NAVIGATING US TAX REFORM:

WHAT BUSINESSES NEED TO KNOW

International Implications

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AGENDA

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SECTION 01

SECTION 965 – DEEMED REPATRIATION OF FOREIGN CORPORATION EARNINGS & PROFITS

Section 965 – Overview

- As part of the transition to the participation exemption system of taxation, new Section 965 requires 10% "US shareholders" of CFCs and certain other foreign corporations to include a pro rata portion of existing untaxed foreign source E&P as subpart F income.
- Impact of Section 965 subpart F income inclusion lessened by (1) reduced effective tax rates imposed on this inclusion via deduction (15.5% effective rate for cash and cash equivalents and 8% effective rate for residual), and (2) an election to pay the tax liability on the associated income over an 8-year period.
- Significant unanswered issues remain under the statute as to general computation and possible planning matters that could impact a taxpayer's Section 965 inclusion. The government has already responded by publishing Notice 2018-7 on Dec. 29, 2017 (the "Notice"), which expresses the government's intent to issue regulations addressing a variety of open, largely computational issues.

Section 965(a) – Subpart F Income Inclusion Amount of "DFICs"

- Section 965(a) increases subpart F income of a "Deferred Foreign Income Corporation" or "DFIC" for its last taxable year beginning before 1/1/18 by its "Accumulated post-1986 Deferred Foreign Income" determined as of 11/2/17 or 12/31/17, whichever is greater.
  - DFICs only include any "Specified Foreign Corporation" ("SFC") – (1) any CFC, or (2) any other foreign corporation with respect to which one or more domestic corporations is a US shareholder and that is not a PFIC.
  - "Accumulated post-1986 Deferred Foreign Income" or "ADFI" includes "Post-1986 E&P" or E&P accumulated in taxable years after 1986 other than (1) ECI, or (2) Section 959 PTI (if distributed), but only taking into account periods when the foreign corporation was a SFC.
    - ADFI not reduced for inclusion year distributions by the SFC other than for distributions made to another SFC.

Section 965(a) – Subpart F Income Inclusion Amount of "DFICs" (cont.)

- The Notice expresses the government's intent to issue regulations addressing:
  - potential distortions to ADFI caused by payments between related SFCs during the interim period between the 11/2/17 and 12/31/17 (e.g., through double counting or double non-counting of E&P);
  - distributions between SFCs during the inclusion year to the extent the distributor's ADFI reduction from the distribution does not equal the distributee's corresponding ADFI increase; and
  - reductions of ADFI of a CFC with non-US shareholders attributable to E&P that, if distributed, would be PTI under Section 959 if such shareholders were US shareholders.

US Shareholder's Gross Income from Section 965 Inclusion

- US shareholder's gross income:
  - increased by pro rata share of the DFIC's Section 965 inclusion amount as if it was subpart F income (and treating the DFIC as a CFC for purposes of these rules); and
  - decreased by pro rata share of "Aggregate Foreign E&P Deficit" or post-1986 E&P deficits of SFCs determined as of 11/2/17.
- The statute permits netting among shareholders in an affiliated group where there are one or more US shareholders with a net E&P surplus and another with a net E&P deficit.
- The Notice describes that forthcoming regulations will treat all of the members of a consolidated group that are US shareholders of one or more SFCs as a single US shareholder for purposes of calculating the consolidated group's gross income amount under Section 965.

Coordinating Section 965 with PTI Rules

- For purposes of the Section 959 PTI rules, amounts taken into account as an E&P deficit reducing a US shareholder's Section 965 inclusion treated as included in gross income under Section 951(a) with respect to such US shareholder.
- The Notice describes that regulations will describe a five-step method for determining subpart F inclusions under Section 951(a)(1)(A), the effect of distributions of PTI under Section 959, and Section 956 inclusions under Section 951(a)(1)(B):
  1. a DFIC's subpart F income and the US shareholder's Section 951(a)(1)(A) inclusion are determined first, ignoring Section 965;
  2. the Section 959 PTI treatment of pre-1/1/18 distributions from a DFIC to another SFC is determined;
  3. the DFIC's Section 965 inclusion amount and the US shareholder's corresponding Section 951(a)(1)(A) amount are determined;
  4. the treatment of all distributions other than those described in (2) is determined under Section 959; and
  5. any Section 956 amount is determined for the DFIC and the US shareholder, and the US shareholder's Section 951(a)(1)(B) inclusion is taken into account.

Coordinating Section 965 with PTI Rules (cont.)

