# The Impact of the Tax Cuts and Jobs Act (TCJA) After Five Years

January 23, 2023

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# 1

Speaker Bios

# *Speaker Bios*

## Reid Meyer

- Reid is a Director in PwC's International Tax Practice serving clients primarily in the private equity / private company space of the Pittsburgh and Cleveland markets. Reid has over 15 years of experience in tax planning and structuring, compliance, and tax accounting for multinational businesses of all sizes. Recently, Reid has been focused on assisting small and mid-size companies deal with the additional rigors imposed by the 2017 international tax reform passed by Congress and helping those clients manage this significant legislative change. Prior to tax practice, Reid worked supporting IBM's corporate finance and planning function in Armonk, NY.
- Reid has a JD from the University of Pittsburgh School of Law, where he was on the executive board of the Pittsburgh Tax Review, and a BS in Finance from the Pennsylvania State University. He is a member of the Bar of the Commonwealth of Pennsylvania, former Chair of the Allegheny County Bar Association Tax Section, member of the Allegheny Tax Society, and member of the Pittsburgh Tax Club, where he formerly served as President. Reid is also an Adjunct Professor at the University of Pittsburgh School of Law teaching introductory accounting for lawyers and has taught international tax courses for the MST programs at the University of Akron and Robert Morris University.

# Speaker Bios

## Tom Carpenter

- Tom is a Director in PwC's International Tax Practice with over 10 years of international tax experience. In his practice, Tom advises multinational companies on the US international tax implications of a wide range of transactions such as cross-border payments, international structuring, and operating models. From 2018 to 2020, Tom was based in London as a member of PwC UK's US International Tax Desk. In that role, Tom predominantly advised non-US multinational companies on inbound US investment in areas such as US tax treaty qualification, financing US operations, and various structuring transactions. With the exception of his time in London, Tom has been based in PwC's Pittsburgh, PA office throughout his career.
- Tom has a JD from the University of Pittsburgh School of Law, where he was Editor-in-Chief of the Pittsburgh Tax Review, and a BBA in Economics and Finance from James Madison University. He is a member of the Bar of the Commonwealths of Pennsylvania and Virginia. Tom has taught international tax courses for the MST program at Robert Morris University and has presented at various professional organizations (*e.g.*, ACBA Tax Section, TEI, etc.).

# 2

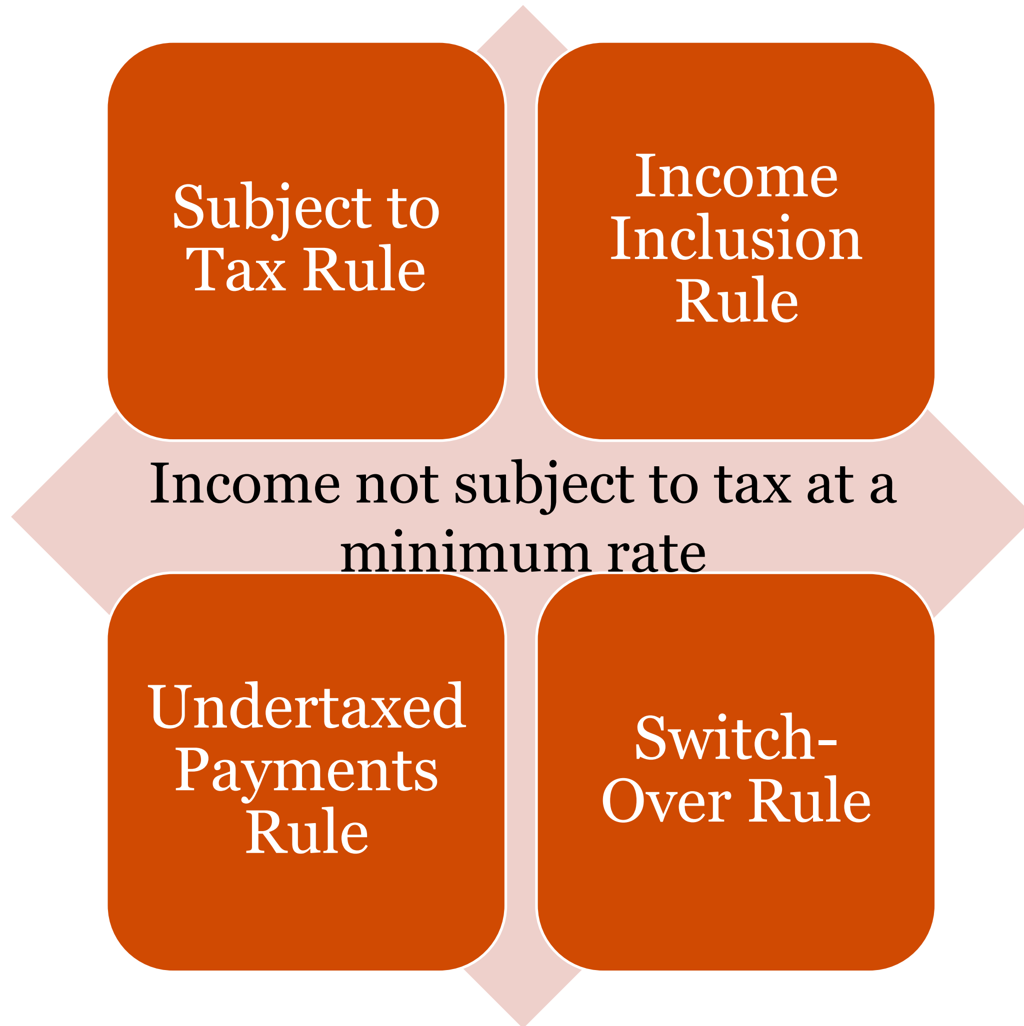
# International Tax – A Changing Landscape

