

International Provisions of the “Tax Cuts and Jobs Act”

BACKGROUND

Allegheny Tax Society

Harvard Yale Princeton Club

617 – 619 William Penn Place

Pittsburgh, PA 15219

Monday, Dec. 17, 2018, 6:00 – 7:00 PM



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ATS TCJA – Dec. 17, 2018 - BACKGROUND.pptx

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Overview

Base Erosion and Profit Shifting (“BEPS”)

Race to the Bottom

Organization for Economic Cooperation and Development (“OECD”) and Group of 20 (“G-20”) - Actions

European Union (“EU”) – Anti-Tax Abuse Directive (“ATAD”)

Brexit

Donald J. Trump – Candidate for President of the United States of America

Donald J. Trump – President of the United States of America

Legislative Branch of USA Government – Republican Control

Big Six Proposal – September 27, 2017

Pub. L. No. 115-97 (December 22, 2017)

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Base Erosion and Profit Shifting (“BEPS”)

Debt versus Equity

Hybrid Entities

Hybrid Instruments

High Tax Countries (France, Germany, Italy, Spain, United Kingdom, etc.)

Low Tax Countries (Belgium, Cyprus, Gibraltar, Ireland, Luxembourg, Netherlands, etc.)

Deductible Dividends (Hybrids)

Non-Taxable Dividends (Participation Exemptions)

Profit Participating Loans (“PPL”) (Hybrids)

Check-the-Box (“CTB”) Elections

IRC § 954(c)(6) [look-thru rule for related CFCs], (h) [banking or financing business], and (i) [insurance business]

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Race to the Bottom

Due to Base Erosion and Profit Shifting (“BEPS”), countries began to compete by lowering corporate income tax rates and making certain types of income (such as dividends) totally or partially free of corporate income tax (total or partial participation exemption)

Countries competed by **NOT** having certain rules, regarding

Controlled Foreign Corporations (“CFCs”)

Thin Capitalization to minimize Interest Expense Deductions

Permanent Establishment creating Taxable Nexus or Presence

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OECD and G-20 - Actions

1. Addressing the Tax Challenges of the Digital Economy
2. Neutralizing the Effects of Hybrid Mismatch Arrangements
3. Designing Effective Controlled Foreign Company Rules
4. Limiting Base Erosion Involving Interest Deductions and Other Financial Payments
5. Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance
6. Preventing the Granting of Treaty Benefits in Inappropriate Circumstances
7. Preventing the Artificial Avoidance of Permanent Establishment Status
8. – 10. Aligning Transfer Pricing Outcomes with Value Creation
11. Measuring and Monitoring BEPS
12. Mandatory Disclosure Rules
13. Transfer Pricing Documentation and Country-by-Country Reporting – Form 8975
14. Making Dispute mechanisms More Effective
15. Developing a Multilateral Instrument to Modify Bilateral Treaties

EU – Anti-Tax Abuse Directive (“ATAD”)

Controlled foreign company (CFC) rule: to deter profit shifting to a low / no tax country

Switchover rule: to prevent double non-taxation of certain income

Exit taxation: to prevent companies from avoiding tax when re-locating assets

Interest limitation: to discourage artificial debt arrangements designed to minimize taxes

General anti-abuse rule: to counteract aggressive tax planning when other rules do not apply

Brexit

United Kingdom departing from the EU

Soft Brexit – Harmony with EU - negotiated terms of departure

Hard Brexit – More UK control after departure from EU, but “crash out” of EU

Target Departure Date – March 29, 2019

EU remaining 27 member states have agreed to negotiated terms of departure

UK Prime Minister, Theresa May (who survived a no confidence vote by her own Conservative Party on Dec. 12, 2018), is trying to convince UK Parliament to support negotiated terms of departure – January 21, 2019 deadline

Donald J. Trump – Candidate for President of the USA

Anti-establishment candidate

Supported by voters who thought they were forgotten (left behind)

No vested interest in USA institutions, prior policies, or prior or current leaders

Real estate developer who hates taxes and government regulation

Campaign promises:

- a. Restore USA manufacturing and mining,
- b. Roll Back Patient Protection and Affordable Care Act (“PP” and “ACA”),
- c. Roll Back Environmental Regulations,
- d. Disrupt Establishment, and
- e. Others

Make America Great Again (“MAGA”)

America First

Donald J. Trump – President of the USA

Executive Order 13771 (Jan. 30, 2017) – withdraw at least 2 prior regulations for each new regulation issued

Executive Order 13789 (Oct. 16, 2017) - 8 tax regulations identified for withdrawal

Paris Climate Agreement (174 signatories + EU) – USA not a signatory

Kyoto Protocol – USA not a signatory (signatories not ratified)

Trans-Pacific Partnership (“TPP”) – USA not a signatory

North American Free Trade Agreement (“NAFTA”) – Out (Maybe)

US Mexico Canada Agreement (“USMCA”) – In (Maybe)

Immigration Executive Orders – Many overturned by US 9th Cir. Ct. of Appeals

Tariffs – Steel 25%, Aluminum 10%, Autos __%, China __%, Other __%

Disrupter versus Dysfunctional

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Legislative Branch of USA Gov't – Republican Control

US House of Representatives (Simple majority carries vote)

Republicans 236

Democrats 197

Vacancies 2

Total 435

US Senate (60% carries vote on most revenue matters, but simple majority carried vote for Pub. L. No. 115-97)

Republicans 52

Democrats 48

Total 100

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Big Six Proposal – September 27, 2017

Paul Ryan (R-Wisconsin) – US House of Representatives - House Speaker

Orrin Hatch (R-Utah) – US Senate - Finance Committee Chairman

Mitch McConnell (R-Kentucky) – US Senate - Majority Leader

Kevin Brady (R-Texas) – US House of Representatives - House Ways and Means Chairman

Steven Mnuchin – US Treasury Secretary

Established Tax Policy
for Pub. L. No. 115-97
View to 2018 elections

Gary Cohn – National Economic Council Director

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Pub. L. No. 115-97 (December 22, 2017)