- The Notice further describes that regulations will provide a rule that reduces the Section 961(b)(2) gain (distributions of PTI in excess of basis) for inclusion year distributions from a DFIC to the US shareholder by reducing such gain by the Section 965 inclusion amount.
  - Helpful for taxpayers wanting to pull out cash from SFCs prior to the end of the tax year of the Section 965 inclusion. Example:
    - 6/30 fiscal year US shareholder owns 100% the stock of 6/30 fiscal year CFC
    - US shareholder has $0 basis in CFC stock
    - CFC has $100 ADFI
    - CFC distributes $100 to US shareholder on 2/1/18

Section 965 Income Inclusion Year Timing Issues

- Because the Section 965(a) subpart F income inclusion is based on a DFIC's last taxable year beginning before 1/1/18 (the "inclusion year"), a US shareholder may potentially recognize income under Section 965 during multiple tax years.
  - For example, if calendar year taxpayer U.S. Co is a US shareholder of a DFIC that has a calendar year tax year and another DFIC with a fiscal year tax year ending 11/30, Section 965 ADFI with respect to the first DFIC would be included on U.S. Co's 2017 return while ADFI with respect to the second DFIC would be included on U.S. Co's 2018 return.

- Having a US shareholder with DFICs with different inclusion years could lead to distortions (e.g., double counting of "foreign cash positions" as described in subsequent slides). The Notice recognizes this and signals the government's intent to issue regulations addressing these issues.

- For fiscal year SFCs, income earned by the SFC after 12/31/2017 until end of its fiscal year is not taxed under Section 965 or under the GILTI provisions (discussed later in this presentation).

Section 965(h) – Election to Pay Section 965 Inclusion in Installments

- Election may be made (no later than the due date of the return of the US shareholder reporting the Section 965 inclusion) to pay Section 965 liability in 8 yearly installments:
  - 8% of the total net tax liability for each of the first 5 installments;
  - 15% of the total net tax liability for the 6th installment;
  - 20% of the total net tax liability for the 7th installment; and
  - 25% of the total net tax liability for the 8th installment.
- Acceleration events for payment of remaining unpaid Section 965 tax liability:
  1. there is a failure to pay timely any required installment;
  2. there is a liquidation or sale of substantially all of the US shareholder's assets, including in a bankruptcy case;
  3. the US shareholder ceases business; or
  4. any similar circumstances.
- No acceleration if sale of substantially all the assets of a taxpayer to a buyer if the buyer enters into an agreement with the Secretary agreeing to satisfy all future installments.
- Special rule for S corporations permitting S corporation shareholders to elect to defer paying any Section 965 liability until a "triggering event": (1) the corporation ceases to be an S corporation; (2) a liquidation or sale of substantially all the assets of the S corporation (including in a title 11 or similar case), a cessation of business by the S corporation, the S corporation ceases to exist, or any similar circumstance; or (3) a transfer of any share of stock in the S corporation by the taxpayer (including by reason of death, or otherwise).

Participation Exemption Deduction

- The US shareholder's gross income inclusion under Section 965 attracts a deduction such that, before credits or NOL deductions, the amount of the Section 965 gross income inclusion (net of deficits), if taxed at the highest corporate tax rate for the year, would be subject to tax at the rate of:
  - 15.5%, up to the amount of the US shareholder's "aggregate foreign cash position", PLUS
  - 8%, for any gross income (net of deficits) in excess of the US shareholder's aggregate foreign cash position.

Aggregate Foreign Cash Position

- The aggregate foreign cash position of a US shareholder is the aggregate, over all SFCs, of the US shareholder's pro-rata share of the SFCs' cash position.
- As with ADFI, the cash position is measured using different dates, and the aggregate foreign cash position taken into account is the larger of the US shareholder's pro-rata share of:
  - (i) The aggregate year-end "cash position" of each SFC for the last taxable year beginning before 1/1/2018; or
  - (ii) The average of:
    - (a) the aggregate year-end cash position of each SFC for the last taxable year beginning before 11/2/2017, and
    - (b) the aggregate year-end cash position of each SFC for the last taxable year preceding the one referenced in (a).

Cash Position of a Specified Foreign Corporation

- The cash position of a foreign corporation is made up of:
  - Cash it holds
  - Net accounts receivable [per Notice 2018-07, ignoring US shareholder's pro-rata share of inter-SFC accounts]
  - FMV of:
    - Property of a kind actively traded in an established financial market
    - Commercial paper, certificates of deposit, government securities
    - Foreign currency
    - Short-term (< 1 year) obligations
    - [Per Notice 2018-07: Derivative financial instruments, except for *bona fide* hedges (under the Subpart F rules)]

Cash Position – Delegated Authority

- The statute explicitly authorizes the Secretary to:
  - Issue regulations to identify a class of assets as being equivalent to one of the enumerated assets;
  - Exclude net accounts receivable, actively traded personal property, or short term obligations if necessary to avoid double counting; and
  - Disregard transactions for which a principal purpose is to reduce the aggregate foreign cash position.
- This is in addition to the broad authority under Section 965(o) to prescribe regulations or other guidance "to prevent the avoidance of the purposes of this section, including through a reduction in earnings and profits, through changes in entity classification or accounting methods, or otherwise."

