35th Annual TEI-SJSU High Tech Tax Institute

International Tax Basics to be Provision Compliant

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Speakers

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Agenda

- Global Intangible Low-Taxed Income under § 951A
- Foreign-Derived Intangible Income under § 250
- The Foreign Tax Credit post-TCJA
- US Participation Exemption under § 245A
- Base Erosion and Anti-Abuse Tax under § 59
- Interest Limitation under § 163(j)
- IRS Communications and Training

§951A Global Intangible Low-Taxed Income ("GILTI")

§951A GILTI
Overview – GILTI calculation

Summary of GILTI calculation:

- First step is to determine the CFC tested items of each CFC with a US shareholder (CFC-level calculation).
- A US shareholder of a CFC determines its pro rata share of the CFC's tested items.
- A US shareholder aggregates its pro rata share of the CFC tested items of each of its CFCs (and then nets or multiplies, as relevant, each item into a single US shareholder-level amount).
  - The excess (if any) of the aggregate of pro rata shares of tested income over the aggregate of pro rata shares of tested loss is the US shareholder's net CFC tested income.
  - The excess (if any) of the product of the aggregate of pro rata shares of qualified business asset investment (QBAI) and 10% over any specified interest expense is the US shareholder's net deemed tangible income return.
- Finally, the US shareholder determines its GILTI inclusion amount.
- A deemed paid credit is allowed for taxes properly attributable to tested income under Section 960(d).

Treas. Reg. §1.951A-2
Tested income and tested loss

- Treatment of CFCs as domestic corporation – Gross tested income and allowable deductions are determined under the rules of Treas. Reg. §1.952-2 that apply for determining the subpart F income of a CFC.
  - A foreign corporation is treated as though it were a domestic corporation for purposes of determining gross tested income and allowable deductions.
  - Guidance is expected to clarify that, in general, any provision that is expressly limited in its application to domestic corporations, such as section 250, does not apply to CFCs by reason of §1.952-2
  - Comments are requested as to applicability of section 245A to CFCs
- Gross tested income and allowable deductions are determined without regard to Section 952(c).
- High tax exclusion from tested income applies only to income that is excluded from subpart F income **solely** by reason of an election under section 954(b)(4).
  - Until 2019 Proposed GILTI Regulations are finalized and effective, a taxpayer may not exclude any item of income from gross tested income under the high-tax exception unless the income would otherwise be FBCI or insurance income but for the application of section 954(b)(4)

Treas. Reg. §1.951A-2(c)(5)

Disqualified basis

- Anti-abuse rule generally disallows, for purposes of calculating tested income or tested loss, any deduction or loss attributable to **disqualified basis** in depreciable or amortizable property
- Disqualified basis is basis created by reason of a property transfer between related CFCs during the “gap period”
- A deduction or loss attributable to disqualified basis is not “properly allocable” to gross tested income, subpart F income, or ECI of a CFC, and is consequently allocated to the residual income grouping
- Election to reduce adjusted basis – final regulations permit taxpayers to make an election to reduce the adjusted basis in property by the amount of disqualified basis for all purposes of the Code, including section 901(m), ensuring no concurrent application of GILTI and section 901(m)

Treas. Reg. §1.951A-3

QBAI

- Tested loss CFC has no QBAI (including from a partnership investment), even if the entity was a tested income CFC in other tax years.
- Adjusted basis of specified tangible property is determined as if the Alternative Depreciation System (ADS) convention had applied from the date the property was placed in service.
- Dual use property – specified tangible property used in the production of gross tested income and other gross income – the amount included in QBAI is the average adjusted basis of the property multiplied by a dual use ratio (based on section 861 principles for allocating depreciation or amortization deduction to categories of income).
- Two QBAI anti-abuse rules:
  - Disqualified basis resulting from a property transfer between related CFCs during the “gap period” is disregarded for purposes of QBAI
  - Temporarily held property – includes safe-harbor for transfers between related CFCs; provides rebuttable presumption for property held for less than 12 months

Treas. Reg. § § 1.951A-5 and 1.951A-6

Treatment of GILTI and adjustments to E&P

- GILTI (§951A) inclusion is treated as a subpart F inclusion for specified Code provisions (e.g., §959, §961, etc.)
- GILTI push-down – the GILTI inclusion amount calculated at the US shareholder-level allocated to each CFC is:
  - In the case of CFCs without tested income, zero
  - In the case of tested income CFCs, a share of US shareholder's GILTI based on tested income of the CFC relative to the US shareholder's aggregate amount of tested income
- For purposes of § § 163(e)(3)(B)(i) and 267(a)(3)(B), each of which limits deductibility, an item is treated as includible in the gross income of a US person to the extent it increases a US shareholder's pro rata share of tested income, reduces its pro rata share of tested loss, or both.
- E&P fill-in for subpart F current E&P limit – E&P of a tested loss CFC is increased by an amount equal to the tested loss of the CFC for the CFC inclusion year.

