

International Tax: Tax Reform

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The below summary contains a high level overview of certain international tax provisions contained in the new bill and is not intended to be a comprehensive discussion of all the numerous rules, definitions and special rules relating to the provisions discussed herein.

Establishment of Participation Exemption

- ▶ 100% DRD for certain foreign source portion of dividends received from specified 10% owned foreign corporations (10% SFCs) by U.S. C corporations (other than RICs or REITs) that are U.S. shareholders (section 951(b)) of those foreign corporations
 - A 10% SFC is any foreign corporation with respect to which any domestic corporation is a U.S. shareholder (such term does not include any corporation which is a PFIC with respect to the shareholder and which is not a CFC)
 - No DRD for hybrid dividends
 - One year holding period requirement (with certain required conditions)
 - Gains treated as a dividend for purposes of section 1248 may qualify for the DRD (applicable for sales/exchanges after 12/31/17)
 - Special rules under new section 964(e)(4) for coordinating the DRD with certain sales by a CFC of a lower-tier CFC
 - No foreign tax credit or deduction for any taxes paid or accrued for exempt dividends
 - For purposes of computing section 904(a) foreign tax credit limitation, such domestic corporation must compute its foreign source taxable income (and entire taxable income) by disregarding the foreign source portion of any dividend received for which the DRD is taken, and any deductions properly allocable and apportioned to that foreign source portion or the stock with respect to which it is paid
 - Numerous other special rules
 - Applicable to distributions made (and for purposes of determining a taxpayer's foreign tax credit limitation under section 904, deductions in tax years beginning after) after 12/31/17



Establishment of Participation Exemption

- ▶ Reduce basis (but not below zero) in stock of 10% SFCs by exempt dividends (except to extent basis reduced under section 1059 by reason of such dividends) but only for purposes of determining loss on subsequent disposition of 10% SFC shares
 - Applicable for distributions made after 12/31/17

- ▶ If U.S. corporation transfers substantially all of the assets of a foreign branch to a 10% SFC with respect to which it is a U.S. shareholder after the transfer, the U.S. corporation includes the “transferred loss amount” (calculation relating to post-2017 branch losses), subject to certain limitations, coordinating rules and other special rules (e.g., amount included in income treated as U.S. sourced income)
 - Applicable to transfers after 12/31/17

- ▶ Repeal of the active trade or business exception under section 367(a)
 - Applicable to transfers after 12/31/17

- ▶ Election to increase the percentage (but not greater than 100%) of domestic taxable income offset by any pre-2018 unused ODL and re-characterized as foreign source
 - Applicable to taxable years beginning after 12/31/17



Establishment of Participation Exemption

- ▶ U.S. shareholders (as defined in section 951(b)) of deferred foreign income corporations required to include their pro rata share of accumulated post-1986 deferred foreign income as of 11/2/2017 or 12/31/2017 (whichever is greater)
 - Deferred foreign income corporation is a specified foreign corporation (SFC) of the U.S. shareholder which has positive accumulated post-1986 deferred foreign income on 11/2/2017 or 12/31/2017
 - SFC is (a) a CFC and (b) any foreign corporation with respect to which one or more domestic corporations is a U.S. shareholder (such term shall not include any corporation which is a PFIC with respect to the shareholder and which is not a CFC)
 - SFC described in (b) treated as CFC for purposes taking into account Subpart F income under provision
 - Subpart F inclusion is mechanism for inclusion
 - Can apply to non-corporate U.S. shareholders
 - Deficits of certain SFCs available to reduce inclusion if certain conditions are satisfied
 - Very generally, 15.5% rate for E&P comprising of cash and cash equivalents/8% rate for remaining E&P (see section 965(c) for specific details on computing rates—rates generally higher for non-corporate taxpayers)



Establishment of Participation Exemption

- ▶ Scaled back deemed paid FTCs for eligible domestic corporations related to subpart F inclusion
- ▶ Election to pay liability in 8 installments (with amounts paid in later years increasing)
- ▶ Election not to apply NOL deduction
- ▶ Special rules for S corporation shareholders allowing them to elect to defer payment of tax liability until certain triggering events
- ▶ Special rules relating to REITs
- ▶ Broad regulatory authority including authority to prevent the avoidance of the purposes of the provision, including through a reduction of E&P through check-the-box elections or accounting method changes, or otherwise
- ▶ Numerous definitions and operating rules for applying provision
- ▶ Applicable for the last taxable year of a foreign corporation beginning before 1/1/18, and with respect to U.S. shareholders for tax years in which or with which such tax years of the foreign corporation end
- ▶ See Notices 2018-07 and 2018-13 and Rev. Proc. 2018-17 for additional guidance on transition tax (several open issues remain relating to the application of provision)