Pro-Rating the Indirect Foreign Tax Credit

- In the case of a CFC, Section 960 allows a deemed paid credit for Subpart F inclusions as if earnings in the amount of the Subpart F income were directly distributed by the CFC as a dividend to the US shareholder.
- Section 965(g) pro-rates the credit to take account of the 15.5% and 8% tax rates on the gross Section 965 inclusion by disallowing credits for:
  - 77.1% [=27%/35%] of the credit allocable to ADFI subject to 8% tax, and
  - 55.7% [=19.5%/35%] of the credit allocable to ADFI subject to 15.5% tax.
- The Section 78 gross-up is adjusted to take account of the reduced credit
  - The gross-up amount is essentially:
    Credit after Section 965(g) limitation x
    (35%)/(Highest Corporate Tax Rate in Inclusion Year)

Election Not to Apply NOL Deduction

- A taxpayer may elect to exclude the Section 965 inclusion (net of the participation exemption deduction, but grossed up by any Section 78 amount) from the calculation of current year NOL and not apply carryover NOLs in the inclusion year (up to the amount of the Section 965 inclusion).
- Election due by due date of tax return (with extensions).

Special Rules

- If a US shareholder becomes an expatriated entity during the 10-year period beginning with the date of enactment of the TCJA, then in the year of expatriation, the US shareholder is subject to additional tax of 35% of the amount of the participation exemption deduction allowed (with no allowance of credits against the additional tax liability).
- A REIT that is a US shareholder of DFIC excludes the Section 965 inclusion in testing the limitation on types of income in Section 865(c)(2) and (3).
  - Elective 8-year spreading of the inclusion of the Section 965 in gross income for purposes of the REIT tax under Section 857.

SECTION 02

TAXATION OF FOREIGN INTANGIBLE INCOME – GILTI & FDII

GILTI – The Stick

- **New Sections 951A and 250**
  - Section 951A effectively imposes a minimum tax on "US shareholders" of CFCs to the extent of such CFCs' global intangible low taxed income ("GILTI").
  - Similar to the FDII provisions there is no requirement to actually trace or attribute the income to the exploitation of intangibles owned by the CFCs.
  - At a very high level the GILTI income is generally the income of the CFCs less a deemed return (10%) on tangible assets.
  - Section 250 contains a companion provision that provides for a 50% deduction for the amount of the GILTI inclusions (and Section 78 deemed dividend associated therewith) subject to certain limitations. The 50% deduction is reduced to 37.5% for taxable years beginning after December 31, 2025.

GILTI – The Stick

- **<u>Section 951 - Formula</u>**

GILTI = Net CFC Tested Income – [(10% x QBAI)- Interest Expense]

- **<u>Net CFC Tested Income</u>** = aggregate of tested income of each CFC less aggregate tested losses of each CFC.
  - Tested Income = Gross income of the CFC (other than ECI, Subpart F income, Section 954(b)(4) high tax income, related person dividends, certain oil and gas income) less allocable deductions
  - Tested Loss = where allocable deductions exceed Tested Income of the CFC
- **<u>QBAI</u>** = <u>Q</u>ualified <u>B</u>usiness <u>A</u>sset <u>I</u>nvestment or, generally, the average of the adjusted basis (using straight line) of specified depreciable tangible property determined as of the close of each quarter.

GILTI – The Stick

- **<u>Observations</u>**
  - When comparing the GILTI inclusions to FDII, Congress has apparently provided taxpayers with an incentive to locate investment offshore. This is because the deemed return on tangible property reduces the GILTI inclusion (thereby effectively reducing the amount of offshore income subject to US tax). Under the FDII rules, the deemed return on tangible property reduces the amount of income subject to lower tax rates on FDII.
  - Given that GILTI is an aggregate concept (in relation to the US Shareholder's CFCs), cross crediting is allowed. In other words, foreign tax credits a higher taxed CFC may be used to effectively lower the tax rate on GILTI income of lower tax CFCs.
  - If the US Shareholder is otherwise in a loss position, the amount of the Section 250 deduction is reduced.

GILTI – The Stick

- **Observations**
  - It is unclear the extent to which Subpart F conditions & restrictions mirror those imposed on GILTI.
  - Section 951A(f)(1)(A) says any GILTI inclusion under § 951A(a) is be treated in the same manner as an amount included as Subpart F income for purposes of applying Sections 959 and 961. This means, for example, that a distribution of GILTI is treated as distribution of PTI. There are some tricky issues that can arise under § 959 and § 961 with distributions of GILTI, especially given some of the uncertainties as to how the general Subpart F limitations and restrictions apply to GILTI (e.g., to what extent is distributed PTI Subpart F versus GILTI). Section 961 could also create some odd basis results for distributions.

GILTI – The Stick

- **Observations**
  - Because the GILTI determination is done on an aggregate CFC basis, but a tested loss is a CFC-by-CFC determination, the tested loss of one CFC can lower the overall GILTI inclusion which in effect allows the tested loss to be used to reduce tested income (GILTI income) of another CFC. However, the GILTI rules require the E&P of the CFC with the tested loss to be increased by the amount of the tested loss under Section 951A(c)(2)(B)(ii).
  - This could result in allowing for Subpart F inclusions where the CFC would otherwise be in a negative E&P position. Section 951A(c)(2)(B)(ii) prevents to dual use of such loss to both offsetting other CFC GILTI income and acting as a limit on Subpart F inclusions.