§951A GILTI

Deemed-paid foreign income taxes

- Pursuant to Section 960(d), a **US corporation** with a GILTI inclusion that elects to take a "foreign tax credit" is treated as having paid foreign income taxes equal to 80% of the product of: (i) its "**inclusion percentage**" and (ii) the aggregate "**tested foreign income taxes**" paid or accrued by its CFCs.

$$80\% \times \overbrace{\text{GILTI Inclusion} \div \text{Aggregate Tested Income}}^{\text{Inclusion Percentage}} \times \overbrace{\text{Aggregate Foreign Income Taxes Properly Attributable to the Tested Income of Each “Tested Income” CFC}}^{\text{Aggregate Tested Foreign Income Taxes}}$$

- Tested foreign income taxes of a CFC means the foreign income taxes paid or accrued by the CFC that are "properly attributable" to the tested income of the CFC that is taken into account by the US corporation under Section 951A.
  - Heavily mechanical and contain multiple categorizations and groupings of income, deductions, foreign taxes and E&P
- Section 78 gross-up included at 100% and described as a dividend (but not for purposes of calculating dividend- received deductions under Section 245 or 245A).

IRC § 951A GILTI

State Guidance Indicates 951A Income Qualifies for State DRDs or Subtraction Modifications Otherwise Applicable to Subpart F Income

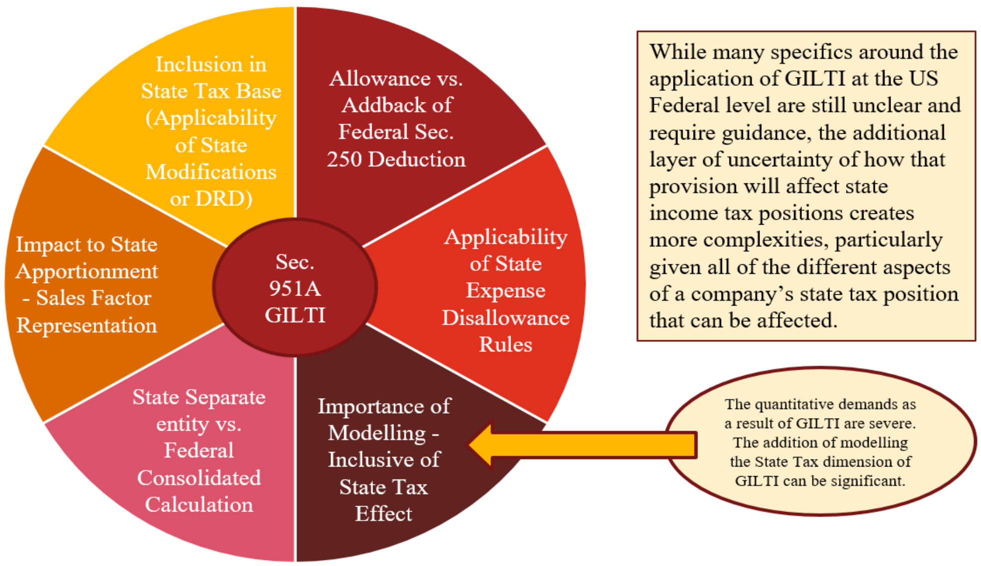
State	Guidance Issued	How Have States That Have Issued Guidance Responded to DRD Applicability? GILTI Treated The Same as SubF Income	Date
CT	Notice	Citing 951A(f), the DRS advised that because GILTI is treated in a manner similar to Subpart F income for federal tax purposes, Connecticut will treat such income as dividend income subject to the DRD. "Because GILTI is treated in a manner similar to Subpart F income for federal tax purposes, Connecticut will treat such income as dividend income subject to the DRD"	7/20/2018
GA	Statute	State's dividend subtraction modification applies to 951A income	3/26/2018
IL	Notice	IRC Sections 965 and 951A will increase FTI but that "the Illinois subtraction modification for foreign dividends will exclude a portion of the increase from Illinois base income."	3/1/2018
IN	Statute	The amount treated as a foreign source dividend will be equal to the amount included after application of IRC Sec. 951A but will not include any related Section 78 amounts	5/14/2018
KY	Notice	"GILTI is treated similarly to Subpart F income, therefore GILTI is considered nontaxable income for Kentucky income tax purposes."	8/1/2018
ME	Statute	Subtraction modification equal to 50% of GILTI	9/12/2018
MA	Statute	"Section 951A amounts are treated as dividends received"	10/23/2018
MI	Notice	Under IRC 951A, a U.S. Shareholder of a controlled foreign corporation (CFC) must include in its gross income its GILTI inclusion in a manner similar to Subpart F income. Therefore, the Department preliminarily concludes that GILTI income is included in FTI, but would be deducted as a dividend from a foreign entity, similar to other Subpart F income, when determining the CIT tax Base	7/2/2018
MO	Notice	"The Net GILTI Amount is treated as though it were a dividend for Missouri purposes."	1/31/2019
MT	Notice	For Montana Corporate Income Tax purposes, Montana considers GILTI a foreign dividend that is included in the owner's federal taxable income.	10/4/2019
NC	Statute	State subtraction adjustment for "Any amount included in Federal taxable income under section 78, 951, 951A, or 965 of the code net of related expenses."	7/1/2018
OK	Regulation	Regulation Sec. 710:50-17-51 "has been amended to clarify that foreign income deemed repatriated under IRC § 965 and global intangible low-taxed income included in taxpayer's federal taxable income under IRC § 951A will be considered dividend income for purposes of 68 O.S. § 2358(A)(4)(b)	08/01/2019
PA	Notice	"GILTI is included in Federal taxable income in a manner similar to Subpart F income insofar as it is deemed repatriated in the year earned. Taxpayers reporting GILTI may, for Federal income tax purposes, also claim a deduction against a portion of their GILTI income."	1/24/2019
VT	Notice	The Department stated that GILTI is included in federal gross income – "as a result, GILTI is automatically included in Vermont taxable income and Vermont net income." Furthermore, the Department explains that the federal GILTI deduction now allowed under IRC Sec. 250 is also available to domestic corporations for Vermont corporate income tax purposes.	08/01/2018