All support from Republicans

No support from Democrats

All Republican staff drafting

No Democratic staff drafting

No US Treasury staff drafting

300 – 500 pages of legal text depending of size of print

500 pages of Committee Reports

1000 + pages of Proposed Treasury Regulations

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International Provisions of the “Tax Cuts and Jobs Act”¹

¹ (The informal name of Pub. L. No. 115-97 (“Act”), which was enacted on December 22, 2017. Complications arose when the House-passed measure reached the Senate later in the day, after the Senate parliamentarian determined that the short title (along with two (2) other provisions) violated the chamber’s Byrd Rule because they had either no impact or only an incidental impact on the federal budget and would need to be stripped out of the bill, unless supporters could produce 60 votes to overcome a point of order. A subsequent effort to waive the point of order failed by a party-line vote of 51 Republican – 48 Democrat. (Striking the short title means that the measure is not officially called the *Tax Cuts and Jobs Act* and is now known only by its formal title: *An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018.*)

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Overview

Former international tax rules remain – Except where changed

Foreign Tax Credit (“FTC”)

Transition Tax (“TT”)

Global Intangible Low-Taxed Income (“GILTI”) with 100% Dividends Received Deduction (“DRD”) (Participation Exemption)

Business Interest Expense Deduction Limiters

Foreign Derived Intangible Income (“FDII”)

Base Erosion Anti-Abuse Tax (“BEAT”)

Branch Income

Hybrid Transactions

Miscellaneous Changes

Accounting - SAB 118 and ASC Topic 740, *Income Taxes*

If Regulations become final within 18 months of enactment (by June 22, 2019), they can be retroactive to date of enactment – Dec. 22, 2017 – IRC § 7805(b)(2)

Overview - Former International Tax Rules Remain – Except Where Changed

- 21% Tax Rate for Corporations
- Subpart F Income
- High Tax Exception (“HTE”)
- Previously Taxed Income (“PTI”)
- Foreign Tax Credits (“FTCs”)

21% Tax Rate for Corporations

For calendar year corporations, the US income tax rate and alternative minimum tax rate follows:

Prior to 2018:

Regular Income Tax – 15%, 25%, 34%, and 35%

Alternative Minimum Tax - 20%

After 2017

Regular Income Tax – 21%

Alternative Minimum Tax (Repealed) – 0%

Non-Calendar Year End Corporations (Year-End Not December 31, 2017):

Proration based on days before and after December 31, 2017

IRC §§ 11, 15, and 55, Notice 2018-38, and IR-2018-99

Subpart F Income

Subpart F Income is foreign income that is taxable annually in the US whether or not distributed, unless certain exceptions apply

Foreign Personal Holding Company Income ("FPHCI"): – Dividends, Interest, Royalties, Rents, unless from a Controlled Foreign Corporation ("CFC") and not otherwise reducing subpart F income, received prior to 2020

Foreign Base Company Sales Income ("FBCSI"): - Personal property purchased from a related person and sold outside the country in which the purchaser is created or organized, unless used by purchaser to manufacture

Foreign Base Company Services Income ("FBCServicesI"): - Income from the performance of services for or on behalf of a related person performed outside the country under laws of which the CFC is created or organized

Insurance Income: - Income from insurance or annuity contracts from a CFC

This is **NOT** a comprehensive analysis of subpart F income

IRC §§ 951, 952, 953, and 954(a), (c), (d), and (e) and Prop. Treas. Reg. §§ 1.952-1 and 1.954-1

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Subpart F Income – IRC § 954(c)(6)

Sec. 954(c)(6) excludes dividends, interest, rents, and royalties received from related controlled foreign corporations from income of US shareholder that would ordinarily be taxed under subpart F from Jan. 1, 2006 to Dec. 31, 2019, if from active conduct of a trade or business.

Income from inter-company loans creates interest income that is currently taxed in the US as sub-part F income, unless (a) the income is from a corporation created under the laws of the same country as the lending entity ("**Same Country Exception**") or (b) the interest income is taxed to the recipient at a rate that is at least 90% of the US highest tax rate – prior to 2018 was 31.5% ($35\% \times 90\% = 31.5\%$) and after 2017 is 18.9% ($21\% \times 90\% = 18.9\%$) ("**High Tax Exception**").

Interest income generated among entities, which are a single entity for US tax purposes, is disregarded for US tax purposes and does NOT create sub-part F income. The funding of payments of interest among entities can create sub-part F dividend income that is currently taxed in the US, unless the dividends are (1) PTI, (2) same country exception, or (3) high tax exception or (4) funded by loans.

This is **NOT** a comprehensive analysis of subpart F income

IRC §§ 951, 952, and 954(a), (b)(4), (c)(6), (d), and (e)

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Subpart F Income – Individuals – Taxed as Corporation

Individuals required to pay tax on their share of Subpart F income can elect to be taxed as corporations.

Election is based on Revenue Act of 1962 with some minor amendments.

Few individuals have made the election.

IRC §§ 951, 951A, 953, 954, and 962

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High Tax Exception

An item of income that would be taxable annually in the US under subpart F, whether or not distributed, would not be so taxed if it bears a rate of income tax that is at least 90% of the maximum US regular income tax rate and an **election** is made to exclude from taxation

Prior to 2018:

Regular Income Tax – 15%, 25%, 34%, and 35%

High Tax Exception – 31.5%

After 2017

Regular Income Tax – 21%

High Tax Exception – 18.9%

Fiscal year end taxpayers - blended rates based on days before and after December 31

IRC §§ 11, 15, and 954(b)(4) and Treas. Reg. § 1.954-1(d)(5) and Prop. Treas. Reg. § 1.954-1(d)(3)

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Previously Taxed Income (“PTI”)

PTI is foreign income that was previously taxed in the US

When PTI is distributed, it is not taxed in the US again, except when the entity distributing the PTI has a Functional Currency (“FC”) that is not the US dollar

If the entity making the distribution has a FC other than the US dollar, foreign currency gain or loss is recognized due to changes in the rate of exchange between the dates the income is taxed and the dates that the PTI is distributed

There may be additional FTC in the year of receipt of PTI (when distributed)

