Getting Credit – Generating and Using Foreign Tax Credits After the TCJA (Breakout E)

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Topics

New GILTI Basket
New Foreign Branch Income Basket
Affirmative Planning
Other FTC Considerations
Foreign Tax Audits
Election under Section 962
Section 901(m) Post-Reform

New GILTI Basket

Statutory Overview

Section 960(d)

- A domestic corporation that includes GILTI in gross income will be deemed to have paid foreign income taxes equal to 80% of the product of (i) the Inclusion Percentage *multiplied by* (ii) the aggregate Tested Foreign Income Taxes of all CFCs
  - Inclusion Percentage: ratio of (i) GILTI over (ii) the aggregate tested income of all CFCs
  - Tested Foreign Income Taxes: foreign income taxes paid or accrued by a CFC that are properly attributable to the tested income of such CFC

Section 904(d)(1)(A)

- GILTI is treated as a separate basket for purposes of section 904
  - Section 78 Gross-up for GILTI: "It is anticipated that the proposed regulations relating to foreign tax credits will provide rules for assigning the section 78 gross-up attributable to foreign taxes deemed paid under section 960(d) to the separate category described in section 904(d)(1)(A) [illegible] cs 0.753 0 0 scn/C2_0 1 Tf 0 Tc 0 Tw 20.04 -0 0 20.04 55

Practical Considerations – Varying Tax Years

Tested

Practical Considerations – Expense Apportionment

		Without Expenses	With Expenses
Pre-Tax	Pre-Tax Income	100,000	100,000
GILTI	Net CFC Tested Income	86,875	86,875
	QBAI	0	0
	Net Deemed Tangible Income Return	0	0
	GILTI	86,875	86,875
Section 78 Deemed Dividend	Tested Foreign Income Taxes	13,125	13,125
	Inclusion Percentage	100%	100%
	Section 78 Deemed Dividend	13,125	13,125
Section 250 Deduction	Total Gross Income Inclusion	100,000	100,000
	Section 250 Deduction	(50,000)	(50,000)
	Taxable Income	50,000	50,000
80% FTC & US Tax	US Tax Before FTC	10,500	10,500
	80% FTC	(10,500)	(8,400)
	Residual US Tax	--	2,100
Section 904 FTC Limitation	Total Gross Income Inclusion	100,000	100,000
	Section 250 Deduction	(50,000)	(50,000)
	Allocated / Apportioned Expenses	0	**(10,000)**
	Net Income in GILTI Separate Basket	50,000	40,000
	FTC Limitation	**10,500**	**8,400**

New Foreign Branch Income Basket

New section 904(d)(2)(J) defines foreign branch income:

In general. The term "foreign branch income" means the business profits of such United States person which are attributable to 1 or more qualified business units (as defined in section 989(a)) [("QBUs")] in 1 or more foreign countries. For purposes of the preceding sentence, the amount of business profits attributable to a qualified business unit shall be determined under rules established by the Secretary.

Exception. Such term shall not include any income which is passive category income.

The definition raises 4 key questions:

What are business profits?

What is a QBU?

When is a QBU in a foreign country?

What business profits are attributable to a QBU?

Transition rules for carryback/carryforward of excess foreign taxes?

Treasury provided transition rules when the FTC limitation went from 9 separate baskets i

Business profits is not a widely used term for U.S. federal income tax purposes, but is widely used in the treaty context

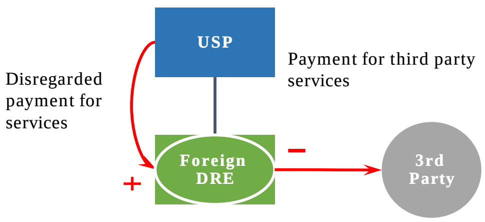
Like PEs, many QBUs are disregarded entities or branches that are not treated as entities separate from their owners

A QBU is any separate and clearly identified unit of a trade or business of a taxpayer provided that separate books and records are maintained

The final regulations under section 989(a) describe two types of QBUs:

- Entities: A corporation is a QBU. A partnership,* trust, or estate is a QBU of its partners or beneficiaries.
- Activities: The activities of an entity or individual qualify as a QBU if both—
  - The activities constitute a trade or business,

Foreign Branch Income Issues – Attribution of Profits

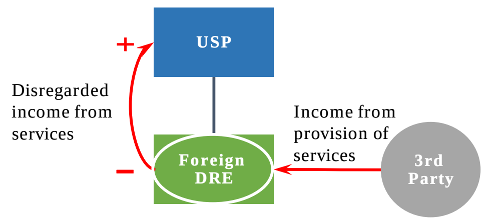


Scenario:

- USP provides services to third parties utilizing the services of a foreign DRE and pays DRE an arm's length price for services
- DRE contracts with a third employees for the performance of the services.
- Assume DRE is a QBU

Considerations

- What income and deduction are attributable to DRE?
- Should DRE be attributed a portion of the income earned by USP?
- Consider the source of the income



Scenario:

- DRE purchases services from USP at an arm's length price
- DRE sells services to an unrelated third party at a mark up
- Assume DRE is a QBU
- Assume sale to foreign party for foreign use

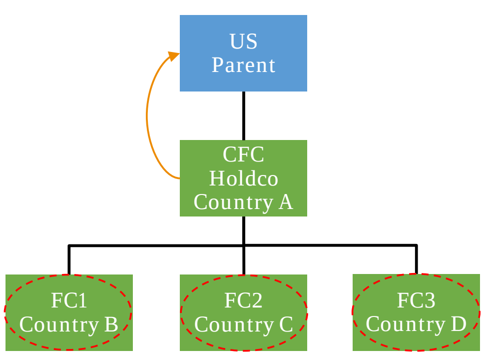
Considerations

- What income and deduction are attributable to DRE?
- Is income paid to DRE foreign branch income and, therefore, not DEI for purposes of FDII? See section 250(b)(3)(A)(i)

Affirmative Planning

High Taxed CFCs and Section 956

Section 956 and High-Taxed CFCs.



- CFC Holdco has, from its first subpart F year, earned income for which it made a high-tax exception election under section 954(b)(4)
- In 2020, CFC Holdco makes a loan to US parent such that US Parent includes an amount in income under section 956

Analysis

- Section 956 was not repealed by the TCJA, and section 960, as applicable to tax years of domestic corporations beginning after December 31, 2017, provides that US parent may choose to claim a credit, subject to the limitation under section 904, a foreign tax credit for those foreign taxes that are attributable to the section 956 inclusion.
- TJCA repealed former section 960(c), which had the potential to reduce, or eliminate, foreign tax credits deemed paid from indirectly held CFCs, in the case of a section 956 inclusion.

Considerations

- What does it mean for taxes to be “attributable to” a section 956 inclusion.
- What if US Parent has a section 956 inclusion attributable to earnings of CFC Holdco that were earned in a pre-TJCA year?

Foreign Tax Credits

US Tax on GILTI = 21% x (GILTI and **related §78 gross-up** - §250 Deduction) - **FTCs**

- Deemed Taxes Paid (§960(d)) = **80%** x Aggregate **Tested Foreign Income Taxes** paid or accrued by CFCs x **Inclusion Percentage**
  - **80%:** Credits are capped at 80% of foreign taxes (except for PTI and 901 withholding taxes)
  - **Tested Foreign Income Taxes**: Foreign income taxes paid or accrued by a CFC which are properly attributable to the tested income of such CFC.
    - Foreign income taxes of a tested loss CFC are not included

Inclusion Percentage:

- §78 gross-up = 100% of deemed taxes paid (instead of 80%)
- Separate section 904 FTC basket for GILTI
- Excess credits cannot be carried forward or back to other taxable years

SCENARIO: A US shareholder with a calendar year end owns a CFC with an 11/30 US tax year end