FDII & GILTI deductions in § 250—the carrots

High level

- ◊ New § 951A deemed a GILTI gross income inclusion for U.S. shareholders of certain foreign corporations ⇒ GILTI inclusion nominally taxed at 21 percent (ignoring creditable foreign taxes)
- ◊ New § 250 combines two kinds of tax relief for a U.S. domestic corporation:
  - ❑ a deduction depending on the corporation's GILTI income inclusion; &
  - ❑ a deduction depending on its "foreign derived intangible income."
- ◊ New § 250 arose in the Senate, and is quite similar to Prop. § 250 from the 2014 Camp H.R. 1 (different GILTI-type deduction).

FDII & GILTI deductions in § 250—the carrots [cont'd]

<u>§ 250 mechanics</u>

◊ New § 250(a)(1) provides that a domestic corporation shall be allowed as a <u>deduction</u> for each of 8 taxable years beginning after 12-31-17 and before 1-01-26 an amount—

37½% × corporation's *foreign derived intangible income* (“***FDII***”)

\+ 50% × {corporation's § 951A GILTI inclusion

\+ corporation's § 78 gross up attributable to GILTI}

◊ For taxable years beginning after 12-31-25 the percentages <u>drop</u>: 37½% → 21⅞%, and 50% → 37½%

FDII & GILTI deductions in § 250—the carrots [cont'd]

<u>§ 250 mechanics</u> [cont'd]

◊ § 250 GILTI deduction component ⇒ tax imposed on GILTI inclusion is (ignoring FTCs) 21% × [100% – 50%] = 10½%.

◊ FDII is an <u>approximation</u> to the domestic corporation's taxable income from exploiting intangible property outside the U.S.:

$$\textit{FDII} = \textit{deemed intangible income} \times \frac{\textit{foreign-derived deduction eligible income}}{\textit{deduction eligible income}}$$

$$= (\textit{deduction eligible income} - 10\% \times \textit{QBAI}) \times \frac{\textit{foreign-derived deduction eligible income}}{\textit{deduction eligible income}}$$

⇒ FDII amount turns on definition of *deduction eligible income*.

FDII & GILTI deductions in § 250—the carrots [cont'd]

§ 250 mechanics [cont'd]

deduction eligible income = gross income – exceptions – allocable deductions

- There are 6 *exceptions*:

§ 951 subpart income	Dividends received from CFCs
GILTI	Domestic oil & gas extraction income
§ 904(d)(2)(D) financial services income	§ 904(d)(2)(J) foreign branch income

- FDII deduction increases if *foreign derived intangible income* increases.
  - § 250 has many rules to prevent "artificial" increases in FDII (including, e.g., round tripping) ↔ *cf*. no "foreign" qualification for GILTI.

FDII & GILTI deductions in § 250—the carrots [cont'd]

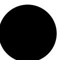
§ 250 mechanics [cont'd]

◊ *foreign-derived deduction eligible income* is *deduction eligible income* derived in connection with:

- ❑ **Property** "sold" by corporation to any person who's not a U.S. person and provided the Secretary is satisfied the property is for foreign use; &
- ❑ **Services** provided by the corporation, provided the Secretary is satisfied they're provided to any person, or w/r/t property, not in the U.S.

◊ "**Use**" means use, consumption, or disposition.

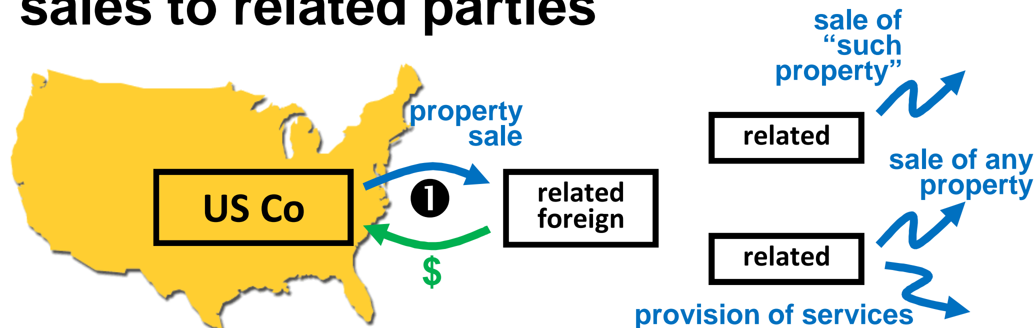
◊ "**Sold**" includes transfer through lease, license, exchange, or other disposition.