IRC §§ 959 and 986(c) and Prop. Treas. Reg. § 1.960-4

Previously Taxed Income (“PTI”) – Tax Basis in Shares

IRC § 959(c)(1) – IRC § 956 investment in US property, guarantees, pledges =
IRC § 961 tax basis – IRC § 986(c) applicable

IRC § 959(c)(2) – IRC §§ 951 & 954 subpart F income & IRC § 951A GILTI = IRC §
961 tax basis – IRC § 986(c) applicable

IRC § 959(c)(2) – IRC § 965(a) PTI – PTI from TT income (net of E&P deficits) =
IRC § 961 tax basis – IRC § 986(c) applicable

IRC § 959(c)(2) – IRC § **965(b) PTI** – PTI from TT linking IRC § 965(a) PTI to E&P
deficits **≠** IRC § 961 tax basis – IRC § 986(c) **NOT** applicable

IRC §§ 951, 951A, 954, 956, 959, 961, and 986(c) and Prop. Treas. Reg. § 1.956-
1(a)(2) and (3) and (g)(4) and (5)

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Overview – Foreign Tax Credits (“FTCs”)

- Computation
- Excess FTCs
- FTC Limiters
- IRC § 901(m) – Covered Asset Acquisitions
- Reduce Cash Tax – FTCs Less Useful
- FTCs – Categories of Income
- FTCs – Gross Up
- FTCs – Individuals – GILTI
- FTCs – Tax Forms
- FTCs – Proposed Treasury Regulations

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Foreign Tax Credits (“FTC”) - Computation

Separate computation for each category of income

(a) FTC for US Category of Income Limit = Tax on World Wide Income X $\frac{\text{All of a Category of Income Minus Allocated and Apportioned Expenses}}{\text{World Wide Income Taxed in US}}$

(b) Actual Foreign Tax on Category of Income

Lesser of (a) or (b) is allowable FTC for Category of Income

IRC §§ 861-865, 904(a) and (d) and Treas. Reg. § and Prop. Treas. Reg. § with 1.861 preface 12

Excess Foreign Tax Credits (“FTC”)

Carry Back (“C/B”) 1 Year and Carry Over (“C/O”) 10 Years – But NOT for GILTI

IRC § 904(c) and (d)(1)(A) and Prop. Treas. Reg. § 1.904-2 and -3

10 Years to Change Election to Claim FTC or Deduct Foreign Income Taxes, Rather than General 3 Year Statute of Limitations for Refunds – Foreign Tax Deductions, Rather than FTCs, can Reduce GILTI

IRC §§ 901 and 6511(d)(3) and Treas. Reg. § 1.901-1(d)

Unable to Claim FTC Due to Losses

IRC § 904(a) and Prop. Treas. Reg. § 1.904-2, -3, -4, and -5

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FTC Limiters

There is no discussion herein of additional US tax costs attributable to allocations and apportionment of interest expenses, research & experimental expenses, stewardship expenses, or other expenses under IRC §§ 861 & 864(e).

Also, there is no discussion herein of categories of foreign source income and the relationship of categories of foreign source income to categories of FTCs under IRC § 904(d) and recapture of Overall Foreign Loss and recharacterization of Overall Domestic Loss (“ODL”) under IRC § 904(f) & (g).

All of the issues identified herein (other than ODL) limit the use of FTCs to offset US tax obligations on various types of foreign source income. ODL recapture allows use of excess FTCs.

See the next slide for “covered asset acquisitions under IRC § 901(m).
Treas. Reg. § & Prop. Treas. Reg. § with 1.861 preface

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IRC § 901(m) - Covered Asset Acquisitions

Entities that make an IRC § 338 election (timely filing Forms 8023 / 8883) for a corporation or make an IRC § 754 election for a partnership or other transaction to step up the basis of their assets to FMV on the acquisition date for US tax purposes and do not have similar treatment under local law have made “covered asset acquisition.”

Some (maybe all) local income taxes paid by entities that make IRC §§ 338 and 754 elections might not be creditable for US tax purposes because the entity acquisitions making IRC §§ 338 and 754 elections will be making “covered asset acquisitions,” which limit available Foreign Tax Credits (“FTCs”) for US tax purposes under IRC § 901(m).

Foreign tax, if not creditable due to IRC § 901(m), will be deductible under IRC § 164(a)(3) and (b)(3) and IRC §§ 78 and 275 will not apply. IRC § 901(m)(6).

Although IRC § 901(m) was enacted in 2010, Treasury Regulations providing direction to taxpayers have not yet been proposed or promulgated.

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Reduce Cash Tax – Foreign Tax Credits (“FTCs”) Less Useful

Historically, we have been able to claim 100% of FTCs to offset 100% of US tax obligations

GILTI provides *de minimis* benefit for foreign taxes paid

Due to the Act and allocations and apportionments of interest, research & experimental, stewardship, and other expenses against foreign source income causing overall foreign losses, it is possible that taxpayers will **deduct**, rather than claim FTCs, for foreign taxes paid. Foreign taxes are now offering little significant US tax benefit. Related party interest is becoming more beneficial

IRC §§ 164, 275, 861, 864(e), 901, 904(f), 960(a), and 6511(d)(3) and Treas. Reg. § 1.901-1(d)

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Foreign Tax Credits (“FTCs”) – Categories of Income

Use of FTCs is limited to certain categories of income

(A) GILTI * (Other than Passive Category Income)

(B) Foreign Branch Income

(C) Passive Category Income **

(D) General Category Income **

Other Categories of Income are not herein addressed

Categories of Income	Foreign Tax Credit Categories			
	GILTI	For. Branch	Passive	General
GILTI	X		X	
Foreign Branch		X	X	
Subpart F			X	X

* - Does not carry back and does not carry over

** - Can apply against subpart F income and effectively connected income

Excess FTCs from a category of income cannot offset US tax obligations from another category of income – Cross crediting of excess FTCs is not permitted

IRC §§ 904(c) & (d)(1) & for TT §§ 902 & 960 before January 1, 2018 & Treas. Reg. § 1.904-6 and Prop. Treas. Reg. §§ 1.904-4, -5, and -6

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Foreign Tax Credits (“FTCs”) – Gross Up

Generally, 100% of categories of FTCs are added to 100% of categories of income to arrive at taxable income for a category of income.

