35th Annual TEI-SJSU High Tech Tax Institute

International Tax Basics to be Provision Compliant

Monday, November 4th

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")

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-

Treas. Reg.

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

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Pursuant to Section 960(d), a **US corporation** with a GILTI inclusion that elects to take

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	

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 computlorl 14(om)-S(or)0.6on 951A,ectie on ofow ede-14.5(c)enton ofILTI37	

Global Intangible Low-Taxed Income

§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

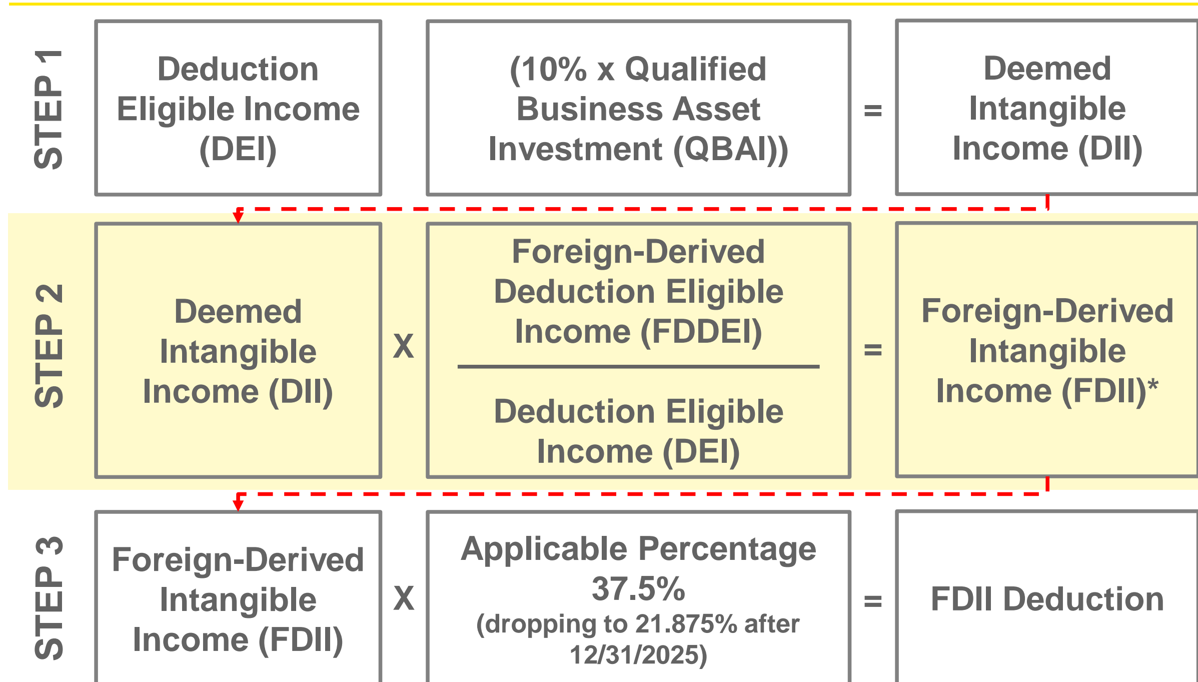
The FDII computations are complex, but the questions underlying FDII are simple…

- 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



*Consider taxable income limitation which may reduce FDII amount

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

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.

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

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)

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 forei

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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

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(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 p( )-.3( )0.6.5.3(.)3.5( )17.2-1.3(n)-25.lao, 4

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.

§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

§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

§163(j) key considerations

- Effective date of regulations

IRS Communications

Efforts in 2018

2019 Overview

Outreach