use
 - Written statement – establishing foreign use
 - Binding contract – requiring foreign use
 - Shipping documentation (e.g., export bill)
- Special rules
 - Small business / transaction exception (foreign person) – shipping address may be used if:
 - Seller gross receipts < \$10M
 - Sales to recipient < \$5K

FDDEI Sales – Intangible Property

- Property sold for foreign use
 1. Do not know or have reason to know that property is not for foreign use
 2. Documentation requirement
 - Written statement – establishing foreign use
 - Binding contract – requiring foreign use
 - Audited financial statements – showing location where revenue generated
 - Statements / documentation used to determine / compute royalties or compensation
- Evidence of foreign use
 - Revenue from sale / license generated outside of United States
 - Mixed use – foreign use determined based on percentage of revenue generated outside of U.S.
 - Reliance on projections and financial data permitted in some circumstances

FDDEI Services – In general

- Four principal categories:
 1. Proximate services
 2. Property services
 3. Transportation services
 4. General services
 - To consumers
 - To business recipients
- General requirements
 - Provision to a person or with respect to property located outside U.S.

FDDEI Services – Proximate, Property, Transportation

- Proximate Services
 - Substantially all of services performed in the physical presence of recipient outside U.S.
 - Meets threshold if > 80% of time spent in physical presence
 - If less the substantially all performed outside U.S., allocation based on time spent performing inside / outside U.S.
- Property Services
 - Property must be located outside U.S. for duration of services
- Transportation Services
 - Services involving vehicles or other transportation
 - FDDEI Service if departure and destination located outside U.S.
 - If either departure or destination in U.S., 50% of service treated as FDDEI Service

FDDEI Services – General - Consumers

- Requirements to establish foreign use:
 1. Do not know or have reason to know recipient is not a foreign person
 2. Documentation requirement – may be satisfied through:
 - Written statement
 - Valid government identification
 - Small business / transaction exception – billing address sufficient

FDDEI Services – General – Business Recipients

- General Rule – Gross income allocable to operations of business recipient located outside of U.S. eligible for FDDEI treatment
 - Specifically identifiable operations
 - No specifically identifiable operations (or general benefit)
 - Allocation pro rata to all operations of business recipient
 - May use any reasonable methodology (see Treas. Reg. § 1.482-9(k)), including: time spent, costs incurred, gross receipts, revenue, profit, or assets of business recipient
- Requirements to establish foreign use:
 1. Do not know or have reason to know recipient is not a foreign person
 2. Documentation requirement – may be satisfied through:
 - Written statement
 - Binding contract
 - Documents prepared in ordinary course of business
 - Publicly available information
 - Small business / transaction exception – shipping address sufficient

FDDEI Sales – Related Party Rules

- Related Party Sales – count as FDDEI Sales if either:
 1. Related buyer sells to foreign unrelated party (unrelated party transaction)
 - The unrelated party transaction would otherwise constitute an FDDEI sale / service
 - The unrelated party transaction occurs either:
 - Before the filing date, or
 - After the filing date, and an amended return is filed
 2. Property used in unrelated party transaction
 - Seller reasonably expects property will be used in unrelated party transaction
 - The unrelated party transaction would otherwise constitute an FDDEI sale / service
 - Revenue from unrelated party transaction > 80% of total revenue received by related buyer

FDDEI Services – Related Party Rules

- Related Party Services – count as FDDEI Services if:
 - Service is not substantially similar to service provided by related party to persons in U.S.
 - Considered substantially similar if:
 - 60% of benefit of related party service conveyed to persons in U.S.
 - 60% of price for unrelated party service paid by persons in U.S.
 - If substantially similar, gross income from FDDEI Services allocated based on benefits conferred to persons outside U.S. relative to total benefit

Qualified Business Asset Investment

- Anti-abuse rule – Transfer of property disregarded if:
 - Transferred to a specified related party (50%-related)
 - During the disqualified period
 - Beginning 1 year prior to transfer, and
 - Ending earlier of (i) end of recovery period or (ii) 1 year after transfer
 - Lease back (or lease to a FDII-eligible 80%-related corporation or partnership)
 - With a principal purpose of reducing DTIR
 - *Per se* rule deems principal purpose if sale and lease occur within 6 months