However, only 80% of GILTI FTCs are allowed to offset 100% of GILTI taxable income

Excess GILTI FTCs do not carry back and do not carry over

Excess FTCs related to other categories of income do carry back and carry over.

IRC §§ 78 and 960(d)(1) and Prop. Treas. Reg. §§ 1.78-1, 1.904-2 and -3, and 1.960-1, and -2

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Foreign Tax Credits (“FTCs”) – Individuals - GILTI

Individuals required to pay tax on their share of GILTI income can elect to be taxed as corporations.

However, 50% of GILTI deduction is not available to individuals.

Election is based on Revenue Act of 1962 with some minor amendments.

Few individuals have made the election.

IRC §§ 250, 951A, and 962

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Foreign Tax Credits (“FTCs”) – Tax Forms

Form 1116 – Foreign Tax Credit (Individual, Estate, or Trust)

Form 1118 – Foreign Tax Credit - Corporations

Separate Forms 1116 and 1118 are required for each category of income:

- (A) GILTI (Other than Passive Category Income)
- (B) Foreign Branch Income
- (C) Passive Category Income
- (D) General Category Income

Other Categories of Income are not herein addressed

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Foreign Tax Credit ("FTC") – Proposed Treasury Regulations

§ 1.78-1 Gross up for deemed paid foreign tax credit

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§ 1.861-8 Computation of taxable income from sources within the United States and from other sources and activities [also issued under 26 U.S.C. 250(c), 864(e)(7), and 882(c).]

§ 1.861-9 and 1.861-9T Allocation and apportionment of interest expense and rules for asset-based apportionment [also issued under 26 U.S.C. 863(a), 26 U.S.C. 864(e)(7), 26 U.S.C. 865(i), and 26 U.S.C. 7701(f).]

§ 1.861-10(e) Special allocations of interest expense - Classification of hybrid stock [also issued under 26 U.S.C. 863(a), 26 U.S.C. 864(e)(7), 26 U.S.C. 865(i), and 26 U.S.C. 7701(f).]

§ 1.861-11 Special rules for allocating and apportioning interest expense of an affiliated group of corporations [also issued under 26 U.S.C. 863(a), 26 U.S.C. 864(e)(7), 26 U.S.C. 865(i), and 26 U.S.C. 7701(f).]

§ 1.861-12 Characterization rules and adjustments for certain assets [also issued under 26 U.S.C. 864(e)(7).]

§ 1.861-13 Special rules for characterization of controlled foreign corporation stock [also issued under 26 U.S.C. 864(e)(7).]

§ 1.861-14 [Amended]

312 pages with Preamble when released – Nov. 28, 2018

§ 1.861-17 Allocation and apportionment of research and experimental expenditures

285 pages as sent to the Federal Register – Dec. 7, 2018

REG-105600-18, RIN 1545-B062, 83 Fed. Reg. ___

§ 1.901(j)-1 Denial of foreign tax credit with respect to certain foreign countries

§ 1.904-1 Limitation on credit for foreign taxes [also issued under 26 U.S.C. 904(d)(7).]

§ 1.904-2 Carryback and carryover of unused foreign tax [also issued under 26 U.S.C. 904(d)(7).]

§ 1.904-3 Carryback and carryover of unused foreign tax by spouses making a joint return [also issued under 26 U.S.C. 904(d)(7).]

§ 1.904-4 Separate application of section 904 with respect to certain categories of income [also issued under 26 U.S.C. 250(c)21, 904(d)(2)(j)(i), 904(d)(6)(C), 26 U.S.C. 904(d)(7), and 26 U.S.C. 951A(f)(1)(B).]

Foreign Tax Credit ("FTC") – Proposed Treasury Regulations

§ 1.904-5 Look-through rules as applied to controlled foreign corporations and other entities [also issued under 26 U.S.C. 904(d)(7), and 26 U.S.C. 951A(f)(1)(B).]

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§ 1.904-6 Allocation and apportionment of taxes [also issued under 26 U.S.C. 904(d)(7).]

§ 1.904(b)-3 Disregard of certain dividends and deductions under section 904(b)(4)

§ 1.904(f)-12 Transition rules

§ 1.952-1 [Amended]

§ 1.954-1 Foreign base company income

§ 1.960-1 Overview, definitions, and computational rules for determining foreign income taxes deemed paid under section 960(a), (b), and (d) [also issued under 26 U.S.C. 960(f).]

§ 1.960-2 Foreign income taxes deemed paid under sections 960(a) and (d) [also issued under 26 U.S.C. 960(f).]

§ 1.960-3 Foreign income taxes deemed paid under section 960(b) [also issued under 26 U.S.C. 960(f).]

§ 1.960-4 Additional foreign tax credit in year of receipt of previously taxed earnings and profits [also issued under 26 U.S.C. 951A(f)(1)(B) and 26 U.S.C. 960(f).]

§ 1.960-5 [Amended]

312 pages with Preamble when released – Nov. 28, 2018

285 pages as sent to the Federal Register – Dec. 7, 2018

REG-105600-18, RIN 1545-B062, 83 Fed. Reg. ___

§ 1.960-6 [Amended]

§ 1.960-7 Applicability dates

§ 1.965-5 Allowance of a credit or deduction for foreign income taxes [also issued under 26 U.S.C. 965(o).]

§ 1.965-7 Elections, payment, and other special rules [also issued under 26 U.S.C. 965(o).]