# *International Tax – A Changing Landscape*

## New items and key changes since the 2017 TCJA - Reform

| Consideration | Pre-Reform | Post-Reform | Next-Steps |
|---|---|---|---|
| Overall Character | - Worldwide Taxation | - Quasi-territorial with Global Minimum Tax | - Pillar 2 Alignment? |
| Repatriating Earnings | - Taxable to US with FTC Offset | - Exemption for Foreign Dividends (C-corps)<br>- No change for Individuals / Partnerships | - No changes expected |
| Foreign Tax Credit | - Main Mechanism to Prevent Double Tax | - Reduced Importance / More Baskets | - Country-by-country reporting? |
| Anti-Deferral | - Subpart F for Unfavored Transactions<br>- Section 956 for Investment in US Property | - Subpart F Expanded to Include GILTI<br>- GILTI Serves as Global Minimum Tax<br>- Section 956 Scaled Back for C-corps | - GILTI alignment with Pillar 2 Income Inclusion Rule ("**IIR**")? |
| Export Subsidies | - Section 199 / IC-DISC | - FDII / IC-DISC | - FDII alignment with Pillar 1 sourcing rules and Pillar 2 Subject to Tax Rule ("**STR**")?<br>- FDII as a potential illegal export subsidy? |
| Base Erosion | - 163(j) - Debt-to-Equity Approach | - 163(j) with Broader Reach / Bigger Bite<br>- BEAT Regime | - BEAT alignment with Pillar 2 undertaxed payment rule ("**UTPR**")? |
| Tax Rate | - 35% | - 21%<br>- Broader base (but not Revenue Neutral) | - Unclear |

# *Pillar 2 – Overview*




- If members have agreed to enact a jurisdictional-level minimum tax system with a minimum ETR of 15%.
- Companies with global turnover above EUR 750M will be within the scope of Pillar 2, with headquarter jurisdictions retaining the option to apply the rules to smaller, domestic multinational enterprises ("**MNE**").
- Exclusions from the GloBE rules are available for pension funds or investment funds that are Ultimate Parent Entities ("**UPE**") of an MNE Group or any holding vehicles used by such entities, organizations, or funds.
- Various international shipping services will also be excluded from the GloBE rules. Countries also agreed on a number of carve-outs to the GloBE rules.

# 3

## Foreign Tax Credit

# *Foreign Tax Credit*

## General Overview

- The US tax system provides the foreign tax credit (“**FTC**”) or deduction in order to lessen the effects of double taxation since the foreign earnings have already been subject to tax in the foreign jurisdiction.
  - An FTC can be directly paid (under Section 901) or “deemed paid” (under Section 960) by a US shareholder.
  - If a domestic corporation chooses to claim a credit for foreign income taxes, the amount of the taxes deemed paid must be treated as gross income to the US corporation. This is referred to as the ‘**Section 78 gross-up**’.
- To be creditable, a foreign tax must be:
  - A compulsory payment to a foreign government, and;
  - An income tax under the US rules or a tax in lieu of an income tax.
- US corporations have an option each year to claim an FTC or a deduction for foreign income taxes against foreign source income.
- US corporations, citizens, and residents may claim foreign tax credits by filing Form 1118 (corporations) or Form 1116 (individuals).
- FTCs can be claimed once the taxes have been ‘paid or accrued’ (Section 905(a)).
- Substantiation requirement for claiming an FTC (Section 905(b)) :
  - Receipt for each tax payment for taxes already paid
  - Tax return for accrued taxes

# *Foreign Tax Credit*

## FTC Limitation

- A premise of the FTC limitation calculation is that FTCs should not reduce a taxpayer's US tax on its US taxable income, only a taxpayer's US tax on its foreign source income (by baskets).
- As such, the tax laws impose a limitation on the amount of FTCs that can be claimed in a year under section 904. The FTC limitation prevents taxpayers from using FTCs to offset US tax on US taxable income.
- Before calculating the FTC limitation, foreign source income needs to be placed into various categories of foreign source income ('baskets') (Section 904(d)).
  - Applying separate limitations by baskets prevents taxpayers from 'cross-crediting' foreign taxes on higher-tax foreign income.
  - Against foreign taxes on more mobile, lower-tax foreign income.
- There are four main FTC limitation baskets (Section 904(d)):
  - Global Intangible Low-Taxed Income ("**GILTI**") (introduced with the 2017 tax reform);
  - Foreign branch income (introduced with the 2017 tax reform);
  - Passive income; and
  - General income.