IRC § 951A GILTI

State Guidance Indicates 951A Income DOES NOT Qualify for State DRDs or Subtraction Modifications or Otherwise Departs from Treatment of Subpart F Income

State	Guidance Issued	How Have States That Have Issued Guidance Responded to DRD Applicability? GILTI Treated Differently Than SubF Income	Date
FL	Report on TCJA Impact	Section 951A, IRC, global intangible low-taxed income (GILTI) is included in the computation of federal taxable income, which is the starting point for the Florida corporate income tax computation. Likewise, the deduction of 50 percent of GILTI (37.5 percent for taxable years beginning on or after January 1, 2026) is included in the computation of federal taxable income, and therefore is also included in the starting point for the Florida corporate income tax computation. There is no Florida subtraction for a GILTI inclusion.	2/1/2019
MD	Tax Alert	GILTI is not a dividend or deemed dividend and is therefore ineligible for Maryland's dividend subtraction. Moreover, as GILTI represents a "supernormal" return beyond the 10% attributable to a return on assets, GILTI is apportioned in a manner consistent with income attributable to intangibles resulting in Maryland numerator inclusions based on the average of the property and payroll factors. Alternative apportionment petitions must be made in writing.	04/18/2019
MN	H.F. 5	Enacted as part of conformity legislation, statutory subtraction modification for 100% of 951A GILTI income	05/30/2019
NJ	Bulletin	"GILTI and FDII are not treated as dividends or deemed dividend income for New Jersey CBT purposes; they are separate categories of income and are not treated as distributions from earnings and profits."	Updated 08/22/2019
NYS	Preliminary Report on TCJA	"Although this new GILTI income is treated similarly to Subpart F income, it is specifically not characterized as Subpart F income under the IRC and therefore would not qualify as other exempt income. Thus, the income would flow through to New York, be treated as business income, and be subject to tax . . . If New York takes no action, the State would tax a portion, but not 100%, of the GILTI income, due to the deduction under § 250." Subsequent legislation effective for the 2019 tax year provides for a separate 95% deduction for GILTI.	1/23/2018
NYC	Notice	951A income less the GILTI Section 250 deduction is included in Entire Net Income (ENI).	01/01/2019

Global Intangible Low-Taxed Income State Tax Implications - Summary



§250 Foreign-Derived Intangible Income ("FDII")

§250 deduction
Overview

Taxable income limitation on FDII and GILTI inclusion

- §250(a)(2) establishes a limitation based on taxable income
- If the sum of FDII and the GILTI inclusion amount (prior to the §250 deduction) exceeds taxable income, then both FDII and the GILTI amount are reduced proportionately by the excess
- For purposes of §250, taxable income is determined taking into account NOLs

Foreign Derived Intangible Income IRC 250

- The FDII computations are complex, but the questions underlying FDII are simple…
  - What amount of intangible income is the domestic corporation deemed to produce?
    -and-
  - What is the foreign-derived ratio of that deemed intangible income?
    Note: foreign-derived ≠ foreign source (*not the same concept as sourcing*)
- 13.125% Effective Tax Rate