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(Repatriation) Transition Tax ("TT") - Summary

- Overview
- Computation of Tax Rates
- TT Computation
- Cash Equivalents
- Elections
- E&P Deficit Foreign Corporations
- Installment Payments - Generally
- Installment Payments – C Corporations
- Installment Payments – S Corporations
- Installment Payments – US S/Hs REITS
- Expatriated Entities (Inversions)
- Specified Foreign Corporation ("SFC")
- Affiliated Groups
- Individuals – Taxed as Corporations
- Anti-Abuse Rule
- E&P Inclusion
- Limited Use of Foreign Tax Credits
- State Income Tax
- Form 965
- Notices
- Proposed Treasury Regulations
- Revenue Procedures
- Publication 5292
- Frequently Asked Questions

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(Repatriation) Transition Tax ("TT") - Overview

Post-1986 Earnings & Profits ("E&P") pay TT at the higher amount of E&P (excluding current year subpart F income) as of Nov. 2, 2017 or Dec. 31, 2017 for calendar year end corporations (based on last fiscal year beginning before January 1, 2018) translated (if necessary) using the spot rate into USD on December 31, 2017 – "IRC § 965(a) earnings amount" limited to pro rata share without reduction for dividends, except to another Specified Foreign Corporation ("SFC"), if it increases its E&P – only tax one (1) time

Positive E&P can be offset with E&P deficits (only to common shareholders with none to preferred shareholders), resulting in "IRC § 965(a) inclusion amount"

Pre-existing PTI & Effectively Connected Income ("ECI") as of the measurement date is not subject to TT

E&P in the form of **cash** (including equivalents) is taxed at a rate of 15.5% *

Remaining E&P (**non-cash**) is taxed at a rate of 8% *

* - Creates "IRC 965 PTI" and basis in shares until distributed

Statute of limitations is 6 years from filing of return

Can satisfy TT liability with excess FTCs & / or with cash (1 payment or 8 installments) **

** - Can elect not to use Net Operating Losses so that TT is satisfied with FTCs and / or cash

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IRC §§ 961 and 965 and Prop. Treas. Reg. 51.965-1 and -7

Transition Tax ("TT") – Computation of Tax Rates

E&P in the form of **cash** (including equivalents) is taxed at a rate of 15.5% *

Remaining E&P (**non-cash**) is taxed at a rate of 8% * (Participation Exemption)

A deduction is provided to arrive at the above tax rates considering general corporate rate of 35%, 21%, or a blended rate under IRC § 15 – "IRC § 965(c) deduction amount" (Participation Exemption)

FTCs ** used to offset TT are subject to a reduction (haircut) and are not deductible:

55.7% = $(1 - (15.5\% / 35\%))$ of foreign taxes on **cash** E&P are disallowed and

77.1% = $(1 - (8\% / 35\%))$ of foreign taxes on **non-cash** E&P are disallowed

IRC § 78 gross up only applies to foreign taxes generated with the mandatory inclusion

When PTI from TT is distributed, WHT, subject to a reduction (haircut) on distribution, is creditable or deductible

* - Creates IRC § 965 PTI

** - for 10 / 50 SFCs, no FTCs allowed below 3rd tier

IRC §§ 11, 15, and 965(c) and (g) and Prop. Treas. Reg. § 1.965-1 & -5

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Transition Tax ("TT") – TT Computation

Five (5) step process:

1. Determine SFC's subpart F income
2. Treatment of any distributions made by SFC to another SFC before January 1, 2018 is determined under IRC § 959
3. SFC's IRC § 965(a) inclusion is determined
4. Treatment of all other distributions made by the SFC (other than those determined under step 2) is determined under IRC § 959
5. An amount is determined under IRC § 956 with respect to the SFC and its US shareholders

Following each above step, the SFC's E&P is adjusted to account for each relevant item

IRC §§ 965, Notice 2018-07, and Prop. Treas. Reg. § 1.965-2

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Transition Tax (“TT”) – Cash Equivalents

The following are examples of cash equivalents:

1. Net accounts receivable
2. Commercial paper, certificates of deposit, and securities of US, state, or foreign government
3. Foreign currency
4. Obligation with a term of less than 1 year
5. Publicly traded stock owned by Specified Foreign Corporations (“SFC”)
6. Commodities representing inventory / supplies
7. Derivatives as cash positions can have positive and negative values netted but not below zero
8. Accounts payable for inventory and supplies, but **NOT** certain depreciable properties

Double counting and double non-counting are prohibited

Last year beginning before Jan. 1, 2018 (> Dec. 31, 2017 or Nov. 2, 2017) **OR** average of 2 years prior to Nov. 2, 2017 – Rule for cash equivalents

IRC §§ 965(c)(3) and 1221(a)(1), (2), (4), and (8), Notice 2018-78, § 3, 2018-42 I.R.B. 605 at 605, and Prop. Treas. Reg. § 1.965-1(f) Definitions generally and -4(f)

Transition Tax (“TT”) – Main Elections

1. Election by individual US shareholders of SFC to be taxed as corporations
2. Election to make adjustments to basis by reason of IRC § 965(b) (offset E&P with E&P deficits) – Not follow general rule – Notice 2018-78, § 2. See next slide
3. Paying TT in installments
4. S corporation shareholders
5. US shareholders that are Real Estate Investment Trusts
6. Not to apply Net Operating Loss deduction *
7. Use alternative method for calculating post-1986 E&P (52-53 week year)

Each provision has separate detailed rules

* – Deductions allocated & apportioned (not deferred) – Prop. Treas. Reg. § 1.965-7(e)(1)

No Treas. Reg. §§ 301.9100-2 or -3 relief for late elections. For basis elections, see Notice 2018-78, § 2, 2018-42 I.R.B. 604 at 605. [REG-104226-18, RIN 1545-B051, 83 Fed. Reg. __ (Oct. 10, 2018)]

IRC §§ 11, 172, 961, 962, 965(b), (h), (i), (m), and (n) and Prop. Treas. Reg. §§ 1.962-1(b) and 1.965-2(a) and 1.965-2(f)(2) and -7 Elections and payment rules

Transition Tax (“TT”) – E&P Deficit Foreign Corporation

E&P deficit of an E&P deficit foreign corporation used to reduce a US shareholder’s IRC § 965(a) inclusion increases the E&P of the E&P deficit foreign corporation in the following year

No adjustment (increase) is made to the basis of stock to account for any reduction in a US shareholder’s IRC § 965(a) inclusion, even though the E&P not included in income is treated as IRC 965(b) PTI

However, a US shareholder can **elect** [can delay until final regulations are issued] to the following basis adjustments for **all** SFCs:

- Basis of DFIC stock is increased by the IRC § 965(b) PTI
- Basis of E&P deficit foreign corporation is reduced by the US shareholder’s IRC § 965(b) PTI (could result in taxable income, if basis is exhausted)

IRC §§ 961(a) and 965(b), Notice 2018-78, § 2, 2018-42 I.R.B. 604 at 605, and Prop. Treas. Reg. § 1.965-2(d)(2) and (f)(2)

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Transition Tax (“TT”) – Installment Payments - Generally

May elect payments due by the due date of tax return without regard to extensions.