Qualified Business Asset Investment

- Anti-abuse rule – Structured transactions – unrelated lessor treated as a specified related party if:
 - Reduction in DTIR is a material factor in pricing of the lease
 - Based on all facts and circumstances, reduction of DTIR was a principal purpose of arrangement
 - Marketed as “tax-advantaged”
 - Primarily marketed to domestic corporations earning FDDEI
 - Terms of arrangement allow for change if DTIR becomes no longer relevant
 - Below market return in the absence of tax effects

Sec. 250 Calculations

Taxable Income calculated with regard to:	Tent. § 250 Ded.	§ 163(j) Lim.	NOL
Step 1 – Tentative § 250 Deduction	-	YES	YES
Step 2 – Section 163(j) limitation (30% ATI)	YES	-	NO
Step 3 – NOL limitation (80% TI)	NO	YES	-
Step 4 – FDII (DEI)	NO	YES	YES
Step 5 - § 250 Deduction / § 250(a)(2)	-	YES	YES

SECTION 04

THE POTENTIAL IMPACT OF ANTI-BASE EROSION PROVISIONS

**GREG HARTKER (SF) & MIKE
LIU (CH / SV)**

BEAT -- General Rules

- Base erosion anti-abuse tax ("BEAT," Code Section 59A) imposes tax on an **applicable taxpayer** equal to the base erosion **minimum** tax amount, calculated as equal to the excess of
 - (1) 10% (5% for 2018, 12.5% beginning after 2025) of modified taxable income ("**MTI**") over
 - (b) regular tax liability ("**RTL**") net of certain credits
- MTI is generally taxable income increased by adding back deductions for payments to and depreciation and amortization for property acquired from **foreign related persons**
- RTL is reduced by all tax credits other than the R&D credit and 80% of three categories of credits (not including FTC)
- Applies to domestic corporations and foreign corporations with effectively connected income (ECI), regardless of whether such corporations are part of a U.S.-owned or a foreign-owned group
- Because MTI times 10% is measured *without* regard to FTCs, and regular tax liability is fully reduced by FTCs, the excess of (1) 10% of MTI over (2) RTL could be substantial. BEAT is not simply an additional 10% tax on the base erosion payment. It can have a cliff effect!

Who is Subject to BEAT: “Applicable Taxpayer”

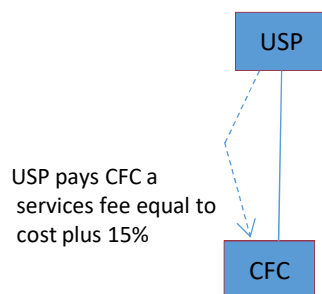
- BEAT applies only to an “applicable taxpayer,” defined as a corporation (other than RIC, REIT, or S corporation) with
 - substantial gross receipts (average annual gross receipts for the 3-year period ending with the preceding taxable year are at least \$500 million) and
 - generally more than a *de minimis* amount (3%) of the add-backs to taxable income in computing MTI as a percentage of the sum of all such-add backs and other deductions for the year (referred to as the “base erosion percentage”)

Exclusions from Base Erosion Payment

- **Exceptions for**

- Cost of goods sold on payments to related foreign persons other than related post-11/9/17 inverters
- Amounts to the extent U.S. tax withheld on base erosion payment under section 1441 or 1442
 - If reduced withholding tax applies (e.g. treaty), only the percentage of the total amount subject to withholding is excluded
- Only the mark-up component of payments to foreign affiliates for low-margin services (those qualifying for services cost method) is a base erosion payment, and not the entire payment—the cost component is not a base erosion payment for such low-margin services.
- Proposed BEAT regulations do not address whether certain royalties are treated as part of COGS—Section 263A.