§250 FDII
Overview

STEP 1	Deduction Eligible Income (DEI)	–	(10% x Qualified Business Asset Investment (QBAI))	=	Deemed Intangible Income (DII)
STEP 2	Deemed Intangible Income (DII)	X	Foreign-Derived Deduction Eligible Income (FDDEI) / Deduction Eligible Income (DEI)	=	Foreign-Derived Intangible Income (FDII)*
STEP 3	Foreign-Derived Intangible Income (FDII)	X	Applicable Percentage 37.5% (dropping to 21.875% after 12/31/2025)	=	FDII Deduction

*Consider taxable income limitation which may reduce FDII amount

Qualification of transactions as FDII
Key FDII requirements

Key FDII requirements

FDDEI

- **FDDEI = DEI** derived by the taxpayer in connection with –
  - **Property** sold by the taxpayer
    - to any person **who is not a US person**, and
    - which is for **foreign use;** or
  - **Services** provided by the taxpayer
    - to any person **not located within the US**, or
    - with respect to property **not located in the US**
  - "**Sold**" includes any sale, lease, license, exchange, or other disposition
  - "**Foreign use**" means any use, consumption, or disposition that is not within the US

Related party rules

- **Sales of Property:** Property sold to a **related non-US party** will not be treated as sold for foreign use unless -
  - Such property is **ultimately sold**, or used in connection with property that is sold or the provision of services, to an **unrelated non-US party** for **foreign use**
- **Services:** Services provided to a **related party** who is **not located in the US** will not be treated as qualifying foreign services unless –
  - Such services are **not substantially similar to services** provided by such related party **to persons located within the US**

FDDEI sales: foreign use
Prop. Reg. §1.250(b)-4

	General (tangible) property	Intangible property (IP)	Security or specified commodity
Eligible	Yes	Yes	No
Requirements to establish foreign use	▪ Property is not subject to domestic use within three years of delivery. OR ▪ Property is subject to manufacture, assembly or other processing outside the US before any domestic use: ▪ There is a physical and material change to property OR ▪ Property is incorporated as a component into a second product and is no more than 20% of the fair market value of the second product ▪ For transportation property: during the three-year period from date of delivery, property is located outside the US more than 50% of time and for more than 50% of miles traversed	▪ Foreign use to extent revenue is earned from exploiting the IP outside the US ▪ Revenue is generally considered earned in the location of the end-user customer licensing the IP or purchasing a product for which the IP is used ▪ For IP sales in exchange for lump-sum payment, foreign use is determined based on the net present value of the projected revenue	▪ Not eligible for foreign use

FDDEI services: delivery location
Prop. Reg. §1.250(b)-5

	Proximate services	Property services	Transportation services	General services
Definition	• Service substantially all of which is performed in the physical presence of the recipient (other than transportation or property service) • Substantially all = > 80% (unclear whether a bright-line test)	• Service provided with respect to tangible property (other than trans service) if: • 1) Substantially all of the service is performed at location of the property • 2)Service results in physical manipulation of property (e.g., assembly, maint. • Substantially all = > 80% (unclear whether a bright-line test)	• Service to transport a person or property using a mode of transportation (e.g., aircraft).	• Residual category (everything else)
Requirement to establish location outside US	• Service is performed in presence of recipient outside the US • If portion of service is performed partly in the US, the service is considered performed outside the US based on the proportion of total time spent outside the US performing the service	• Tangible property is located outside the US for the duration of the service	• If both origin and destination are outside the US, then 100% FDDEI service • If either the origin or destination is outside the US (but not both) then 50% FDDEI service	• If **consumer**: residence of consumer when service is provided is outside US • If **business**: location of business operations that receive benefit of service is outside US

FDII – Direct implications of TC&JA and resulting SALT considerations

TC&JA implications	SALT considerations
• ‘Domestic corporation’ vs Federal consolidated group	• Separate entity vs. combined group • Sec. 250(a)(2) Taxable Income Limitaton
• Deductibility of FDII	• IRC conformity • If deductible – Representation in sales factor?
• Deductions properly allocable to FDDEI	• Could deductions 'properly allocated' to FDII be disallowed under state expense disallowance provisions?
• Maximization of FDII through operational model/supply chain	• Consideration of state tax effect (after state modifications) • Separate state considerations – Tax base, apportionment • General state tax implications of supply chain or operational changes.