# *Foreign Tax Credit*

## High Level Overview of Final FTC Regulations

- The 2020 Final Regulations provide additional guidance with respect to the FTC regime and clarify and finalize certain aspects of the new FTC regime including:
  - the allocation and apportionment of deductions and creditable foreign taxes (*e.g.*, R&E and stewardship);
  - foreign tax redeterminations; and
  - adjustments to hybrid deduction accounts to take into account certain inclusions in income by a US shareholder.
- The 2021 Final Regulations adopt both new rules relevant to the new FTC regime and significant changes to the basic FTC architecture, including:
  - definitions of creditable foreign income taxes and taxes in lieu of income taxes, including the new attribution requirement;
  - timing rules on the foreign income tax credit claims and the period of limitations for refunds;
  - disallowance of a credit or deduction for foreign income taxes with respect to dividends eligible for a DRD;
  - allocation and apportionment of foreign taxes to different categories of gross income; and
  - transition rules relating to the carryback of post-TCJA NOLs to pre-TCJA years.
- Corrections to the 2021 Final Regulations were released in mid-2022 to update certain portions of the 2021 Final Regulations.

# *Foreign Tax Credit*

## Future Impacts

- New proposed regulations issued November 18, 2022
  - Relax some of the stringent creditability requirements of the 2021 Final Regulations.
    - Addresses cost recovery requirement.
    - Clarification on the attribution requirement for withholding tax (“**WHT**”) on royalty payments.
    - Clearer definition of a reattribution asset for allocating / apportioning foreign taxes.
  - Added flexibility to account for the wide varieties in countries' income tax laws.
  - Comments due in 60 days from publication in Federal Register (11/22/22).
- If other countries adopt Pillar 1 and Pillar 2, further changes to the FTC rules can be expected. Those changes are expected to include the computation and reporting of foreign tax credits on a country-by-country basis.

# 4

## Subpart F/GILTI

# *Subpart F/GILTI*

## General anti-deferral principles

- Since 1962, the tax code has had rules that can subject the foreign earnings of US foreign subsidiaries to immediate US taxation.
  - Such rules are referred to as ‘anti-deferral’ rules.
  - The major historical anti-deferral regime is subpart F:
    - Primarily intended to discourage passive activity in foreign jurisdictions; and
    - Also intended to discourage certain activities in tax haven jurisdictions.
- Later, expanded to include GILTI.
  - A new tax regime intended to discourage US taxpayers from shifting profits from the US to low-tax foreign jurisdictions or from generally earning profits in low-tax jurisdictions.
- Anti-deferral regimes subject US shareholders of controlled foreign corporations (“**CFCs**”) to taxation on foreign earnings, even though those earnings have not yet been distributed to the US shareholder.
  - Foreign tax credits may provide some relief.

# *Subpart F/GILTI*

## Subpart F income – Definition and categories

- US shareholders ("**USSHs**") of CFCs:
  - that own stock in the CFC on the last day of their tax year;
  - must include their pro rata share of the CFC's subpart F income for the tax year;
  - in their gross income (Section 951(a)).
- Most types of subpart F income refer to foreign base company income (Section 952(a)). Foreign base company income ("**FBCI**") (Section 954) includes:
  - foreign personal holding company income ("**FPHCI**");
  - foreign base company sales income ("**FBCSI**"); and
  - foreign base company services income ("**FBCSvcI**").
- US source income that is effectively connected with a US trade or business is excluded from the definition of subpart F income (Section 952(b)).

# *Subpart F/GILTI*

## Subpart F income - Types

| Category | Examples |
| --- | --- |
| Foreign Personal Holding Company Income | • Dividends, interest, rents, royalties, and annuities<br>• Excess of gains over losses from the sale or exchange of property:<br>– that gives rise to dividends, interest, royalties, rents, and annuities<br>– which is an interest in a trust, partnership, or REMIC, or<br>– which does not give rise to income<br>• Net gains from commodities transactions<br>• Certain foreign currency gains, income equivalent to interest, income from notional principal contracts<br>• Certain personal services contract income and<br>• Certain Section 1058 payments (payments in lieu of dividends) |
| Foreign Base Company Sales Income | • Includes income, profits, fees, gains, etc. arising when the following three requirements are met:<br>– personal property is purchased from (or on behalf of) and/or sold to (or on behalf of) a related person;<br>– the personal property was manufactured, produced, grown, or extracted outside the country in which the CFC is organized or created; and<br>– the personal property was sold for use, consumption, or disposition outside the country in which the CFC is organized or created |
| Foreign Base Company Services Income | • Arises if a CFC generates income from services that satisfy the following criteria:<br>– The services are performed for or on behalf of any related person; and<br>– The services are performed outside the CFC’s country of incorporation |

# *Subpart F/GILTI*

## Subpart F income - Exceptions

| Exceptions | FPHCI | FBCSI and FBCSvI |
|---|---|---|
| Same Country | Dividends, interest, rents and royalties received from a related person with a CFC's country of organization. | Property is manufactured or sold for 'use, consumption, or disposition' in CFC's country of incorporation. |
| CFC Look-through | Dividends, interest, rents and royalties received by one CFC from another CFC. Expired January 1, 2021. | N/A |
| Active Rents and Royalties | Rents and royalties received from unrelated persons in the active conduct of a trade or business. | N/A |
| Gain on Active Assets | Gains from the sale of property used in an active trade or business and from the sale of inventory. | N/A |
| Active Financing | Income from the active conduct of a banking, financing, insurance, or securities business. | N/A |