Outbound Payments-Services



- Assume USP is required to pay a 15% markup under applicable transfer pricing laws.
- Under recently released proposed BEAT regulations, depending on type of service—15% mark-up or entire payment may be treated as a base erosion payment.
- If USP's payment to CFC is Subpart F income (or GILTI), USP's tax benefit of deduction is offset (at least in part) by tax cost of including Subpart F (or GILTI) income.
- However, USP's deduction may be added back for BEAT purposes even if USP effectively does not enjoy a net tax benefit.
- Moreover, while USP may claim foreign tax credit as an offset to its US tax on Subpart F income, the foreign tax credit does not reduce MTI for purposes of calculating the BEAT liability.
- Check the box on CFC?

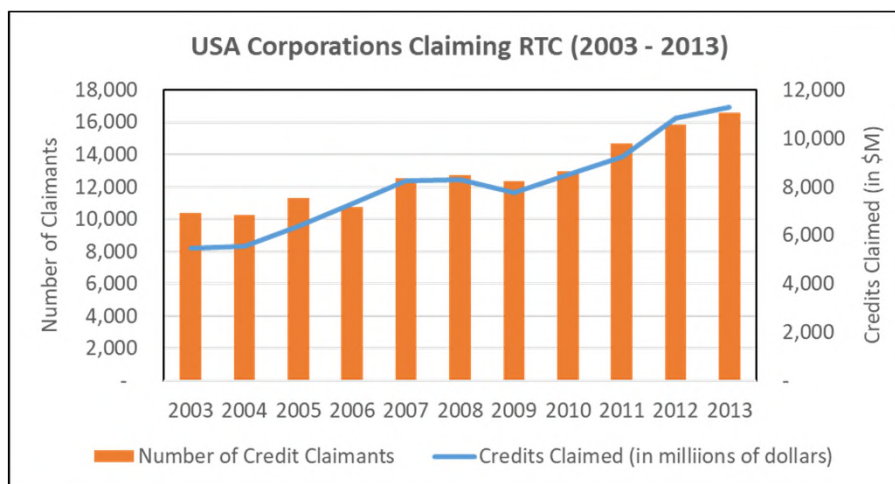
SECTION 05

**R&D TAX CREDIT
OPPORTUNITIES FOR NEW
TOOLING & PROTOTYPE
EXPENDITURES**

ALEX SADLER (DC)

What Is the R&D Tax Credit?

- Now-permanent provision in the Internal Revenue Code allowing a tax credit for **Qualified Research Expenses** or **QREs**.
- Widely claimed by companies doing business in the United States.



Source: IRS, Statistics of Income Division, 1990-2013 Corporate Return Data, Sept 2016

What Is the R&D Tax Credit?

- Your company likely claims the R&D tax credit.
 - **Best Practice:** Each year, tax department & advisors identify QREs, accumulate supporting evidence, and calculate the credit.
- Our automotive industry experience
 - Tier 1 suppliers providing sub-system assemblies
 - Other parts of the supply chain (e.g., steelmakers)

Qualifying Activities – “4 Part Test”

New or Improved Business Component

1

Eliminate Technical Uncertainty

2

Technological in Nature

4

Process of Experimentation

3

Eligible Costs – “QREs”

- In-house research expenses
 - Wages of employees directly contributing to the R&D
 - Cost of supplies
- Contract research expenses
 - Payments to third parties directly contributing to the R&D

Prototype Development & Construction Costs

- In 2014, the Treasury Department and IRS amended the regulations defining **Research & Experimental (R&E) Expenditures** for tax purposes.
 - Costs to develop a **Pilot Model** are R&E Expenditures.
 - A **Pilot Model** is a representation or model of a product that is **produced to evaluate and resolve uncertainty** concerning the product **during development** and includes a **fully-functional** representation or model of the product.
 - The ultimate success, failure, sale, or use of the product is **irrelevant**.
 - Examples from regulations:
 - New custom-built machine for customer
 - Experimental vertical-takeoff airplane sold for \$5 million

TSK of America, Inc. v. Commissioner



Window Regulators and Production Tooling



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IRS Concession

01918 //

UNITED STATES TAX COURT

TSK OF AMERICA INC., and)
SUBSIDIARIES,)
)
Petitioner,)
)
v.) Docket No. 4766-17
)
COMMISSIONER OF INTERNAL REVENUE,)
)
Respondent.)