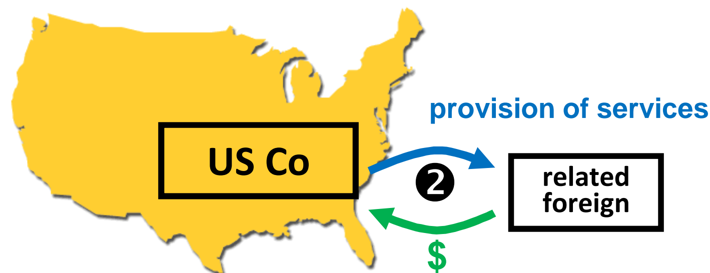
FDII & GILTI deductions in § 250—the carrots [cont'd]

§ 250—special rules for related party transactions

◊ **sales to related parties**



◊ **services provided to related parties**



Income from ❶ can qualify if:

- "Such property" is ultimately sold for foreign use by a related party;
- "Such property" is used by a related party "in connection with"
  - sale of (any) property, or
  - provision of services,

  to a foreign, unrelated person.

Income from ❷ can't qualify unless such services are not substantially similar to services provided by such related party to persons within the U.S.

FDII & GILTI deductions in § 250—the carrots [cont'd]

§ 250 taxable income limitation

- ◊ § 250(b) provides that if —

  FDII + GILTI > taxable income (ignoring § 250) (‡)

  ⇒ FDII & GILTI taken into account for deduction purposes in § 250(a)(1) are reduced pro rata based on the excess

(‡) ⇒ *taxable income (ignoring § 250) = (losses) + FDII + GILTI + § 78 g/u*

$$\Rightarrow \textit{taxable income} = (\textit{losses}) + \textit{FDII} - 37\tfrac{1}{2}\% \times \textit{FDII} \times \left[100\% - \frac{\textit{losses}}{\textit{FDII + GILTI}}\right] + \textit{GILTI} - 50\%\ \textit{GILTI} \times \left[100\% - \frac{\textit{losses}}{\textit{FDII + GILTI}}\right] + 50\% \times [\textit{GILTI § 78 gross up}]$$

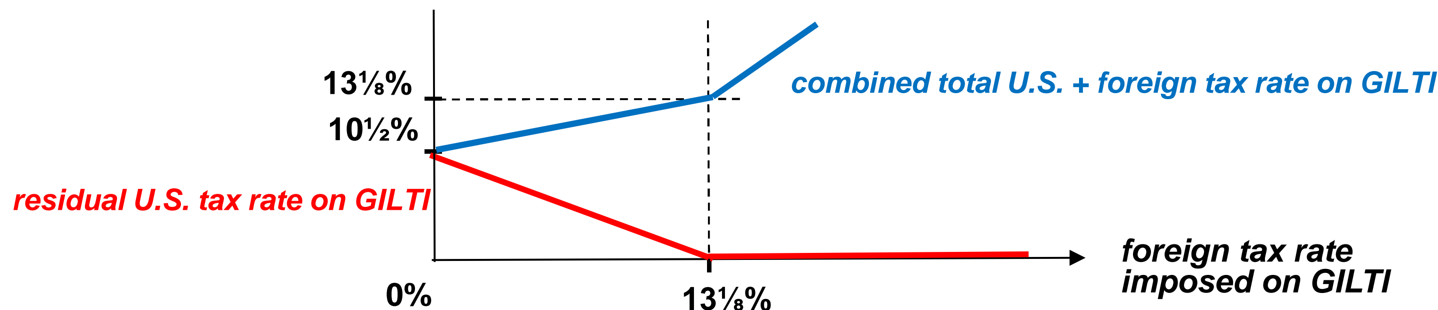
⇒ taxable income limitation means (other) losses increase tax imposed on FDII and GILTI inclusion (by reducing deductions).

FDII & GILTI deductions in § 250—the carrots [cont'd]

<u>Combined §§ 250 & 960(d) tax effect on GILTI</u>

- New § 960(d) provides that only 80% of FTCs are allowed to offset U.S. tax on GILTI.
- Taking § 250 deduction and § 960(d) FTCs into account, at what foreign tax rate (*X*%) imposed on GILTI would a domestic corporation pay <u>no residual U.S. tax</u> on GILTI?

i.e., 21% × [100% – 50%] – 80% × *X*% = 0 ⇒ *X*% = 10½% ÷ 80% = 13⅛%



SECTION 03

PARTICIPATION EXEMPTION/REPEAL OF SECTION 902

Participation Exemption – New Section 245A

Domestic corporation that is a "U.S. shareholder" of a "specified 10% owned foreign corporation" is allowed a deduction in an amount equal to the "foreign-source portion" of any dividend received from the specified 10% owned foreign corporation

- **U.S. shareholder**
  - expanded section 951(b) definition: U.S. shareholder that owns by vote or value 10% of the stock of a foreign corporation, either directly, indirectly, or constructively, including attribution from foreign persons
- **Specified 10% owned foreign corporation**
  - foreign corporation to which any domestic corporation is a U.S. shareholder, except a passive foreign investment company (PFIC) that is not a CFC
- **Foreign-source portion of dividend**
  - portion of undistributed earnings of the foreign corporation that is neither attributable to ECI or dividends received (directly or through a wholly owned foreign corporation) from an 80% owned domestic corporation (determined without regard to whether the domestic corporation is a RIC or a REIT)
- **Effective date**: Distributions received after Dec. 31, 2017