Modifications to Foreign Tax Credit System

- ▶ Repeal of section 902 indirect FTCs for dividends; Determination of section 960 indirect FTC on a current year basis for subpart F inclusions
 - What about section 956 inclusions?
 - Applicable to taxable years of foreign corporations beginning after 12/31/17 and to taxable years of U.S. shareholders in which or with which such taxable years end
- ▶ Sourcing for produced inventory--Sourced based solely on jurisdiction(s) of production activities under section 863(b)
 - Applicable to taxable years beginning after 12/31/17
- ▶ Creation of separate foreign tax credit limitation basket for foreign branch income (exception for certain income which is passive category income)
 - Applicable to taxable years beginning after 12/31/17



Modifications to Foreign Tax Credit System

- ▶ Repeal of section 955
 - Applicable to taxable years of foreign corporations beginning after 12/31/17 and to taxable years of U.S. shareholders in which or with which such taxable years end

- ▶ Elimination of foreign base company oil related income as a category of foreign base company income
 - Applicable to taxable years of foreign corporations beginning after 12/31/17 and to taxable years of U.S. shareholders in which or with which such taxable years end

- ▶ Repeal of section 958(b)(4) so that certain stock of a foreign corporation owned by a foreign person is attributed to a related U.S. person for purposes of determining CFC status
 - Applicable to the last taxable year of foreign corporations beginning before 1/1/18 and each subsequent year of such foreign corporations and for the taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end
 - See also Notice 2018-13 for additional guidance (other open issues remain relating to repeal of section 958(b)(4)).



Modifications to Subpart F

- ▶ Expansion of the definition of U.S. shareholder to include U.S. persons who own 10% or more of the total value of all classes of stock of a foreign corporation
 - Applicable to taxable years of foreign corporations beginning after 12/31/17 and to taxable years of U.S. shareholders in which or with which such taxable years end

- ▶ Elimination of the requirement that a corporation be controlled for an uninterrupted period of 30 days before subpart F inclusions apply
 - Applicable to taxable years of foreign corporations beginning after 12/31/17 and to taxable years of U.S. shareholders in which or with which such taxable years end



Modifications to Subpart F (GILTI)

- ▶ U.S. shareholders of any CFC must include in gross income for a taxable year “**global intangible low-taxed income**” in a manner generally similar to inclusions of subpart F income (new section 951A) (Complex formula for determining the amount)
 - **Global intangible low-taxed income** with respect to a U.S. shareholder for a tax year of such shareholder is the excess (if any) of such shareholder’s “**net CFC tested income**” for such year over such shareholder’s “**net deemed tangible income return**” for such year
 - “**Net deemed tangible income return**” is, with respect to any U.S. shareholder for a taxable year, the excess (if any) of 10 percent of the aggregate of its pro rata share of the Qualified Business Asset Investment (QBAI) of each CFC with respect to which it is a U.S. shareholder over the amount of interest expense taken into account in determining its net CFC tested income for the taxable year to the extent that the interest expense exceeds the interest income properly allocable to the interest expense that is taken into account in determining its net CFC tested income



Modifications to Subpart F (GILTI)

- ▶ **QBAI** means, with respect to any CFC for a taxable year, the average of the aggregate of its adjusted bases, determined as of the close of each quarter of the taxable year, in specified tangible property used in its trade or business and of a type with respect to which a deduction is generally allowable under section 167. The adjusted basis in any property must be determined using the alternative depreciation system under current section 168(g) and by allocating the depreciation deduction with respect to such property ratably to each day during the period in the tax year to which such depreciation relates, notwithstanding any provision of law which is enacted after the date of enactment of this provision (unless such later enacted law specifically and directly amends this provision's definition)
 - Special rules for partnership property when a CFC holds an interest in a partnership
 - **Specified tangible property** means any property used in the production of tested income. If such property is used in the production of both tested income and income that is not tested income (i.e., dual-use property), the property is treated as specified tangible property in the same proportion that the amount of tested gross income produced with respect to the property bears to the total amount of gross income produced with respect to the property
 - **GILTI**= Net CFC Tested Income - [(10% x QBAI)- interest expense (as limited above)]