DECISION

Pursuant to the agreement of the parties in this case, it is

ORDERED AND DECIDED: That there is no deficiency in income tax due from, nor overpayment due to, petitioner for the taxable year ended September 29, 2013.

(Signed) Ronald L. Buch
Judge

Entered: **AUG 13 2018**

SECTION 06

**STATE & LOCAL TAX ISSUES
IMPACTING THE AUTO
INDUSTRY**

COSIMO ZAVAGLIA (NY)

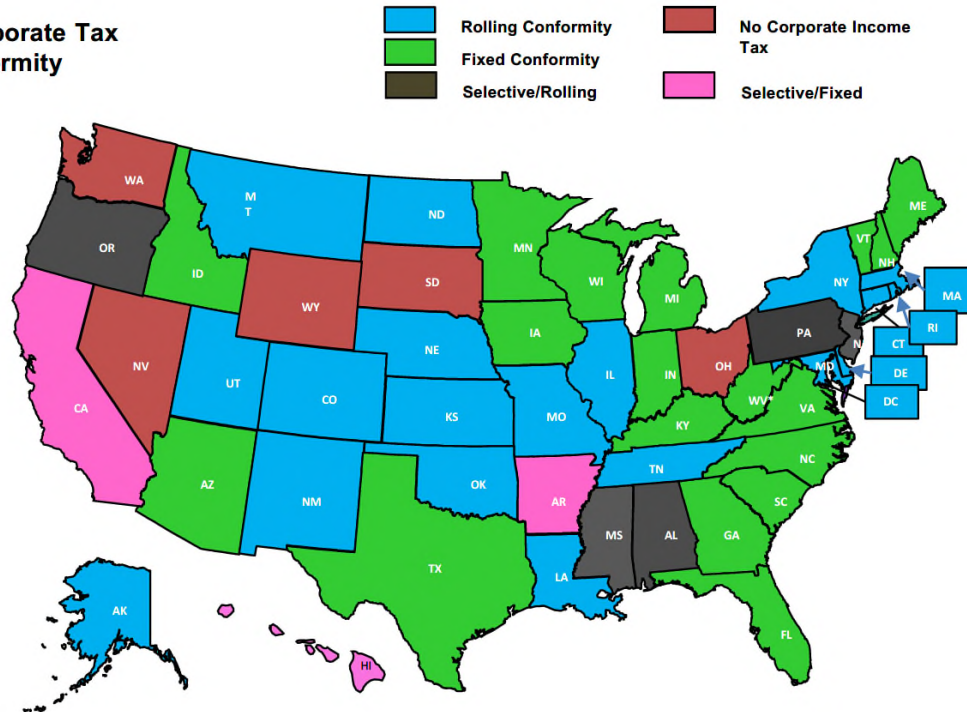
The background features a dark purple gradient. A glowing blue and purple digital network of lines and nodes is overlaid on the scene. In the center, there is a silhouette of a car, possibly a sports car, with a bright blue light reflecting off its side. The overall aesthetic is high-tech and futuristic.

Corporate Income/Franchise Tax

- Nexus
 - Physical Presence / Economic Nexus
- Tax Reform – Conformity with Federal Provisions
 - Rolling
 - Fixed-Date
 - Selective
- State Tax Trends