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FDII – Direct implications of TC&JA and resulting SALT considerations (continued)

TC&JA implications	SALT reactions
• QBAI of Domestic Company *reduces* FDII	• Consider impact on State Effective Rate and/or Credits & Incentives
• Sec. 250(b)(5)(C)(ii) Service provided to related parties outside the US not for foreign use if substantially similar to services provided by such related party to persons within the US.	• Contractual changes to disaggregate such services may isolate and highlight foreign related parties with economic presence in US
• Preference for US to foreign distribution models	• 80/20 Implications • Foreign-destination apportionment

The foreign tax credit post-TCJA

The foreign tax credit post-TCJA
Overview

- Section 904(d)(1) amended to provide two additional foreign tax credit limitation categories:
  - GILTI
  - Foreign branch
- Section 902 repeal
- Section 960 “properly attributable to” standard for deemed paid taxes
- Proposed regulations under Section 861 provided new rules:
  - Characterization of CFC stock for interest expense apportionment purposes
  - Exempt income and assets
  - Allocation and apportionment of Section 250 deduction
  - Research and experimentation (R&E) expense apportionment
- Adjustment to foreign tax credit limitation calculation under Section 904(b)(4)

Foreign tax credit changes
Sections 901, 902 and 960

- Direct foreign taxes
  - Foreign taxes incurred directly by US taxpayers (foreign tax on branch income and withholding taxes) remain creditable under Section 901.
- Indirect foreign tax
  - Section 902 is repealed effective for taxable years of foreign corporations beginning after December 31, 2017, and for taxable years of United States shareholders in which or with which such taxable years of foreign corporations end.
  - Section 960 as amended is the sole mechanism to claim indirect FTCs on foreign taxes paid by foreign corporations.
  - Highlights:
    - Indirect credits only available from CFCs. No FTC ever available from 10-50 companies
    - All US shareholders qualify for FTCs. Section 958(b) remains relevant for that determination. No direct ownership limitation
    - No tier limitation on indirect credits

Foreign tax credit changes
Section 960

- Amended Section 960(a):
  - "For purposes of subpart A of this part, if there is included in the gross income of *a domestic corporation* any item of income under *section 951(a)(1)* with respect to any *controlled foreign corporation* with respect to which *such domestic corporation is a United States shareholder*, such domestic corporation shall be *deemed to have paid so much of such foreign corporation's foreign income taxes as are* ***properly attributable to such item of income."***
- New Section 960(d):
  - "For purposes of subpart A of this part, if there is included in the gross income of *a domestic corporation* any item of income under *section 951A,* such domestic corporation shall be *deemed to have paid foreign income taxes equal to* ***80 percent*** *of the product of (A) such domestic corporation's inclusion percentage, multiplied by (b) the aggregate tested income taxes paid or accrued by controlled foreign corporations."*

Foreign tax credit limitation

- The FTCs that a US taxpayer claims in a taxable year cannot exceed the same proportion of its US tax liability (before FTCs) as:
  - The taxpayer's income from foreign sources, net of allocable deductions, **bears to**
  - The taxpayer's total taxable income
- Prior to the Tax Cuts and Jobs Act (TCJA), this limitation was applied separately to income in the following two categories ("baskets"):
    - Passive income
    - General (other) income
  - FTCs in one basket cannot be credited against foreign income in another basket.
  - Excess FTCs can be carried back 1 year and carried forward 10 years.
- The TCJA created new separate FTC baskets for GILTI and for foreign branch income.
  - In the foreign branch basket – excess FTCs carry forward or back to other taxable years
  - In the GILTI basket - excess FTCs **do not** carry forward or back to other taxable years
    … the credits are lost forever

Prop. Reg. §1.861-12(c)(3) and Prop. Reg. §1.861-13
Interest expense — characterization of CFC stock

Five-step process:

Step 1: Characterize stock as generating income in statutory groupings using the asset or modified gross income method.

Step 2: Assign stock to the §951A category.

Step 3: Assign stock to treaty category.

Step 4: Aggregate stock within each separate category and assign stock to the residual grouping.

Step 5: Determine §245A and non-§245A subgroups for each separate category and US source category in order to apply §904(b)(4).

Statutory groupings:

- Within each of the CFC's general category and passive category, there are a number of subgroups; each subgroup is a separate statutory grouping. The key subgroups are listed below:
    - Foreign source gross tested income
    - Foreign source gross subpart F income
    - Foreign source gross §245(a)(5) income
    - Any other foreign source gross income (specified foreign source general category income or specified foreign source passive category income, as the case may be)
- For each of the above, there is a corresponding US source subgroup.
- For each country described in §901(j), all gross income from sources in that country.