For calendar year corporations – Generally, installment payments are due April 15:

8% - Each of 2018, 2019, 2020, 2021, and 2022 (40%) *

15% - 2023 *

20% - 2024 *

25% - 2025 *

All installments payments are interest free

IRC § 965(h) and (k) and Prop. Treas. Reg. § 1.965-7(b) * - For 2017 calendar year³⁰

Transition Tax (“TT”) – Installment Payments – C Corp.

Acceleration of all remaining TT installment payments regarding C corporation SFC if:

1. Failure to pay any required installment;
2. Liquidation;
3. Sale of substantially all assets, unless buyer enters into agreement with Secretary to be liable for remaining installment payments;
4. Cessation of business; and
5. Any similar circumstance

Some acceleration features may not apply, if an understatement is **NOT** due to negligence, intentional disregard of the statute or regulations, or fraud

IRC § 965(h) and Prop. Treas. Reg. § 1.965-7(b)(1) and (3)

31

Transition Tax (“TT”) – Installment Payments – S Corp.

US shareholder of an S corporation SFC can elect to defer TT payment reporting deferred tax liability annually until triggering events, including:

1. Corporation ceases to be an S corporation;
2. Liquidation;
3. Sale of substantially all assets, unless buyer enters into an agreement with the Secretary to be liable for remaining installment payments;
4. Cessation of business;
5. Any similar circumstance;
6. Transfer of shares of S corporation (including by reason of death);
7. Joint and several liability of S corporation with shareholders on deferred payments; and
8. Additional special rules regarding S corporations

The US shareholder of an S corporation and the S corporation are **jointly and severally liable** for deferred payments, penalties, and additions to tax – Footnote disclosure in Financial Statements

IRC § 965(i) and (j) and Prop. Treas. Reg. § 1.965-7(c)

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Transition Tax (“TT”) – Instal. Pymnts. – US S/Hs REITS

US shareholder that is a Real Estate Investment Trust (“REIT”) may elect to pay their share of TT in 8 installments.

Triggering events for acceleration of TT installments are similar to those of a C corporation

Amounts taken into income of a US shareholder that is a REIT in computing TT is not gross income that is taken into account under IRC § 856(c)(2) and (3) to remain eligible as a REIT

Special rules apply to US shareholders which are REITs - those rules are not herein discussed

IRC §§ 856(c) and 965(c) and (m) and Prop. Treas. Reg. § 1.965-7(d)

33

Transition Tax (“TT”) – Expatriated Entities (Inversions)

Special rules apply to Expatriated Entities (Inversions):

If within 10 years of enactment of the Tax Cuts and Jobs Act, Pub. L. No 115-97 (December 22, 2017) a domestic corporation expatriates, then the untaxed portion (deduction – participation exemption) of a deferred foreign income under IRC § 965(c) is taxed at 35% to a US shareholder with no credits allowed against the increase in tax

Possible unfavorable US tax consequences of inversion, other than those from IRC § 965 above noted, also apply to expatriating entities

IRC §§ 965(c) and (l) and 7874 and Prop. Treas. Reg. § 1.965-3(d)(2) and (e)

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Transition Tax (“TT”) – Specified Foreign Corporation (“SFC”)

SFC is defined as:

Any Controlled Foreign Corporation (“CFC”) and

Any Foreign Corporation with respect to which 1 or more domestic corporations is a US shareholder ($\geq 10\%$ of voting power or value) [treated like a CFC for taking into account subpart F income]

CFC – US shareholders have $> 50\%$ of voting power or value of corporation with both up and down chain for ownership attribution from foreign corporations – downward ownership attribution from a foreign person is now permitted – Old IRC § 958(b)(4) was repealed by Pub. L. No. 115-97, § 14213(a)(1) – (2)

SFC is **NOT** a Passive Foreign Investment Company (“PFIC”)

IRC §§ 951(b), 957, 958, 965(e), & 1297 & Prop. Treas. Reg. § 1.965-1(d) & (f)(45)³⁵

Transition Tax (“TT”) – SFC - Types

SFC are defined differently by E&P:

- Deferred Foreign Income Corporation (“DFIC”) = Accumulated post-1986 deferred foreign income of more than zero (0) = Post-1986 E&P, **ex**cluding ECI and PTI
- E&P Deficit Foreign Corporation (“EPDFC”) = Post-1986 E&P deficit, **in**cluding ECI, PTI, and other E&P
- Neither = Not a DFIC and not an EPDFC

If a corporation is both a DFIC and EPDFC, then it is deemed to be a DFIC

IRC § 965(b)(3)(B) and (d) & Prop. Treas. Reg. § 1.965-1(f)(17) and (22)

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Transition Tax (“TT”) – Affiliated Groups

All members of the consolidated group that are US shareholders of an SFC are treated as a single US shareholder for purposes of:

1. IRC § 965(b) (E&P deficit offset rule)
2. IRC § 965(h), (k), and (n) relating to the election to pay the IRC § 965 net tax liability in installments, the extended statute of limitations, and the election to forgo the use of net operating losses

However, all members of a consolidated group are **NOT** treated as a single US shareholder for certain other purposes, including for purposes of determining:

- i. the amount of any member’s inclusion (may limit use of E&P deficits) or
- ii. the foreign income taxes deemed paid (may limit use of FTCs)

IRC §§ 951, 958, and 965, Notice 2018-78, § 3, 2018-42 I.R.B. 604 at 605, and Prop. Treas. Reg. § 1.965-1(b)(2), -7, and -8 37

Transition Tax (“TT”) – Individuals – Taxed as Corporations

Individual US shareholders who are required to pay tax on their share of DFIC income can **elect** to be taxed as domestic corporations (receiving benefit of indirect FTCs)

