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International Concepts of The TCJA

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Overview

- The New "Territorial System" and Participation Exemption
- Deemed Repatriation
- Foreign Intangible Income (GILTI & FDII)
- Sourcing Rules – Sales of Inventory and Partnership Interests
- Base Erosion Minimum Tax

The New "Territorial System"

- A big headline on the international side of the TCJA was the move to a so-called "territorial system" of taxation.
  - This headline is largely based on the introduction of new Section 245A, which allows a U.S. shareholder of a specified 10% owned foreign corporation to deduct an amount equal to the foreign source portion of any dividend received.
- The reality may not live up to the hype.
  - A true territorial system would tax only U.S. source income at U.S. corporate tax rates and would allow foreign source income to be taxed by foreign jurisdictions at whatever rates such jurisdictions imposed.
  - The new "hybrid" system falls short.

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Participation Exemption – Sec. 245A

- Section 245A only applies to domestic corporations that receive dividends from foreign corporations.
  - Does not apply to income earned through a foreign branch or income earned by an individual, S corporation, partnership, or REIT.
  - Does not apply to subpart F inclusions or GILTI inclusions, even if dividends are distributed during the same year as the inclusion.
    - May limit its application primarily to returns on tangible asset investments.
  - Unclear how regulations will treat stock owned by domestic corporations through partnerships.
- Simultaneous repeal of Section 902 may cause whipsaws
  - E.g., where holding periods are not satisfied, foreign tax credit redeterminations with SOL issues
- Bad news for hybrid debt-equity instruments
  - Both DRD and FTC denied
- Benefit blunted by Section 965 deemed repatriation
  - Long-held CFCs may have high amounts of PTI

Deemed Repatriation

- New Section 965 requires 10% “U.S. 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.
  - Subject to reduced rates of tax (15.5% effective rate for cash and cash equivalents; 8% effective rate for residual)
  - Option to pay tax over an 8-year period
- Significant computational issues

Deemed Repatriation (cont'd)

- Recent FAQs published by the IRS provide that overpayments of estimated 2017 taxes, 2017 extension payments, and amounts paid to satisfy the Section 965(h) installment must be used to satisfy the balance of the taxpayer's Section 965 liability before they can be refunded or applied toward 2018 tax.
- This controversial stance seems to deny Congress's intent to provide taxpayers an installment option.
- Worsened by the fact that many taxpayers made such tax payments (and did so conservatively) well before the FAQs were released in April.

GILTI As Charged

- A new companion to Subpart F is Section 951A, which requires U.S. shareholders of CFCs to include GILTI.

- Effectively, Section 951A imposes a minimum tax on U.S. shareholders of CFCs to the extent of Global Intangible Low Taxed Income ("GILTI").
- At a high level, GILTI is the income of a CFC, less a deemed return (10%) on the adjusted bases of tangible assets.

Foreign "Intangible" Income

- *No* requirement to actually attribute the GILTI income to the exploitation of intangibles owned by CFCs.
- CFC income is "tested" by (i) excluding several categories of income, including Subpart F income, U.S.-source ECI, and related person dividends, (ii) subtracting allocable deductions, and (iii) comparing positive income to a deemed 10% return on Qualified Business Asset Investment ("QBAI").
- QBAI is the quarterly average of adjusted basis of certain depreciable tangible property used in producing tested income.
  - Cliff effect can be onerous, but CFC netting can be generous.

Sticks and Carrots

Sticks and Carrots (cont'd)

- The "stick" is obvious – more CFC income inclusions.
- The "carrot" is lower tax rates for domestic corporations through new Section 250.
  - Corporations may take a 50% deduction against GILTI income, bringing the effective tax rate down to 10.5% (half of 21%).
  - Corporates may use FTCs (at 80%) to reduce GILTI, making the break-even foreign tax rate 13.125%
  - Corporations entitled to a new FDII deduction, which approximates taxable income from exploiting intangible property outside the U.S.
    - Property sold to a non-U.S. person for foreign use
    - Services provided to persons or property not in the U.S.
- The net effect may be an apparent incentive to locate *more* investment offshore.

Escape Routes

- CFC Planning
  - Rearrange corporate group members to match tested losses and tested income
  - Arrange for higher asset bases
- Individuals as shareholders
  - Denied 50% GILTI deduction but must include GILTI and pay tax at marginal rates
  - Section 962 Election?

Gain on the Sale of Partnership Interests

- Addresses sales of US partnership interests by foreign persons
- Uncertainty of Old Law
  - Rev. Rul. 91-32 treats each asset as sold at fair market value and gain sourced to the US to the extent the asset generates effectively connected income.
  - The Tax Court in *Grecian Magnesite Mining* disagreed, instead looking to the residence of the seller.
- Certainty under the Tax Act
  - Takes Rev. Rul. 91-32's approach
  - Look at each partnership asset, with gain sourced to the US to the extent such asset generates US effectively connected income.

Source of Inventory Income

- Old Law
  - Inventory sales sourced partly to country of production, partly to country of sale
- New Law
  - Source of income from the sale of inventory are entirely sourced to the country of production

Base Erosion Minimum Tax

- Applies to
  - Corporations, other than RICs, REITs, and S corporations
  - With average annual gross receipts of at least $500,000,000 and
  - “Base Erosion Percentage” of at least 3% and at least 2% for certain banks and securities dealers

- Base Erosion and Anti-Abuse Tax
  - Or “BEAT”

Base Erosion Minimum Tax

- The BEAT is 10% of modified taxable income
  - 5% for tax years beginning in 2018
  - Increases to 12.5% for tax years beginning after 2025
- Modified Taxable Income
  - Taxable income without regard to any base erosion tax benefit from a base erosion payment, OR
  - The "base erosion percentage" of any allowable net operating loss deduction
- Base Erosion Tax Benefit
  - Deductions generated from base erosion payments

Base Erosion Minimum Tax

- Base Erosion Payment
  - Amounts paid or accrued to foreign related parties
  - Exclude payments subject to US withholding tax when made
- Base Erosion Percentage
  - The aggregate amount of Base Erosion Tax Benefits, divided by
    - (1) the aggregate deductions allowable to the taxpayer for the tax year, plus
    - (2) the base erosion tax benefits relating to reinsurance payments and cost of goods sold payment to surrogate foreign corporations.

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