Modifications to Subpart F (GILTI)

- ▶ Net CFC Tested Income = Sum of CFC Tested Income - Sum of CFC Tested Loss
- ▶ “Net CFC tested income” means, with respect to any U.S. shareholder, the excess (if any) of the aggregate of the shareholder’s pro rata share of the “tested income of each CFC” with respect to which it is a U.S. shareholder over the aggregate of its pro rata share of the “tested loss of each CFC” with respect to which it is a U.S. shareholder
 - Pro rata shares are determined under the rules of section 951(a)(2)
 - The tested income of a CFC means the excess (if any) of the gross income of the corporation—determined without regard to certain exceptions to tested income—over deductions (including taxes) properly allocable to such gross income (“tested gross income”)
 - The exceptions to tested income are: (1) the corporation’s ECI under section 952(b); (2) any gross income taken into account in determining the corporation’s subpart F income; (3) any gross income excluded from foreign base company income or insurance income by reason of the high-tax exception under section 954(b)(4); (4) any dividend received from a related person (as defined in section 954(d)(3)); and (5) any foreign oil and gas extraction income (as defined in section 907(c)(1))



Modifications to Subpart F (GILTI)

- ▶ The tested loss of a CFC means the excess (if any) of deductions (including taxes) properly allocable to the corporation's gross income—determined without regard to the tested income exceptions—over the amount of such gross income
- ▶ Rules to coordinate provision with other rules relating to subpart F (Regulatory authority to provide rules for coordinating GILTI with other provisions of law in which the determining of subpart F income is required to be made at the CFC level).
- ▶ Rules for allocating the amount of GILTI included by a U.S. shareholder across each CFC with respect to which such person is a U.S. shareholder
- ▶ Several special rules and formulas relating to determining deemed paid credit for taxes properly attributable to tested income (e.g., 80% limitation, rules relating to creating separate basket for GILTI, calculating the section 78 gross up, restricting the carryover or carryback of excess taxes)
- ▶ Regulatory authority to address abuse
- ▶ Applicable to taxable years of foreign corporations beginning after 12/31/17 and to taxable years of U.S. shareholders in which or with which such taxable years end



Deduction for Foreign Derived Intangible Income and Global Intangible Low-Taxed Income

- ▶ Domestic C corporations (other than RICs and REITs) permitted a deduction equal to the sum of 37.5% of its foreign derived intangible income of the domestic corporation (as defined in the provision) plus 50% of (i) its global intangible low-taxed income (if any) included in income by the domestic corporation under section 951A (CFC subpart F type provision) and (ii) the amount treated as a dividend received by such corporation under section 78 which is attributable to the amount in (i)
 - Limitation based on taxable income (potential reduction of deductions)
 - Special definitions in applying provision and complex calculation for determining amount
 - Percentages for deduction reduced for tax years after 2025
 - Applicable for taxable years beginning after 12/31/17



Foreign Derived Intangible Income

- ▶ Foreign Derived Intangible Income (FDII) of any U.S. corporation is the amount which bears the same ratio to the corporation's "deemed intangible income" of such corporation as its "foreign-derived deduction eligible income" bears to its "deduction eligible income"
 - General formula--- $FDII = \text{Deemed Intangible Income} \times (\text{Foreign Derived Deduction Eligible Income} / \text{Deduction Eligible Income})$
- ▶ Deduction eligible income means, with respect to any U.S. corporation, the excess (if any) of the gross income of the corporation - determined without regard to certain exceptions to deduction eligible income - over deductions (including taxes) properly allocable to such gross income
 - The exceptions to deduction eligible income are (1) amounts included in the gross income of such corporation as subpart F income under section 951(a)(1); (2) the GILTI of the corporation under section 951A; (3) any financial services income (as defined in section 904(d)(2)(D)) of the corporation; (4) any dividend received from a CFC with respect to which the corporation is a U.S. shareholder; (5) any domestic oil and gas extraction income of the corporation; and (6) any foreign branch income (as defined in section 904(d)(2)(J)) of the corporation
 - General formula--- $\text{Deduction Eligible Income} = \text{Gross Income} - \text{Exceptions to Deduction Eligible Income} - \text{Allocable Deductions}$