# *Subpart F/GILTI*

## GILTI - Overview

- GILTI is a new tax regime that applies to USSHs of controlled foreign corporations CFCs
  - A USSH is a US person that owns 10% or more of the total voting power or value of a foreign corporation;
  - A CFC is a foreign corporation that is more than 50% owned by USSHs.
- The name ‘global intangible low-taxed income’ is somewhat of a misnomer
  - It applies to more than ‘intangible’ or ‘low-taxed’ income;
  - It also applies to CFC earnings (apart from a small return on tangible property) that are not already taxed at the USSH level (such as subpart F income).
- GILTI fundamentally changed the international tax landscape because every dollar of earnings in a CFC is potentially includable to the US; functionally imposes current worldwide taxation.
- Minimal exceptions:
  - High-tax exception from August 2020
  - Credit offset for corporate taxpayers / 962 election for individuals

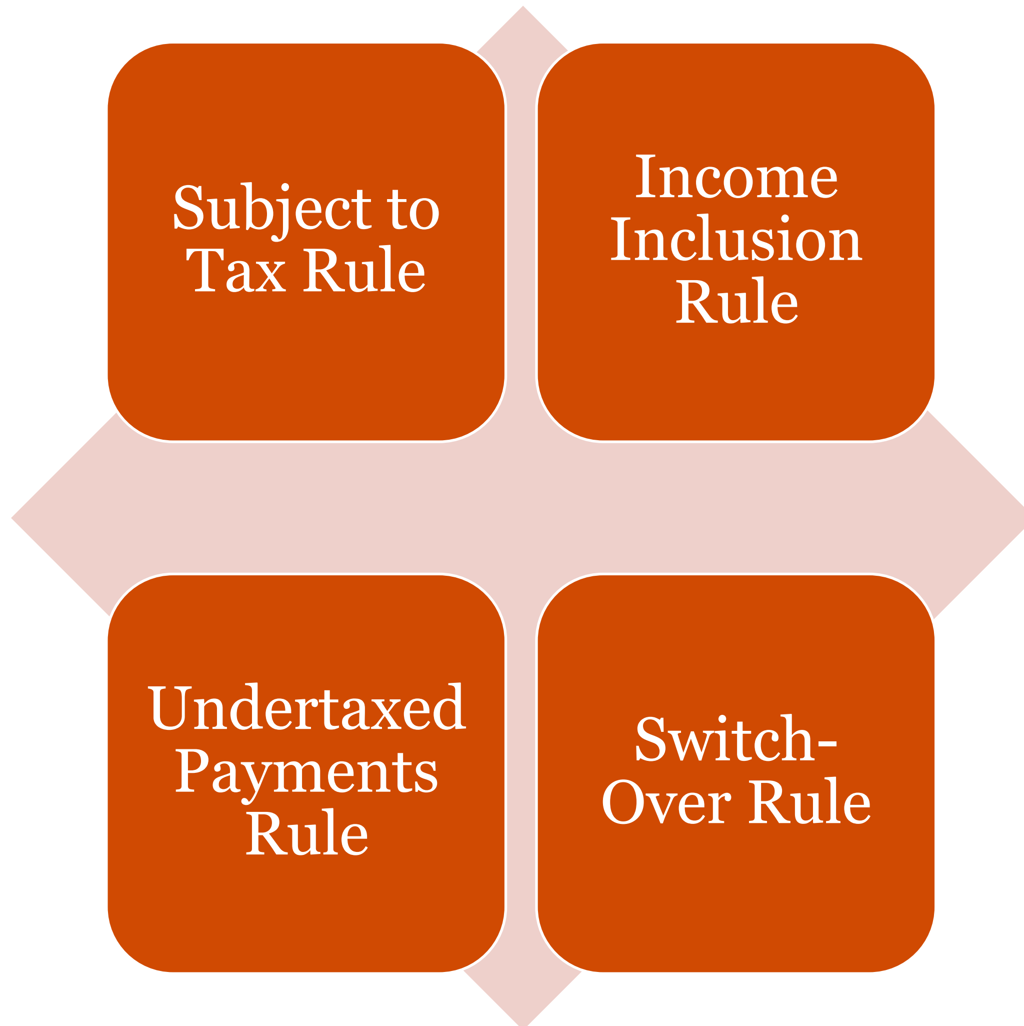
# *Subpart F/GILTI*

## GILTI definitions

- Net CFC tested income: excess of the aggregate of the US shareholder's pro rata share of the tested income of each CFC over the aggregate of its pro rata share of the tested loss of each CFC.
  - Tested income: excess of
    (i) the CFC gross income: excluding US-source ECI, subpart F income, income excluded from foreign base company income or insurance income by reason of the high-tax exception, dividends received from a related person, and foreign oil and gas extraction income over (ii) deductions (including taxes) properly allocable to such gross income (or to which such deductions would be allocable if there were such gross income).
  - Tested loss: excess (if any) of deductions (including taxes) properly allocable to the CFC's gross income determined without regard to the exclusions over the amount of gross income determined with regard to the exclusions.
- Net deemed tangible income return: amount equal to 10% of the aggregate of the shareholder's pro rata share of the qualified business asset investment ("**QBAI**") of each CFC with respect to which it is a US shareholder, reduced by the amount of interest expense taken into account in determining its net CFC tested income to the extent the interest expense exceeds the interest income properly allocable to such expense that is taken into account in determining its net CFC tested income.