Section 861 expense allocation and apportionment
Interest expense – CFC tax book value

- Foreign corporation stock
  - The tax book value of CFC stock is equal to the average of the adjusted tax basis for US federal tax purposes of a group's 1st tier CFCs, plus the accumulated E&P of all CFCs.
  - **Previously taxed income (PTI)** is taken into account for purposes of the E&P "basis bump" described in Reg. §1.861-12(c)(2).
  - The beginning and end-of-year values of stock are determined without regard to any adjustments under §961(a) or §1293(d), and before making the adjustment for E&P. The **adjustment for total E&P is only made after the average** of the beginning and end of year values has been determined.
- Impact of §965(b) PTI
  - For purposes of Reg. §1.861-12(c)(2), basis in the stock of a specified foreign corporation is determined as if the election under Prop. Reg. §1.965-2(f)(2)(i) had been made, even if in fact not made, but does not include basis included under Prop. Reg. §1.965-2(f)(2)(ii)(A).

Prop. Reg. §1.861-8(d)(2)
Exempt income and assets

- Exempt income (not included when apportioning expenses using a gross income method) includes amounts equal to the §250(a) deduction allowed for:
  - FDII: gross income included in foreign-derived intangible income (as defined in §250(b)(1))
  - GILTI: gross income from an inclusion under §951A(a) and the associated §78 gross up
- Exempt assets (not included when apportioning expenses using an asset method) include:
  - FDII: the portion of assets that produce gross income included in foreign-derived intangible income equal to the amount of such assets multiplied by the fraction that equals the §250(a)(1)(A) deduction (taking into account the taxable income limitation under §250(a)(2)(B), if any) divided by foreign-derived intangible income.
  - GILTI: The portion of the value of CFC stock that is characterized as GILTI inclusion stock multiplied by a fraction that equals the §250(a)(1)(B)(i) deduction (taking into account the taxable income limitation under §250(a)(2)(B)(ii), if any) divided by its GILTI inclusion amount.
- Dividends eligible for a §245A deduction are **not** exempt income (but see §904(b)(4) and Prop. Reg. §1.904(b)-3).
- Previously taxed earnings and profits (PTI) does not cause CFC stock to be treated as an exempt asset.

Prop. Reg. §1.861-8(e)
Allocation and apportionment of certain deductions

- Foreign income taxes are allocated and apportioned under the principles of Reg. §1.904-6(a)(1)(i) and Prop. Reg. §1.904-6(a)(1)(iv) to the relevant statutory and residual groupings. In general:
  - Foreign taxes paid or accrued with respect to a separate category of income include only those taxes that are *related* to income in that separate category.
  - Taxes are related to income if the income is included in the base upon which the tax is imposed.
  - Income included in the foreign tax base is calculated under foreign law, but characterized as income in a separate category under United States tax principles.
- FDII deduction: the §250 deduction attributable to FDII is considered definitely related to the specific class of gross income that is included in the taxpayer's foreign-derived deduction-eligible income (as defined in §250(b)(4)).
- GILTI §250 deduction: the §250(a)(1)(B) deduction attributable to a GILTI inclusion and the associated §78 gross-up is considered definitely related to and allocable to the class of gross income included under §951A(a).
- Currently, no changes made to rules regarding stewardship expense allocation/apportionment under Reg. §1.861-8(e)(4)(ii).

Prop. Reg. §1.861-17(e)(3)
Allocation and apportionment of R&E

- In general, the requirement to allocate R&E expenses by product category using the **sales and gross income methods** on an **affiliated group basis** were not altered by the proposed regulations.
- In light of the numerous amendments to the foreign tax credit rules, the proposed regulations provide a one-time exception to the five-year binding election to use the sales or gross income method.
- In the preamble, Treasury noted that the rules could result in (i) R&E expenditures being apportioned under the sales method solely to GILTI even though the royalty income is assigned to the general category under the look-through rules and (ii) under the gross income method, R&E expenditures would be apportioned to both the general and §951A category.

§904(b)(4)
Overview

- Sec. 904(b)(4) provides that foreign source income under Section 904(a) is determined **without** regard to:
  - The foreign source portion of any dividend received from a foreign corporation (Section 245A)
  - Deductions properly allocated to:
    - Income with respect to stock – other than amounts includible under Section 951(a)(1) or 951A(a)

      Or
    - Such stock – to the extent income with respect to such stock is other than amounts includible under Section 951(a)(1) or 951A(a)

§245A US Participation Exemption

Section 245A: US participation exemption

- General rules
  - US shareholder with greater than 10% in vote or value in foreign corporation
  - Owned for longer than 12 months
  - Paid from undistributed foreign earnings
- Considerations
  - Passive foreign investment companies that are not CFCs are not eligible for dividends-received deduction (DRD) treatment
  - Be wary of §1059 extraordinary dividends
  - Role in foreign tax credit income and expense allocation
  - Be wary of §245A(e) (hybrid dividends)