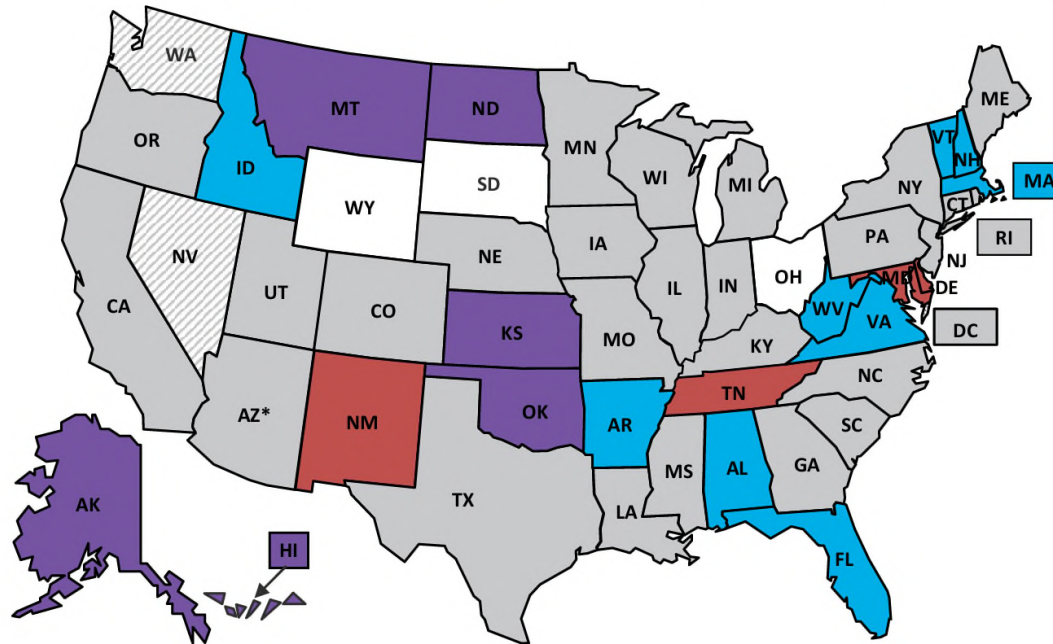
Federal Tax Conformity

State Corporate Tax
IRC Conformity
Map

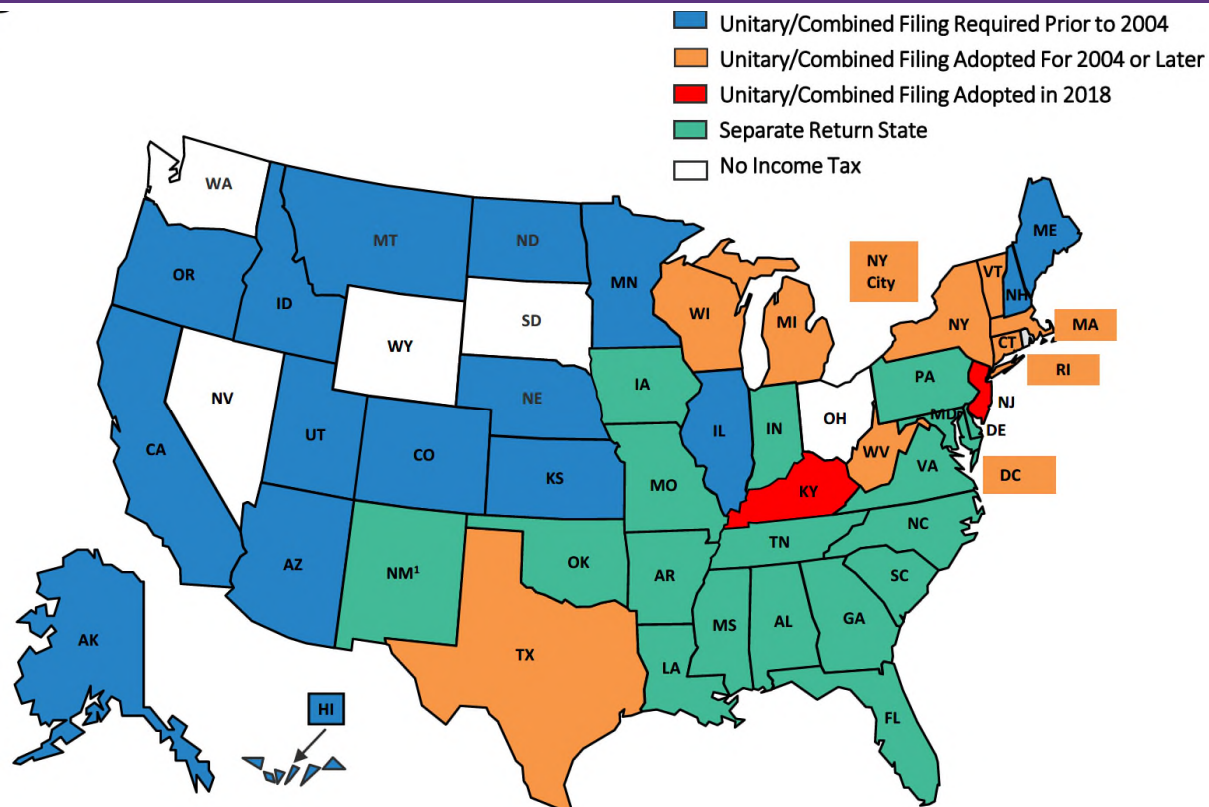


State Tax Trends – Apportionment Formulas in 2018

- Equally weighted three-factor formula
- Double-weighted sales factor
- Triple or greater weighted sales factor
- Single-sales factor



State Tax Trends – State Filing Methods



Sales and Use Tax – Nexus

- Reaction to *Wayfair*

A. Economic nexus with effective date					
Effective Prior to 1/1/2019			Effective 1/1/2019	Effective After 1/1/2019	
AL – 10/1/2018	MD – 10/1/2018	NY – 6/21/2018 *	DC – 1/1/2019	AR – 7/1/2019	RI – 7/1/2019
CT – 12/1/2018	MI – 10/1/2018	NV – 10/1/2018	IA – 1/1/2019	CA – 4/1/2019	TX – 10/1/2019
HI – 7/1/2018	MN – 10/1/2018	SC – 11/1/2018	NE – 1/1/2019	CO – 6/1/2019 ²	VA – 7/1/2019
IL – 10/1/2018	MS – 9/1/2018	SD – 11/1/2018	UT – 1/1/2019	ID – 6/1/2019	WY – 2/1/2019
IN – 10/1/2018	NJ – 11/1/2018	VT – 7/1/2018	WV – 1/1/2019	LA – TBD 2019	
KY – 10/1/2018	NC – 11/1/2018	WA – 10/1/2018		NM – 7/1/2019	
ME – 7/1/2018	ND – 10/1/2018	WI – 10/1/2018		PA – 7/1/2019	
B. Other					
AZ	FL	GA (collect-or-report)	KS	MA (software nexus)	
MO	OH (software nexus)	OK (collect-or-report)	PR (report)	TN (enjoined; needs legislative approval)	
<small>* New York guidance -- issued 1.15.2019 -- indicated that existing statutory thresholds became effective "immediately" after <i>Wayfair</i> (6.21.2018) and vendors meeting the thresholds should register "immediately."</small>					
<small>² Colorado's economic nexus rule was to go into effect December 1, 2018, but the Department announced a grace period through May 31, 2019</small>					

State and Local Tax Impact on Vehicle Telematics