# *Subpart F/GILTI*

## Interplay with Pillar 2




- As currently designed, the GILTI regime generally subjects income to an effective rate of tax below the 15% Pillar 2 threshold.
- To comply with Pillar 2, GILTI could be modified to achieve an effective tax rate of 15% or greater.
- Other modifications to the GILTI regime to make it compliant with Pillar 2 include:
  - calculating GILTI on a country-by-country basis; and
  - certain modifications to the tax base on which GILTI is calculated.

# 5

# Foreign-derived Intangible Income (FDII)

# *Foreign-derived Intangible Income (FDII)*

## Historical Export Regime

- Domestic International Sales Corporations ("**DISCs**") regime allowed US exporters to use foreign subsidiaries to sell to customers in the market country, resulting in the income earned on the sale to not be taxable in the US till repatriated.
- Extraterritorial income regime was enacted in 2000 to provide domestic taxpayers with special benefits for certain export-related income being taxed at a reduced rate which included any sale, exchange, lease, rental, furnishing or services, or any other disposition under Section 943(b)(1)(A).
- Prior to the 2017 tax reform act,
  - Section 863(b) allowed income to be sourced to both where the property was manufactured and to where it was sold.
  - Applied consistently - bifurcating the income from the sale of manufactured inventory based on place of production and place of sale.
- The 2017 Act amended Section 863(b) to provide that income from the sale of manufactured inventory is sourced solely by reference to the location of manufacture.
- Sales activity no longer is a relevant factor for apportioning income from the sale of inventory produced outside the United States and sold within the United States after the Act amended Section 863(b).
- The location of production activity is determined by the location of the underlying production assets, and the location of the underlying production assets is determined by the assets' physical location (or in the case of IP by the location of the tangible assets to which the IP relates).

# *Foreign-derived Intangible Income (FDII)*

## Overview

- While FDII is short for foreign-derived intangible income, it actually includes income derived from any of the following (as opposed to just income related to intangibles):
  - the sale, lease, license, or other disposition of property to foreign persons (includes corporations) for foreign use; and
  - providing certain services to a person, or with respect to property, not located in the US.
- Domestic corporations receive a deduction equal to 37.5% of their FDII, which is an aggregate of the consolidated group.
  - The FDII deduction (along with the 50% GILTI deduction) is subject to a taxable income limitation.
    - That is, the total deduction for FDII and GILTI is phased out proportionately if the corporation's total FDII and GILTI is greater than its taxable income (without taking the FDII and GILTI deductions into account).
    - Beginning in taxable years after 2025, the allowed Section 250(a) deduction will be equal to 21.875% of FDII and 37.5% of the GILTI plus Section 78 amounts.
  - Domestic C corporations are eligible for the deduction, but RICs, REITs, and S corporations are not.
    - Partnerships are treated as an aggregate of its partners for certain FDII calculation purposes but are treated as an entity (and as a legal person) when determining whether a sale or service is a Foreign-Derived Deduction Eligible Income ("**FDDEI**") sale or FDDEI service.
  - The FDII deduction provides a similar rate for similar income earned onshore, thereby increasing the incentive for a domestic corporation to serve foreign markets directly (rather than operate through locally formed controlled foreign corporations) in jurisdictions that would impose greater than a 13.125 % tax on income derived locally.

# *Foreign-derived Intangible Income (FDII)*

## Proposed Regulations vs Final Regulations

- The Proposed Regulations included extensive documentation requirements to support the FDDEI status of both sales and services (and different documentation is required depending on the type)
- Final Regulations require taxpayers to substantiate certain elements of the FDII deduction, thereby relaxing the onerous documentation requirements set forth in Proposed Regulations
  - For many elements, taxpayers need obtain only enough evidence to meet the general substantiation requirement under Section 6001 (required for all deductions)
  - Where Final Regulations require additional substantiation, the options provided to meet such requirement provide greater flexibility than did the Proposed Regulations' documentation options. Items providing such additional substantiation include, but are not limited to, (i) certain provisions in binding contracts, (ii) credible evidence obtained or received from the recipient in the ordinary course of business, and (iii) self-generated statements containing specified information
- Additional substantiation is required for:
  - sales of intangible property;
  - sales of general property to resellers and manufactures; and
  - the provision of general services to business recipients.

# *Foreign-derived Intangible Income (FDII)*

## Expense Allocation and Apportionment

- In general, there is a two-step process for allocating and apportioning expenses:
  - Allocate the expenses to a particular class of gross income based on the factual relationship between the deduction and class of gross income; and
  - Apportion the deduction based on the formula prescribed in regulations depending on the type of expense (Treas. Reg. sec. 1.861-8)
- Absent specific rules, deductions are allocated to the class of gross income to which they are 'definitely related' (*e.g.*, foreign source income vs. domestic income)
- Specific rules exist for interest, R&D, stewardship, deductions related to income qualifying for the Section 245A DRD, as well as certain other items
- Once a deduction has been allocated to a class of gross income, it must then be apportioned between the statutory and residual groupings, based on any reasonable method (Treas. Reg. sec. 1.861-8T(c)(1))