Holding Period Requirement – New Sections 246(c)(1), (5)

- To claim section 245A DRD, must have "held" shares of the specified 10% owned foreign corporation for **more than 365 days during a 731 day** (beginning on the date which is one year before the date on which the shares become ex-dividend with respect to the dividend), and **in addition**,
  - specified 10% owned foreign corporation must have been a specified 10% owned foreign corporation at all times during that period, and
  - the taxpayer must have been a U.S. shareholder of the specified 10% owned foreign corporation at all times during that period
- Additionally, section 245A DRD is not allowed to the extent that the taxpayer is under an obligation (under a short sale or otherwise) to make related payments as to positions in substantially similar or related property

Other Special Rules

- **Denial of FTC**
  - No foreign tax credit under section 901 or deduction allowed for any foreign taxes paid or accrued (or treated as paid or accrued) as to any dividend for which the section 245A DRD is allowed
    - Thus, no indirect credit and no credit or deduction for foreign withholding taxes paid on dividend distribution
- **Hybrid Dividends Do Not Qualify**
  - A hybrid dividend is an amount received from a CFC:
    - for which the CFC received a deduction (or other tax benefit) with respect to any income, war profits, or excess profits taxes imposed by any foreign country or U.S. possession
    - As a back-up, an additional rule treats hybrid dividends received by one CFC from another CFC, if a domestic corporation is a U.S. shareholder with respect to both, as the first CFC's Subpart F income notwithstanding any exception (e.g., same-country dividend exception) and requires the US shareholder to include (without any offsetting Section 245A DRD) its pro rata share of such Subpart F income with respect to shares in the first CFC
- **PFIC Purging Dividends Do Not Qualify**
  - A PFIC dividend as a result of a purging election under section 1291(d)(2)(B) is not treated as dividend for section 245A purposes even though the PFIC is a CFC
- **Partnerships**
  - Regulatory authority ("Secretary shall prescribe such regulations") to defined dividends received to include dividends where a domestic corporation U.S. shareholder owns stock of a specified 10 percent owned foreign corporation through a partnership.

Other Special Rules (con't)

- **Section 1248/964(e) dividends**
  - Section 1248 dividend of a domestic corporation treated as dividend for section 245A purposes
  - Foreign-source portion of a section 964(e) dividend, where a CFC sells the stock of a lower-tier foreign corporation held for more than one year, also treated as dividend for section 245A purposes,
    - by classifying the foreign-source portion of such section 964(e) dividend as Subpart F income of the selling CFC and
    - treating a qualifying domestic U.S. shareholder reporting such Subpart F income as having received a section 245A dividend from the selling corporation equal to that portion
- **Effective date**: Sales or exchanges after December 31, 2017.

Repeal of Section 902

- Because a domestic corporation that is a U.S. shareholder now generally receives a section 245A DRD on dividends from specified 10% owned foreign corporations, section 902 was repealed
- **Effective date**: Dividends received after December 31, 2017.

Observations

- Section 245A DRD applies only to domestic corporations that received dividends from specified 10% owned foreign corporations
  - Thus, does not apply to
    - income earned by a domestic corporation through a foreign branch,
    - or income earned by individuals, whether U.S. or foreign
- Only applies if "dividend received"
  - Thus, subpart F inclusions and section 951A GILTI inclusions do not qualify even if dividends are distributed during the same year as the inclusion, as inclusions are not "dividends"
  - Accordingly, in practice section 245A DRD will likely be limited to returns on investments in tangible assets, at least for CFCs with low-tax earnings, as all other non-subpart F earnings will likely be included in income under section 951A under the GILTI provisions, as discussed below.

Observations (con't)

- What constitutes a "dividend" is not defined
  - Presumably section 367(b) inclusions and section 304 dividends will be treated as dividends for section 245A purposes
  - But holding period requirements may raise unique issues
- Partnerships – Unclear whether grant of regulatory authority to address partnerships should be treated as self-executing
  - the conference committee report supports current treatment (explaining that the "term 'dividend received' is intended to be interpreted broadly . . ." and illustrating that dividends on foreign stock owned through a partnership "would qualify for the participation DRD")
- Repeal of section 902 can result in double taxation in various circumstances, *e.g.*,
  - Domestic corporate shareholder does not satisfy the holding period requirements
  - Dividends received by a domestic corporate shareholder from a PFIC that is not a CFC
- Repeal of section 902 also means that section 905(c) foreign tax credit redeterminations do not adjust the post-1986 foreign income tax pools of foreign corporations, but rather taxpayers will need to claimed additional taxes for the origin year to which the foreign taxes relate
  - If not filed timely, this can raise SOL issues.