Foreign Derived Intangible Income

- ▶ Deemed intangible income means the excess (if any) of its deduction eligible income of the domestic corporation over its “deemed tangible income return”
- ▶ Deemed tangible income return means, with respect to any corporation, an amount equal to 10% of the corporation’s QBAI
- ▶ General formula---Deemed Intangible Income = Deduction Eligible Income - (10% x QBAI)
 - QBAI defined in the same manner as QBAI for GILTI but determined by substituting “deduction eligible income” for “tested income” in section 951A(d)(2) and without regard to whether the corporation is a CFC





Foreign Derived Intangible Income

- ▶ **Foreign derived deduction eligible income** means, with respect to a taxpayer for its taxable year, any deduction eligible income of the taxpayer that is derived in connection with (1) property that is sold by the taxpayer to any person who is not a U.S. person and that the taxpayer establishes to the satisfaction of the Secretary is for a foreign use or (2) services provided by the taxpayer that the taxpayer establishes to the satisfaction of the Secretary are provided to any person, or with respect to property, not located within the United States
 - Foreign use means any use, consumption, or disposition that is not within the United States
 - Special rules for determining foreign use apply to transactions that involve property or services provided to domestic intermediaries or related parties
 - For purposes of this provision, the terms “sold,” “sells,” and “sale” include any lease, license, exchange or other disposition

- ▶ Secretary shall prescribe regulations or other guidance as may be necessary or appropriate to carry out this provision

Base Erosion Provisions (BEAT)

- ▶ Base erosion minimum tax (Base Erosion and Anti-Abuse Tax or BEAT) requires certain corporations to pay additional corporate tax in situations where such corporations have certain “**base erosion payments**” to foreign related parties and certain thresholds and conditions are satisfied (complicated formula for determining the tax)
 - Additional tax applies to an “**applicable taxpayer**”—an applicable taxpayer is a corporate taxpayer (other than a RICs, REIT or S Corporation) with average annual gross receipts of at least \$500 million (three year testing period) and a “**base erosion percentage**” of 3% or more for the tax year (several special rules and definitions in applying test, including aggregation rules and modification of base erosion percentage if bank or registered securities dealer part of group (2%))
 - The BEAT targets “**base erosion payments**” which generally are amounts paid or incurred to foreign related parties (as defined in the provision) for which a deduction is allowable, any premium or other consideration paid or accrued by the taxpayer to a foreign related party for any reinsurance payments which are taken into account under sections 803(a)(1)(B) or 832(b)(4)(A) and also includes amounts paid in connection with the acquisition of depreciable or amortizable property from a foreign related party. Base erosion payments generally do not include amounts constituting COGS except in certain situations dealing with payments to certain expatriated/inverted groups (became a surrogate foreign corporation after 11/9/2017). There are also narrowly targeted exceptions to base erosion payments dealing with certain types of payments for services and certain types of derivative payments that meet certain requirements (see section 59A(d)(5) and (h) for requirements)



Base Erosion Provisions (BEAT)

- The “base erosion percentage” for a tax year used to determine the threshold requirement above is determined by dividing the aggregate amount of “base erosion tax benefits” for the year by the aggregate amount of deductions allowable under Chapter 1 for the year, taking into account base erosion tax benefits and not taking into account any deduction allowed under sections 172, 245A or 250 for the taxable year, any deduction for amounts paid or accrued for services to which the exception for the services cost method applies, and any deduction for qualified derivative payments which are not treated as a base erosion payment



Base Erosion Provisions (BEAT)

- ▶ Generally, a “base erosion tax benefit” is:
 - i. Any deduction allowed for the taxable year under Chapter 1 with respect to a base erosion payment;
 - ii. In the case of a base erosion payment with respect to the purchase of property of a character subject to the allowance for depreciation (or amortization in lieu of depreciation), any deduction allowed in Chapter 1 for depreciation or amortization in lieu of depreciation with respect to the property acquired with such payment;
 - iii. In the case of a base erosion payment with respect to reinsurance payments, any reduction under section 803(a)(1)(B) in the gross amount of premiums and other consideration on insurance and annuity contracts for premiums and other consideration arising out of indemnity insurance and any deduction under 832(b)(4)(A) from the amount of gross premiums written on insurance contracts during the taxable year for premiums paid for reinsurance; and
 - iv. Any reduction in gross receipts with respect to a payment described above with respect to certain expatriated/inverted groups (became a surrogate foreign corporation after 11/9/2017) in computing gross income of the taxpayer for the taxable year