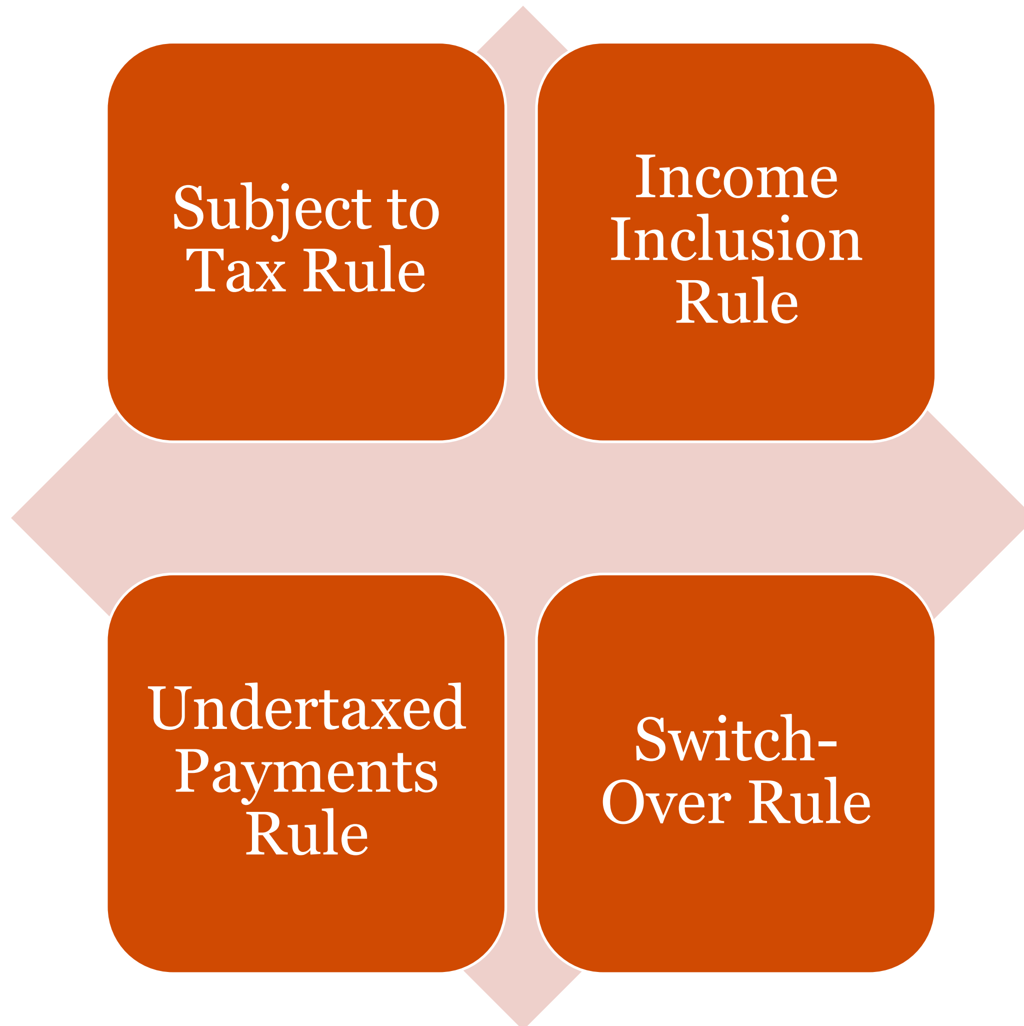
# *Foreign-derived Intangible Income (FDII)*

## Key terms - Defined

1. The **deduction eligible income ("DEI")** is eligible gross income of any domestic corporation (gross income computed without subpart F inclusions, GILTI inclusions, dividends from CFCs, foreign branch income, and certain other items) minus deductions and taxes allocated to such income.
2. The **deemed tangible income return ("DTIR")** is 10% of the corporation's QBAI. QBAI is the adjusted basis in the corporation's tangible depreciable property that it uses in its trade or business to generate DEI, based on its quarterly average and computed under the alternative depreciation system ("**ADS**"). Essentially, QBAI is determined in a manner similar to how it is used in the GILTI calculation, with some modifications.
3. The **deemed intangible income ("DII")** is the DEI minus the DTIR.
4. The FDDEI is the DEI of the company that qualifies for the FDII deduction (generally meaning sales of certain property to foreign persons for foreign use or certain services to foreign persons, or with respect to property, located outside the US).
5. The **foreign derived ratio** is the ratio of the FDDEI to DEI.

# *Foreign-derived Intangible Income (FDII)*

## Interplay with Pillar 2




- As currently designed, the FDII regime generally subjects income to an effective rate of tax below the 15% Pillar 2 threshold.
- To comply with Pillar 2, FDII could be modified to achieve an effective tax rate of 15% or greater.
- Query also whether FDII withstands other scrutiny.

# 6

# Base Erosion Provisions

# *Base Erosion and Anti-abuse Tax (BEAT)*

## Overview

**What is BEAT?**

- The Base Erosion and Anti-abuse Tax ("**BEAT**") is a minimum tax imposed on C corporations with annual gross receipts of over $500 million when they make a certain level of deductible payments (such as interest) to foreign related parties during the year (Section 59A).

**What does it mean that BEAT is a minimum tax?**

- A corporation ultimately only has additional tax liability if the amount computing with the BEAT rules exceeds its regular tax liability (discussed later).

**Why do we have a law for BEAT?**

- BEAT is a new tax regime introduced in the 2017 TCJA to prevent the erosion of the US tax base. Final BEAT regulations, along with additional proposed regulations were introduced in December 2019.
  - Base (US taxable income).
  - Erosion (the gradual destruction or reduction of the taxable base).