SECTION 04

CHANGES TO SECTIONS 367, 482, AND 936(H)(3)(B)

Topics

1. What Changed

2. How Did We Get Here

3. Where Do We Go Now

Intangible Asset Redefined in Section 936(h)(3)(B)

- Goodwill
- Going concern value
- Workforce in place (including its composition and terms and conditions (contractual or otherwise) of its employment)
- Any other item the value or potential value of which is not attributable to tangible property or the services of any individual

Section 367(a) Changes

- General rule prevails – transfers of property from the U.S. to a foreign corporation are taxable
- Active trade or business exception in section 367(a)(3) repealed

Valuation Changes to Sections 482 and 367(d)(2)

- Added following language to section 482:

  "For purposes of this section, the Secretary shall require the valuation of transfers of intangible property (including intangible property transferred with other property or services) on an aggregate basis or the valuation of such a transfer on the basis of the realistic alternatives to such a transfer, if the Secretary determines that such basis is the most reliable means of valuation of such transfers."

- Similar language added to section 367(d)(2)

How Did We Get Here

- Decades of Taxpayer Victories in Courts
- Cost Sharing
- IP Migration

Where Do We Go Now

- Future of IP Migrations
- Future of Outbound Asset Reorganizations
- Future of Cost Sharing
- Future Transfer Pricing Documentation

SECTION 05

BASE EROSION TAX

Base Erosion Tax

- Base erosion anti-abuse tax ("BEAT," Code Section 59A) equal to the excess of (a) 10 percent (five percent in taxable year beginning in calendar year 2018) of modified taxable income ("MTI") over (b) regular tax liability
  - Add one percentage point for banks and securities dealers
- Regular tax liability not reduced by research credit and 80 percent of certain other credits
- Effective for payments paid or accrued in taxable years beginning after 2017

Base Erosion Tax

- For taxable years beginning after 2025, 12.5 instead of 10 percent, credits reduce regular tax liability
- BEAT impactful when deductions from/reductions in gross income taken into account in computing taxable income, but not MTI, exceed 52.38 percent (40.47 percent after 2025) of MTI
  - *Cf.* old law Section 163(j)

Base Erosion Tax

- Taxpayers to which BEAT applies are corporations (or corporate groups) that have at least $500m in gross receipts during the three years prior to current year and that have a "base erosion percentage" of at least three percent for the year
  - Cliff effects
- Base erosion percentage
  - Deductions/reductions taken into account in computing taxable income but not MTI divided by sum of (a) all deductions, (b) reductions for reinsurance premiums paid to a related foreign person, and (c) reductions in gross receipts from payments to a related corporation that inverted after November 9, 2017 and that is treated as a foreign corporation under Section 7874 (and its foreign affiliates).
    - Denominator excludes deductions for NOL carryover, participation exemption, GILTI/FDII

Base Erosion Tax

- Deductions/reductions taken into account in computing taxable income but not MTI
  - Deductions for a "base erosion payment," but only to the extent no withholding
    - "Amount paid or accrued by the taxpayer to foreign person that is a related party"
      - New Section 163(j) first disallows interest paid to unrelated persons
      - Foreign tax treatment irrelevant
      - Inclusion in Subpart F income irrelevant (*cf.* old Section 163(j) regulations)
      - Banks and insurance companies
  - Depreciation/amortization deductions with respect to property purchased by taxpayer from a related foreign person
  - Reductions in income for re-insurance premiums paid to related foreign person
  - Costs of goods sold paid to inverters

Base Erosion Tax

- Excludes deductions for "qualified derivative payments"
  - Taxpayer must mark to market derivative on last day of taxable year, treat gain/loss as ordinary, treat "all items of income, deduction, gain ,or loss" with respect to payment as ordinary
  - "Derivative" includes any contract the value of which/payment with respect to which determined by reference to "any rate, price, amount, index, formula or algorithm"
  - Exclusion does not apply to a payment that would be subject to BEAT if it weren't made pursuant to a derivative, including interest, royalty, or services payment

Base Erosion Tax

- Excludes an amount paid or accrued for services if (a) services meet requirements for eligibility of the Section 482 services cost method (without regard to requirement that services not contribute significantly to fundamental risks of business success or failure) and (b) amount constitutes total services cost with no markup component
  - Portman/Hatch colloquy

Base Erosion Tax

- Related to unrelated
  - Third party borrowing/license (with parent guaranty) rather than back-to-back borrowing/licenses from foreign parent

    Cf. old Section 163(j)

- Reduce amount of deductible payments through netting
  - Cross-licenses?
  - Net amounts generally
    - *Cf.* Section 871(m)(5) ("the term 'payment' includes any gross amount which is used in computing any net amount which is transferred to or from the taxpayer")

Base Erosion Tax

- Reduce amount of deductible payment by avoiding deductible payments
  - Purchase finished product from foreign affiliate (perhaps acting as contract manufacturer for foreign affiliate –*but see* Section 956) rather than license intangibles owned by foreign affiliate and manufacture
  - Services fee paid to contract manufacturer?