Section 245A Temporary Regulations
Overview

- Temporary Regulations deny (in whole or in part)
  - A Section 245A dividends received deduction (DRD) for the "ineligible amount" of any dividend received from a specified foreign corporation (SFC)
  - Application of Section 954(c)(6) for the "ineligible amount" of any dividend received by an upper-tier CFC from a lower-tier CFC
- The ineligible amount of a dividend equal 50% of the "extraordinary disposition amount" and 100% of the "extraordinary reduction amount"
  - An extraordinary disposition amount (and corresponding account) is created by certain property transactions completed by a CFC during its GILTI "gap period"
  - An extraordinary reduction amount (and a corresponding account) is created by certain reductions in a controlling shareholder's ownership in a CFC
- Applicable for distributions (including dividends under section 964(e) and 1248(a)) made after December 31, 2017
  - Application of Section 954(c)(6) for the "ineligible amount" of any dividend received by an upper-tier CFC from a lower-tier CFC

§59A Base Erosion and Anti-Abuse Tax ("BEAT")

§59A BEAT
Overview

- Section 14401 of TCJA imposes a new tax under §59A often referred to as the Base Erosion Anti-Abuse Tax ("BEAT")
- 5% for 2018, 10% for 2019 to 2025
- Form 8991 and instructions released
- BEAT is a minimum tax amount imposed on **applicable taxpayers** that make certain **base erosion payments** to **foreign related parties**
  - Additional tax separate from regular income tax
  - Different from the old alternative minimum tax ("AMT"); for instance, it is computed differently than AMT and any base erosion minimum tax amount ("BEMTA") paid is not credited against future taxes
  - Generally, BEAT targets deductions arising from transactions with foreign related parties

§59A BEAT
Overview

- Minimum tax imposed on an **Applicable Taxpayer** which is a corporation (other than RIC, REIT or S-corporation) that has:
  - Average annual gross receipts of at least $500 million for three-year period ending with preceding tax year
  - A base erosion percentage of at least 3% (or 2% in the case of a bank or registered securities dealer). Base erosion percentage is generally the aggregate amount of base erosion tax benefits divided by aggregate amount of all allowable deductions
  - Applicable Taxpayer test applied based on an **Aggregate Group**
- BEAT = 10% of the Applicable Taxpayer's **modified taxable income**, over an amount equal to its regular tax liability reduced (but not below zero) by certain credits allowed under Chapter 1
  - "Reducing" credits potentially increase the BEAT owed; foreign tax credits are "reducing" credits, while research credits are not
  - Rate increased to 12.5% for tax years beginning after 2025, and BEAT is computed by reference to regular tax liability that is reduced by an amount equal to all credits allowed under Chapter 1
  - BEAT rate is 1% higher for banks and registered securities dealers
  - **Modified taxable income** is computed as taxable income without regard to any base erosion tax benefit with respect to any base erosion payment to a foreign person that is a related party, and without regard to any "base erosion percentage" of any NOL deduction allowed under section 172

§59A BEAT
Overview

- **Base erosion payment** includes:
  - Any amount paid or accrued by a corporation to a foreign related party and with respect to which a deduction is allowable, including amounts paid or accrued to acquire depreciable or amortizable property
  - Any premium or other consideration paid or accrued by taxpayer to foreign related party for certain reinsurance payments
  - Additional amounts that are paid or accrued by taxpayer with respect a related party which is (1) an "inverted" corporation (but only if first inverted after 9 November 2017) or (2) a foreign person that is a member of same expanded affiliated as the "inverted" corporation
- **Base erosion payment** generally does not include:
  - Amounts that constitute reductions in gross receipts, including payments for cost of goods sold,
  - Amounts paid or accrued for services if such services meet initial eligibility requirements of the services cost method ("SCM") under Reg. §1.482-9, and
  - Any qualified derivative payment if certain requirements are met
- **Base erosion tax benefit** generally means
  - Any deduction allowed with respect to a base erosion payment,
  - Any deduction allowed for depreciation or amortization with respect to an amount paid or accrued in connection with acquisition of depreciable or amortizable property, and
  - Certain reinsurance reductions allowed under section 803(a)(1)(B) and deductions under section 832(b)(4)(A)
- Broad grant of regulatory authority to issue rules addressing the use of unrelated persons, conduit transactions, or other intermediaries, or transactions or arrangements designed to avoid the provision
- Applies to base erosion payments paid or accrued in tax years beginning after 31 December 2017

§59A BEAT
Calculating the BEAT

- Step 1 – Determine the taxpayer's Aggregate Group
- Step 2 – Apply the gross receipts test to the Aggregate Group
- Step 3 – Compute the Aggregate Group's base erosion percentage
  - Step 3a – Identify base erosion payments
  - Step 3b – Calculate the aggregate amount of base erosion tax benefits (numerator)
  - Step 3c – Calculate the aggregate amount of deductions allowable under Chapter 1 of the Code with certain modifications (denominator)
- Step 4 – Compute the taxpayer's separate modified taxable income
- Step 5 – Calculate for each taxpayer the base erosion minimum tax amount