- New § 960(d)(1) states that, with respect to a GILTI inclusion, "a domestic corporation shall be deemed to have paid foreign income taxes equal to **80 percent** of the product of such domestic corporation's inclusion percentage, multiplied by the aggregate **tested foreign income taxes** paid or accrued by controlled foreign corporations."
- New § 960(d)(3) defines tested foreign income taxes, with respect to a domestic corporation which is a US shareholder of a CFC, "the foreign income taxes **paid or accrued** by such foreign corporation which are **properly attributable to the tested income** of such foreign corporation **taken into account** by such domestic corporation under § 951A."
- What portion of taxes paid or accrued by a CFC at 12/31/19 are "properly attributable" to the CFC's tested income for the year ending 11/30/19? Consider application of ru

Other FTC Considerations

Illustration

GILTI Calculation	Taxable income	FSI GILTI basket
Net CFC tested income ($140 – 40)	$ 100.0	
Net deemed tangible income return (10% of QBAI)	0.0	
Global intangible low-taxed income (GILTI)	100.0	
§78 gross-up	40.0	
GILTI inclusion + §78 gross-up	140.0	
§250 deduction (50%)	(70.0)	
Taxable income	70.0	$ 70.0
Deductions allocated/ apportioned to the GILTI basket		(70.0)
Net foreign-source income in the GILTI basket		$ 0.0
US statutory rate (21%)	$ 14.7	0.0
Allowable foreign tax credits	$ 0.0	
Residual US tax on GILTI	$ 14.7	

Rate reconciliation and key takeaways

Rate reconciliation:		
Pre-tax book income	$ 100.0	
Tax expense @ statutory rate	$ 29.4	21.0%
Foreign rate differential [$40 – ($140.0 x 21%)]	10.6	7.6%
Residual US tax on GILTI *	14.7	10.5%
Total tax expense	$ 54.7	39.1%

Key takeaways

- Any expense allocated and apportioned to GILTI basket has the potential to increase the US tax
- In this example, even though the CFC's ETR is > 13.125%, every $1 of expense allocated and apportioned to the GILTI basket resulted in an additional US tax of $0.21 ($70.0 x 21% = $14.7 residual GILTI tax in the example)

ODLs, OFLs, and SLLS

Just because a domestic corporation has room in its GILTI “basket” FTC limitation doesn’t necessarily mean it can claim a GILTI FTC

Separate limitation losses (SLL)

- USCo has a general and branch limitation losses and GILTI limitation income

Overall domestic losses (ODL)

- USCo has US source losses, and GILTI limitation Income.

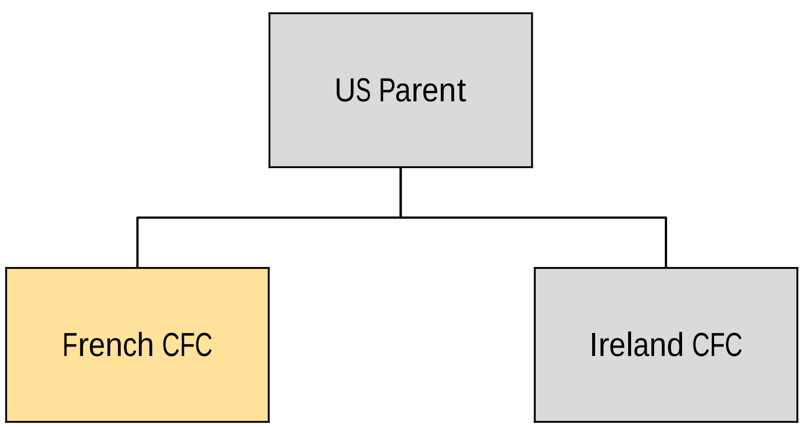
Foreign Tax Audits

Foreign Tax Redeterminations

Section 905(c)

- Prior to TCJA, section 905(c)(2)(B)provided as follows:
  - Any such taxes if subsequently paid – (i) shall be taken into a0iterminations

Practical Considerations – E&P and Cash Balances



Election under Section 962

IRC Section 962 Elections

- Originally enacted with Subpart F.
- Allows noncorporate investors in foreign corporations to elect the same treatment they would have had if they had made the investment through a domestic corporation (i.e., it makes indirect foreign vrpom4-41 74.