Base Erosion Tax

- Regulations to “prevent the avoidance of the purposes” of the BEAT through:
  - “the use of unrelated persons, conduit transactions, or other intermediaries”
  - arrangements designed, “in whole or in part”
  - “to characterize payments otherwise subject to” the BEAT ”as payments not subject to” the BEAT
  - “to substitute payments not subject to” the BEAT for “payments otherwise subject to” the BEAT

QUESTIONS ?

A recording of this presentation will be made available on our Tax Reform resource page, a centralized, cross-practice resource for tax reform-related thought leadership and programs, including webinars, LawFlashes, blog posts, and more.

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Casey S. August’s practice focuses on US federal tax planning and implementation matters. Representing clients across industries, he advises on structuring and documentation issues for mergers and acquisitions, energy project financings, joint venture collaborations, and intellectual property transfers. Casey also counsels clients on issues involving choice of entity and cross-border structuring and planning, as well as on IRS private letter ruling submissions and securities filings.

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Jenny Austin concentrates her practice on federal tax controversy and litigation, working across all industries, with a particular focus on matters involving significant intellectual property interests, including medical device, pharmaceutical, and technology companies. She guides clients through all stages of tax controversies, from the traditional Internal Revenue Service (IRS) examination to administrative appeals, alternative dispute resolution proceedings, and in the US Tax Court. Jenny is prepared to respond to a variety of both domestic and international issues that the IRS audits and challenges.

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With more than 30 years of experience, Peter M. Daub concentrates his practice in the areas of international and domestic tax planning for US- and foreign-based multinationals, financial institutions, and financial intermediaries. Domestically, he helps US-based multinational clients in deferral and repatriation structures and foreign tax credit planning and provides tax advice on financial and currency transactions. For foreign-based multinationals, Peter's principal areas of concentration include the structuring of US operations, withholding tax minimization, and enhancement of US tax treaty benefits. He has counseled a wide range of clients on withholding, including on Foreign Account Tax Compliance Act issues.

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Rod Donnelly focuses his practice on the tax aspects of complex international corporate transactions. Representing large multinational corporations, his experience includes transfer pricing, especially with an intangible property component, at both the planning and controversy stages. Rod's experience also includes Subpart F and foreign tax credits, as well as tax-related aspects of manufacturing supply chain and R&D, at both the planning and controversy levels.

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John G. Ryan focuses on tax planning and audit defense, frequently in connection with international transactions and developing and using intellectual property. With clients praising his "‘broad knowledge of international tax and transfer pricing matters’" and his "‘responsiveness and accessibility,’" Chambers USA named John a leading tax lawyer in California and described him as "a one-stop shop [who] can analyze problems from all angles.

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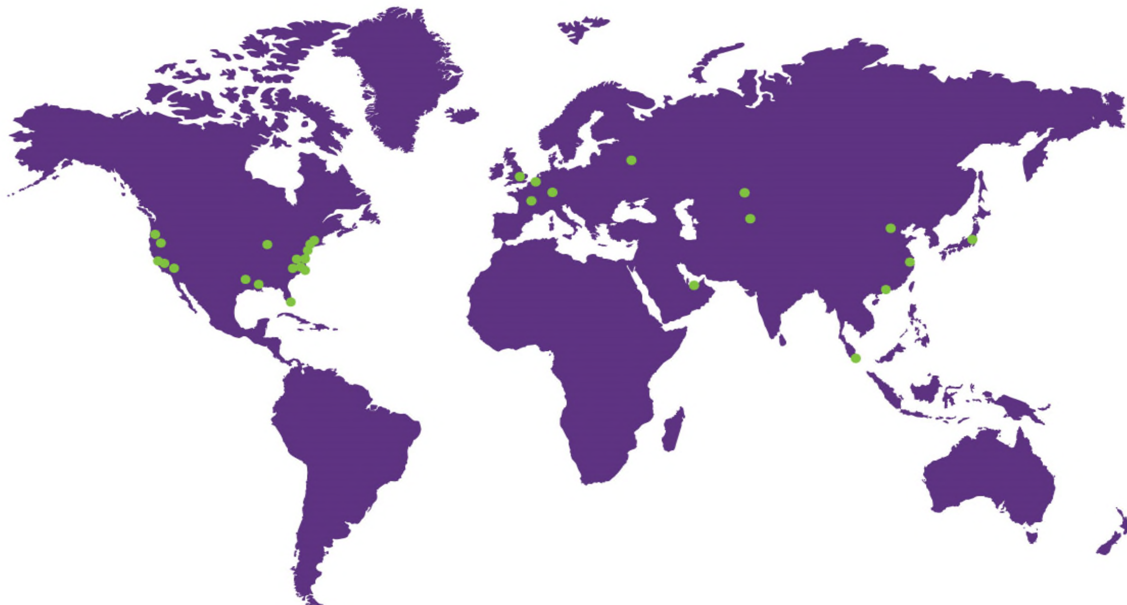

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