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Vehicle Telematics and Communications Tax

- Automotive Telematics
 - Business expected to approach \$99 billion within the next six years – market opens the door to all kinds of advanced offerings — from vehicle security and roadside assistance to concierge luxury services.
 - Combination of *communications* and *information services*. Allows manufacturers to use in-vehicle equipment such as event data recorders, communication systems, navigation devices, and GPS to provide a wide range of information and services.
- Complexity of Telematics Taxation
 - Business growth far outpacing state tax guidance – there are many areas where a company could inadvertently open itself up to a complicated web of communications taxes and regulatory fees.
 - While sales tax can typically fall within the realm of 6–7 percent, communications tax can reach as high as 18 percent.

Vehicle Telematics and Communications Tax (cont'd)

- To stay ahead of state tax issues that arise in this business, there are a few critical steps every provider should do:
 - Do not bundle services – Always keep telematics services, which are largely viewed as information services, separate from communications services, which are subject to communications taxation.
 - Carefully market your services – From web content and brochures to email marketing and advertising, the language used by your marketing team can play a big role in whether or not a service will be deemed liable for communications taxes.
 - Stay up to date – Continually monitor state-by-state activities. With the fast pace of constant innovations, tax law changes and rulings can occur at any time. Hire dedicated personnel or a vendor to keep track of the latest updates.