§59A BEAT
Services cost method exception

- A base erosion payment does not include any amount paid or accrued by the taxpayer for services if:
  - The services are eligible for use of the services cost method (SCM) under §482 (as prescribed by Treas. Reg. §1.482-9(b)), without regard to the requirement that the services not contribute significantly to the fundamental risks or business success or failure; and
  - The amount constitutes the total services cost with no markup component.
- Generally, if a taxpayer applies the SCM in accordance with the rules of Treas. Reg. §1.482-9(b) then it will be considered the best transfer pricing method and any IRS transfer pricing adjustment will be limited to adjusting the amount charged for such services to the properly determined amount of such total services costs. Treas. Reg. §1.482-9(b)(1).
  - If the conditions of the regulations are satisfied, services eligible for the SCM may be charged at cost with no markup. TD 9278.
- A service otherwise eligible for the SCM cannot qualify unless the taxpayer reasonably concludes in its business judgment that the service does not contribute significantly to key competitive advantages, core capabilities, or fundamental risks of success or failure in one or more trades or businesses of the controlled group.
  - This requirement, however, is turned off for determining whether the amount paid or accrued may be excluded by the SCM exception from being a base eroding payment subject to BEAT.

§59A BEAT
Services cost method exception

- Services eligible for the SCM are limited to:
  - "Specified covered services" as identified by Rev. Proc. 2007-13, and
  - "Low margin covered services."
- Specified covered services include, for example, payroll, accounts receivable/payable, general administrative, meeting coordination and travel planning, accounting and auditing, tax, health, safety, environmental and regulatory affairs activities.
- Low margin covered services are "controlled services transactions" for which the comparable markup on total services costs is 7 percent or less.
  - Controlled services transactions include the performance of functions, assumptions of risks, or use by a renderer of tangible or intangible property or other resources, capabilities, or knowledge that results in a benefit. Treas. Reg. §1.482-9(l)(1).
- The following services are not eligible for the SCM (Treas. Reg. 1.482-9(b)(4)):
  - Manufacturing
  - Production
  - Extraction, exploration, or processing of natural resources
  - Construction
  - Reselling, distribution, acting as a sales or purchasing agent, or acting under a commission or other similar arrangement
  - Research, development, or experimentation
  - Engineering or scientific
  - Financial transactions, including guarantees
  - Insurance or reinsurance

§163(j) interest limitation

§163(j) interest limitation
Overview

- Deduction for net business interest expense generally limited to 30% of the taxpayer's **adjusted taxable income** for that year
- Applicable to all taxpayers, regardless of form (special rules apply for partnerships and S-corporations) and regardless of whether interest is paid to related or unrelated parties (foreign or domestic)
  - Exception for taxpayers with average annual gross receipts of $25 million or less during the prior three-year period
  - Limited exemption for interest from motor vehicle floor plan financing and certain other types of interest expense
- **Adjusted taxable income** means taxable income determined without regard to any items not properly allocable to a trade or business, any business interest or business interest income, any NOL deduction, and in the case of tax years beginning before 1 January 2022, any deduction for depreciation, depletion and amortization (**DD&A**), and other adjustments as may be provided by regulations
- Indefinite carry forward of interest expense that is disallowed
- Exemptions available for certain taxpayers (e.g., electing real property trade or business)
- Effective for tax years beginning after 31 December 2017
- Transition rules from old section 163(j) regime into this new one have been articulated in Notice 2018-28

§163(j) key considerations

- Effective date of regulations
  - In general, the provisions are applicable to taxable years ending after the date the Treasury decision adopting these regulations as final regulations is published in the Federal Register.
  - The proposed regulations may be relied on for taxable years beginning after December 31, 2017 so long as the taxpayers and their related parties consistently apply the proposed regulations.
- Evaluate whether to apply the proposed Section 163(j) regulations early — consider:
  - Controlled foreign corporation (CFC) grouping election (note special rules for financial services subgroups)
  - Expansive definition of interest
  - Application to partnerships under the statute versus the proposed regulations
- Interaction with accounting methods and other provisions:
  - Amount of ATI: depreciation, depletion and amortization (DD&A) — amount properly capitalized into cost of goods sold
  - Amount of interest: capitalization (e.g., 263A) and deferral (e.g., 267(a))
- Characterization of income and expense as interest — consider:
  - If applying the proposed regulations, will need to carefully evaluate all debt-related fees and transactions (e.g., hedging)

IRS Communications

- Efforts in 2018
- 2019 Overview
- Outreach

IRS Training

- International Overview Training
- Face to Face Training
- CBA Revenue Agent Deep Dive Training
- New Hire Training