**Are all C corporations subject to BEAT?**

- Only 'applicable taxpayers' are subject to BEAT, which are C corporations that also meet the following thresholds:
  - $500 million in average gross receipts (over a three-year period);
  - Base erosion percentage of 3% or higher (2% or higher for banks and registered securities dealers);
    - Base erosion percentage is discussed in more detail later, but conceptually, it is the ratio of deductible payments to foreign related parties out of a corporation's total deductions (with certain exceptions, discussed later).

# *Base Erosion and Anti-abuse Tax (BEAT)*

## Overview (continued)

**Base erosion percentage**

- Calculated by dividing a corporation's total deductions for payments to foreign related parties (referred to as base erosion tax benefits) by total deductions (excluding deductions under Section 250, the Section 245A DRD, and NOL deductions).
- Base erosion tax benefits are base erosion payments that are deducted on the US return.
  - Three main types of base erosion payments include:
    - Any amount paid or accrued with respect to a foreign related party (such as interest, royalties, or service payments);
    - Payment made in purchase of property that is subject to depreciation or amortization (*i.e.*, the depreciation or amortization deduction is the associated base erosion tax benefit);
    - Certain reinsurance payments and additionally amounts paid to expatriated entities that reduce the taxpayer's gross receipts are considered base erosion payments (does not apply to most company structures).

**Exclusions to base erosion payments**

- Cost of goods sold is not a deduction as it is a reduction in gross receipts, therefore it is not a base erosion payment.
- The non-markup component of payments for services computed using the services cost method ("**SCM**") are not base erosion payments.
- Any qualified derivative payment (*i.e.*, payments made pursuant to a derivative with respect to which the taxpayer marks to market, treats any gain / loss as ordinary, and treats gain / loss on any payment made under the derivative as ordinary).

# *Base Erosion and Anti-abuse Tax (BEAT)*

## Determining BEAT liability

- Corporations subject to BEAT generally have to apply a 10% rate (known as the base erosion minimum tax rate, the applicable rate, or the specified tax rate) against their modified taxable income (“**MTI**”).
- MTI is a company’s regular taxable income plus the base erosion tax benefits for the year and the base erosion percentage of any net operating losses (“**NOLs**”).

  Regular TI + base erosion tax benefits + (base erosion percentage x NOL) = MTI.

- The amount of tax liability under BEAT that exceeds the regular taxable liability (modified for certain credits) is the base erosion minimum tax amount (“**BEMTA**”).
- BEMTA is calculated by multiplying MTI by the specified tax rate, and then reducing that amount by the regular tax liability without regard to certain credits.

  MTI * 10% - (regular tax liability + certain credits) = BEMTA

- Certain credits, including foreign tax credits, cannot be added back to the regular tax liability when computing BEMTA. Therefore, the use of foreign tax credits can increase the BEMTA.
- Taxpayers retain the benefit of the R&E credit, applicable Section 38 credits, and credits under Sections 33 and 37 (*i.e.*, these credits do not cause the BEMTA to increase).

# *Base Erosion and Anti-abuse Tax (BEAT)*

## Calculation

Applicable rate: BEAT is calculated by applying the following tax rates to a taxpayer's modified taxable income (MTI):

- 10% for tax years beginning in calendar year 2019 – 2025.
- 12.5% for tax years beginning after December 31, 2025.

These rates are increased by 1% if an applicable taxpayer is a bank (as defined in Section 581) or securities dealer (registered under Section 15(a) of the Securities Exchange Act of 1934) or is a member of a controlled group that contains a bank or securities dealer:

- 11% for tax years beginning in calendar year 2019 – 2025.
- 13.5% for tax years beginning after December 31, 2025.

The final regulations provide that Section 15 does not apply to change the tax rate for fiscal years ending in 2019. However, Section 15 will apply for fiscal-years ending in 2026. Accordingly, fiscal-year taxpayers have a:

- Blended rate between 10% and 12.5% for the tax year that includes January 1, 2026.

# *Section 163(j)*

## Overview

**General Considerations**

- Section 163(j) limits the deduction for business interest expense.
  - Regardless of whether the interest is for related party or third-party debt.
- The limitation applies to both domestic corporations and CFCs.

**What amount of interest expense is limited?**

- Businesses cannot deduct the amount of business interest expense that exceeds the sum of:
  - 30% of adjusted taxable income ("**ATI**");
  - Business interest income; and
  - Floor plan financing interest expense.

**What happens with the disallowed interest expense?**

- Disallowed interest deductions can be carried forward indefinitely.

**Anti-Avoidance**

- A new broad anti-avoidance rule enables the IRS to treat items as interest expense if they are (i) economically equivalent to interest; and (ii) a principal purpose of structuring the transaction(s) is to reduce an amount that treated as interest under Section 163(j).
  - 'Interest' income may also be recharacterized as 'non-interest' income if a principal purpose of the transaction(s) is to artificially increase business interest income.

# *Anti-Hybrid & Section 267A*

## Overview

**The anti-hybrid rules**

- Intended to stop abusive activity related to hybrid entities and hybrid instruments.
- Targeted abusive activity is generally where a taxpayer utilizes hybrid instruments or entities to receive a double tax benefit
  - First, when making the payment, such as by claiming a deduction for the payment;
  - Second, when the related party does not include the payment as income, such as through a participation exemption.
- Payments already included in a USSH's subpart F or GILTI inclusion are not subject to the anti-hybrid rules.