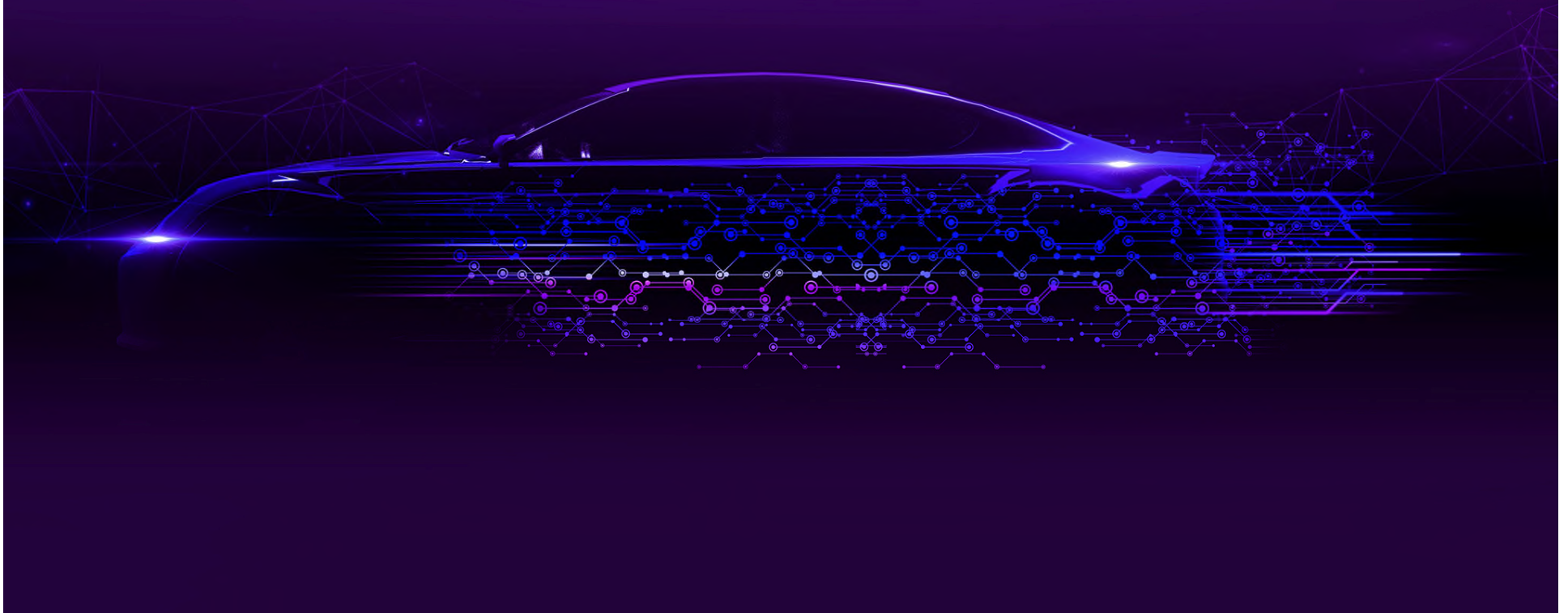
State Payroll Taxes

- Employer Withholding Thresholds
 - Potential withholding thresholds based on days worked, dollars earned, or some combination.
- Employer Audits
 - State tax departments audit employers to hold them liable for under-withheld income taxes because it is more efficient than identifying and auditing individual employees.
 - If employers have not reported or withheld on the income, employees likely have not reported and paid tax to the nonresident's states where they have worked.
 - Employers may not be able to abate withholding liabilities.
 - States know that it is difficult to comply with allocation and residency requirements.
 - Typically focus on highly compensated employees and conduct a sample for other employees.

State Payroll Taxes – Additional Issues

- Nexus Requirements for Other Tax Types Based on Telecommuters
- Nonresident Allocation of Stock Options
- Federal Blocker of State Taxation of Transient Non-Resident Workers
- Practical Approaches for Managing Exposure
- Federal Legislation Update

QUESTIONS?



THANK YOU

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