Base Erosion Provisions (BEAT)

- ▶ The BEAT is calculated through a complex formula. The BEAT generally is the excess of 10% (5% applies for one year for base erosion payments paid or accrued in tax years beginning after 12/31/2017 and 12.5% for tax years after 12/31/2025) of “**modified taxable income**” of the taxpayer for the tax year over an amount equal to the regular US tax liability (defined in section 26(b)) of the taxpayer for the tax year reduced (but not below zero) by the excess (if any) of the credits allowed under Chapter 1 against such regular tax liability over the sum of: (1) the credit allowed under section 38 for the taxable year which is properly allocable to the research credit determined under section 41(a), plus (2) the portion of the applicable section 38 credits not in excess of 80 percent of the lesser of the amount of such credits or the base erosion minimum tax amount (determined without regard to this clause (2)).
 - ▶ Applicable section 38 credits means the credit allowed under section 38 for the taxable year which is properly allocable to: (A) the low-income housing credit determined under section 42(a), (B) the renewable electricity production credit determined under section 45(a), and (C) the investment credit determined under section 46, but only to the extent properly allocable to the energy credit determined under section 48.
 - ▶ For taxable years beginning after December 31, 2025, the regular tax liability is reduced by the aggregate amount of the credits allowed under Chapter 1 (and no other adjustment is made);
 - ▶ Increased rate for certain banks and security dealers (see section 59A(b)(3))



Base Erosion Provisions (BEAT)

- To determine **modified taxable income**, the taxpayer computes its taxable income for the year without regard to any base erosion tax benefit with respect to any base erosion payment or the base erosion percentage of any allowable NOL deduction allowed under section 172 for the tax year
 - Any base erosion tax benefit attributable to any base erosion payments on which tax is imposed under section 871 or 881 and with respect to which tax has been deducted and withheld under section 1441 or 1442 are not taken into account in computing modified taxable income or the base erosion percentage (the amount not taken into account in computing modified taxable income is reduced under rules similar to the rules under section 163(j)(5)(B) (as in effect before the enactment of the Tax Cuts and Jobs Act)
- ▶ Applicable to base erosion payments paid or accrued in taxable years beginning after 12/31/17





Base Erosion Provisions

- ▶ Denies a deduction for certain related party interest and royalty amounts paid or accrued pursuant to certain hybrid transactions, or by, or to, hybrid entities when certain conditions are satisfied
 - Broad regulatory authority to expand scope of provision
 - Applicable to taxable years beginning after 12/31/17
- ▶ Limitations on income shifting through intangible property transfers (including treating workforce in place and goodwill and going concern value as section 936(h)(3)(B) intangibles/use of aggregate methods of valuing transfers of intangibles codified)
 - Applicable to transfers in taxable years beginning after 12/31/17
- ▶ No preferential tax rates on dividends received from a surrogate foreign corporation (section 7874(a)(2)(B)) that becomes a surrogate foreign corporation after date of enactment other than a foreign corporation which is treated as a domestic corporation under section 7874(b)
 - Applicable for dividends after date of enactment





Other International Provisions

- ▶ Restrictions on PFIC Insurance Business Exception--the provision modifies the requirements the income of which is not included in passive income for purposes of the PFIC rules
 - Applicable to taxable years beginning after 12/31/17

- ▶ Repeal of fair market value method of interest expense apportionment
 - Applicable to taxable years beginning after 12/31/17





Other International Provisions

- ▶ Codification of Rev. Rul. 91-32--Gain or loss from the sale or exchange of a partnership interest is ECI to the extent that the transferor would have had effectively connected gain or losses had the partnership sold all of its assets at FMV as of the date of the sale or exchange. The provision requires that any gain or loss from the hypothetical asset sale by the partnership be allocated to interests in the partnership in the same manner as non-separately stated income and loss.
 - Rules for coordinating with FIRPTA and imposing withholding regime
 - Provision treating gain/loss as ECI is applicable for sales, exchanges and dispositions on or after 11/27/17 and provision requiring withholding is applicable for sales, exchanges and dispositions after 12/31/17
 - See Notice 2018-8 for additional guidance



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