**Hybrid instruments**

- Instruments treated as debt by one country for which interest deductions are available, but as equity in another country so that payments are excluded under a participation exemption or similar regime.

**Section 267A**

- Section 267A denies a deduction for interest and royalties paid or accrued by a corporation to a related foreign party with respect to either (1) hybrid transactions or (2) hybrid entities.
- Specifically, the anti-hybrid rules apply to a payment made pursuant to a hybrid transaction or made by, or to, a hybrid entity, to the extent that there is no income inclusion by the foreign related party under the tax laws of its country of tax residence or the related party is allowed a deduction with respect to such amount under the tax laws of its country of tax residence.

# *Future Developments*

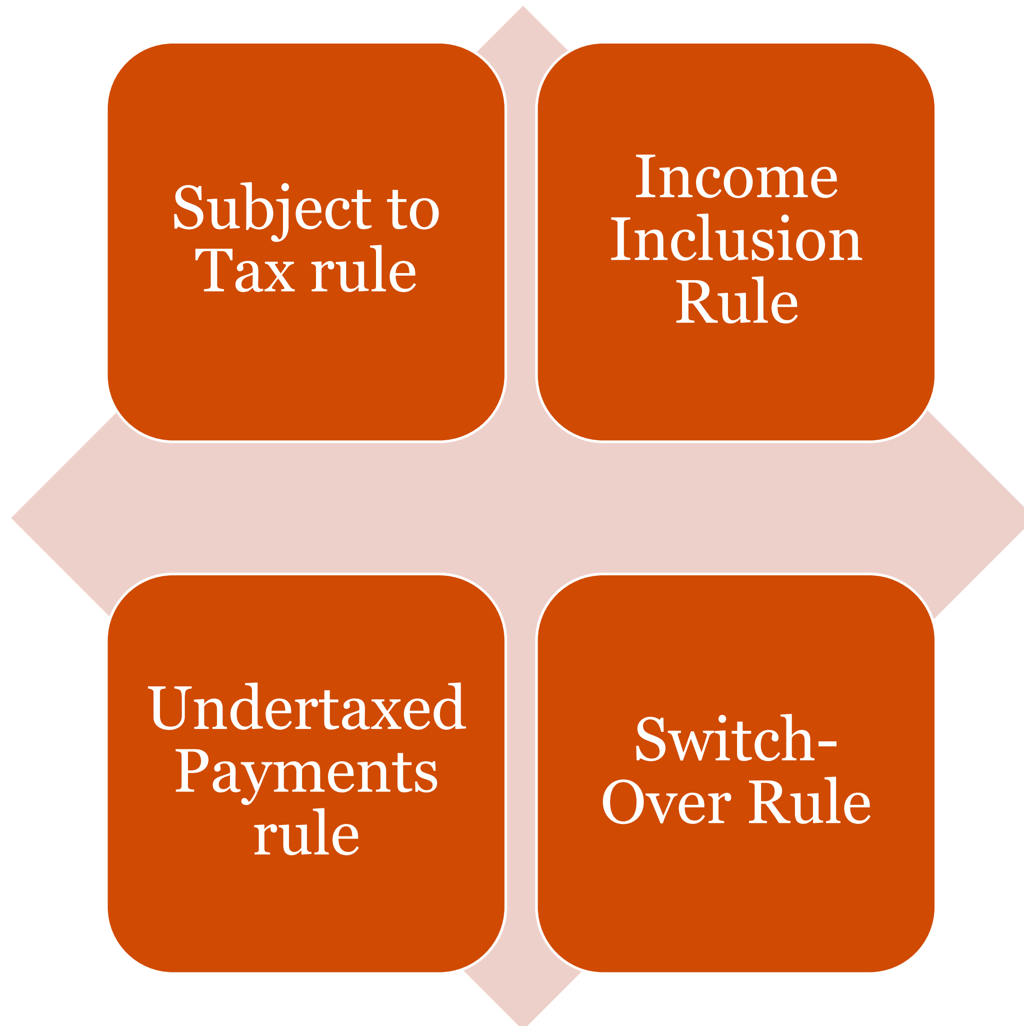
## Overview

**Section 163(n)**

- Proposal intends to limit deductibility of interest expense of multinational's U.S. operations that is part of an international financial reporting group ("**IFRG**") to its proportionate share of the group's interest expense
- Specified domestic corporation ("**SDC**") deduction for interest expense is limited to 110% of net interest expense ("**NIE**") multiplied by the "allowable percentage"
- Allowable percentage is equal to the SDC's allocable share of IFRG's book NIE over the SDC's NIE
- Generally, applies to any domestic corporation that is part of an IFRG
- Exceptions for domestic corporations with average NIE of less than $12 million over last three years, small businesses (defined under Section 163(j)(3)), and S corporations, REITS, and RICs

# *Future Developments – Base Erosion Payments*

## Interplay with Pillar 2




- Undertaxed Payment Rule may step in to address base erosion payments made to jurisdictions not charging sufficient tax locally (15%).
- Consider whether in the form of a new rule supplementing current US base erosion provisions or whether substantial rewrite would be done to implement UTPR.

# Thank you

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