Election permits an IRC 965(c) deduction to individual US shareholders, but no other deductions

Election to pay IRC § 965 TT liability in installments is available to individuals, but IRC § 1411 tax on TT related net investment income cannot be paid in installments

Basis increased in shares for tax paid on Gross Income inclusions – Distributions of E&P on G.I. inclusion exceeding tax paid on G.I. inclusion are included in G.I. – Distributions exceeding E&P are recoveries of tax basis & those exceeding tax basis = gain from sale or exchange of property

Election is based on IRC § 962 enacted by Revenue Act of 1962 with some minor amendments

See IRC § 1248(b)(1) and (d)(1) for FTC & E&P for sales by an individual of a CFC

IRC §§ 11, 961, 962, 965, and 1411 & Prop. Treas. Reg. §§ 1.962-1(b) & -2(a) and 1.965-3(e)³⁸

Transition Tax ("TT") – Anti-Abuse Rule

The Anti-Abuse Rule can apply, even if the reduction in an IRC § 965 tax liability is offset by an increase in TT pursuant to another provision

Accounting method changes reducing TT are subject to the Anti-Abuse Rule even if the change is to go from an impermissible method of accounting to a permissible method of accounting, such as the Alternative Depreciation System for Certain Property ("ADS"), e.g. used predominantly outside the US

The Anti-Abuse Rule prohibits certain elections to become a disregarded entity

The Anti-Abuse Rule prohibits certain changes in accounting periods

The Anti-Abuse applies on a SFC-by-SFC basis (and year-by-year)

IRC §§ 168(g)(1)(A), 951, 958, and 965 and Prop. Treas. Reg. § 1.965-4

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Transition Tax ("TT") – E&P Inclusion

1 / 2

USP = US Parent

FS 1 = Foreign Subsidiary 1 (France)

FS 2 = Foreign Subsidiary 2 (Germany)

FS 3 = Foreign Subsidiary 3 (United Kingdom)

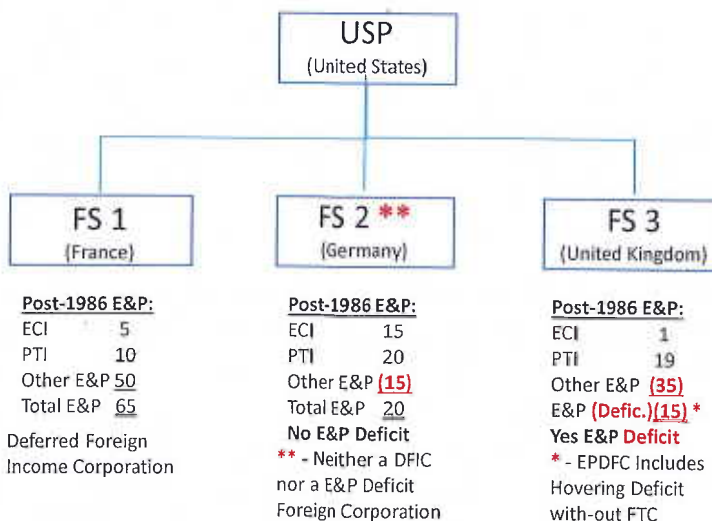
Post-1986 E&P = Earnings & Profits Accumulated after 1986

ECI – Effectively Connected Income - Previously Taxed in US

PTI = Previously Taxed Income – Previously Taxed in US

Other E&P = Post-1986 E&P (**Deficit**) Not Previously Taxed in US

TT is assessed on the post-1986 E&P of a ≥ 10% owned Specified Foreign Corporation that has not been previously taxed in US minus post-1986 E&P



Post-1986 E&P:	
ECI	5
PTI	10
Other E&P	50
Total E&P	65

Deferred Foreign Income Corporation

Post-1986 E&P:	
ECI	15
PTI	20
Other E&P	15
Total E&P	20
No E&P Deficit	

** - Neither a DFIC nor a E&P Deficit Foreign Corporation

Post-1986 E&P:	
ECI	1
PTI	19
Other E&P	35
E&P (Defic.)	15 *

Yes E&P Deficit
* - EPDFC Includes Hovering Deficit with-out FTC

IRC § 965 and Prop. Treas. Reg. § 1.965-1(g) and -2(d)

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Transition Tax ("TT") – E&P Inclusion

2 / 2

TT is assessed on the post-1986 E&P of a ≥ 10% owned Specified Foreign Corporation ("SFC") that has not been previously taxed in US minus post-1986 E&P

Computation of TT to USP for Calendar Year 2017 Based on Net Post-1986 E&P Not Previously Taxed in US:

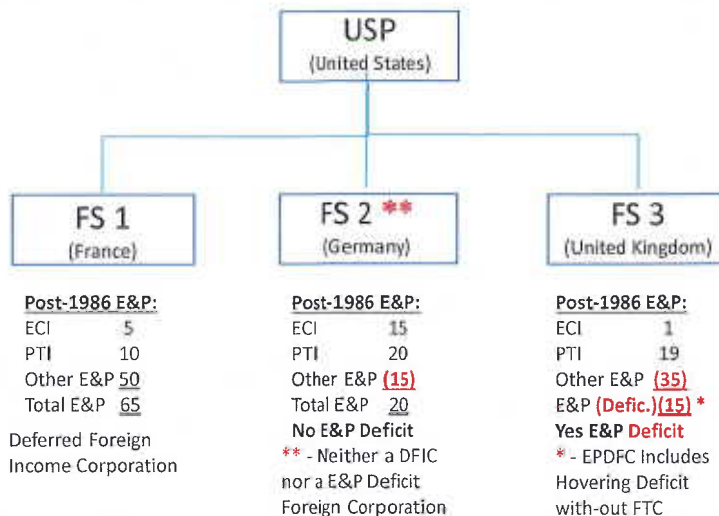
FS 1 (DFIC)	50
FS 2 (Neither) **	0
FS 3 (EPDFC) *	(15)
TT Base	35 (A)

TT Tax Computation:

Cash (Includes Equivalents)		
	@ 15.5% X 15 =	2.325
Non-Cash	@ 8.0% X 20 =	1.600
TT	(A) 35	3.925

TT is Payable in 1 Payment or in 8 Installment Payments

IRC § 965 and Prop. Treas. Reg. § 1.965-1(g) and -2(d)



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TT - IRC § 965 - Taxation of Distributions

IRC § 959(c)(2) – IRC § 965(a) PTI – Previously Taxed Income ("PTI") from TT income (net of E&P deficits) = IRC § 961 tax basis – IRC § 986(c) applicable

IRC § 959(c)(2) – IRC § 965(b) PTI – PTI from TT linking IRC § 965(a) PTI to E&P deficits ≠ IRC § 961 tax basis – IRC § 986(c) NOT applicable

IRC § 245A – IRC 965(c) – Participation exemption from TT – Deductions resulting in reduced rates of tax on distributions – Cash & equivalents E&P - 15.5% and other E&P 8% - Not taxed when distributed ≠ IRC § 961 tax basis – IRC § 986(c) NOT applicable

IRC §§ 245A, 951, 951A, 954, 956, 959, 961, and 986(c) and Prop. Treas. Reg. §§ 1.965-5 and -7

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Transition Tax (“TT”) – State Income Tax

1 / 6

States differ – Rolling or current adoption of Federal tax law

State law may assess TT as Subpart F income or dividend

Tax forms may or may not address TT

State income usually starts with Form 1120, Line 28 or 30

TT is an attachment to Form 1120 – Not on Line 28 or 30

Pennsylvania taxes dividends – including the net IRC § 965 inclusion, but subject to a Dividends Received Deduction (“DRD”)

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TT – State Income Tax – Major Grouping Summary

2 / 6

Effective Dec. 22, 2017, P.L. 115-97, the 2017 tax act, amends [I.R.C. § 965](#) to impose a mandatory tax on post-1986 accumulated foreign earnings. These post-1986 earnings are reported on IRC Form 965 Transition Tax Statement and do not flow through to page 1 of the federal Form 1120. This treatment represents a unique situation for state income tax purposes.

Of the 50 states and the District of Columbia, 5 do not impose an income tax. Of the remaining 46, **14** have issued no guidance with regard to IRC § 965 income. Those states are:

Alaska	Mississippi
Arizona	Montana
Delaware	Nebraska
District of Columbia	New Mexico
Hawaii	Oklahoma
Iowa	Virginia
Kentucky*	West Virginia

* - Kentucky excludes all dividend income

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TT – State Income Tax – Major Grouping Summary 3 / 6

11 states either do not conform to the changes under IRC Section 965, or have issued guidance instructing taxpayers to exclude 965 repatriated earnings from the taxable income computation entirely. Those are:

Arkansas	New Hampshire
California	North Carolina
Florida	South Carolina
Georgia	Tennessee
Michigan	Wisconsin
Minnesota	

8 states will include the net 965 income in their calculation. The net 965 income will be subject to some form of DRD in that state. Those states are:

Alabama	Maryland
Illinois	North Dakota
Kansas	Pennsylvania
Louisiana	Rhode Island

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TT – State Income Tax – Major Grouping Summary 4 / 6

9 states will include only the gross 965 earnings. The gross earnings will be subject to some form of DRD in that state: Those states are:

Connecticut	New Jersey
Indiana	New York
Maine	Oregon
Massachusetts	Utah**
Missouri	** - Utah calculates Repatriation separate from income tax. 50% DRD applies

3 states include 965 earnings with no DRD. These states are:

Colorado (net)***	*** - Colorado allows offset thru foreign source income exclusion
Idaho (gross)	
Vermont (net)****	**** - Vermont offers a foreign dividend subtraction modification, however, guidance does not indicate whether 965 earnings will qualify for this.

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TT – State Income Tax – State by State Summary 5 / 6

	No Guidance	Include 965(a)	Include 965(c)	Subject to State DRD	Notes
1 Alabama		X	X	X	
2 Alaska	X				
3 Arizona	X				Requires Addback of all dividend income received, provides subtraction for dividends from foreign corporations
4 Arkansas					Does not conform, does not tax 965 income, only dividends received are taxed.
5 California					Does not conform, does not include 965 income
6 Colorado		X	X		No DRD in Colorado. Portion of 965 will be excluded through foreign source income exclusion
7 Connecticut		X		X	CT DRD will offset entire amount of dividend income from foreign corporations
8 Delaware	X				
9 District of Columbia	X				
10 Florida					Excludes 965 income
11 Georgia					Excludes 965 income
12 Hawaii	X				
13 Idaho		X			
14 Illinois		X	X	X	
15 Indiana		X		X	
16 Iowa	X				Does not conform to IRC 965
17 Kansas		X	X	X	
18 Kentucky	X				Excludes all dividends from calculation of KY Income Tax
19 Louisiana		X	X	X	
20 Maine		X			2016 DRD
21 Maryland		X	X	X	
22 Massachusetts		X		X	

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TT – State Income Tax – State by State Summary 6 / 6

	No Guidance	Include 965(a)	Include 965(c)	Subject to State DRD	Notes
23 Michigan		X		X	MI excludes all dividend income
24 Minnesota					Exclude all repatriation amounts, only actual dividends received are taxable
25 Mississippi	X				Requires subtraction for dividends from foreign corporations
26 Missouri		X		X	
27 Montana	X				presumably, 965 would be included in income, but subject to MT DRD
28 Nebraska	X				Requires subtraction for deemed dividends from corporations not subject to the IRC
29 Nevada					No Income Tax
30 New Hampshire					No Income Tax
31 New Jersey		X		X	Does not conform to IRC 965
32 New Mexico	X				For tax years beginning 1/1/17 and after, NJ will exclude 95% of deemed repatriation for 80% owned subs
33 New York		X		X	Allows a subtraction for dividends received from a foreign corporation
34 North Carolina					965(a) amounts will be included with other exempt CFC income and subtracted from FTI
35 North Dakota		X	X	X	Exclude all repatriation amounts
36 Ohio					No Income Tax
37 Oklahoma	X				
38 Oregon		X		X	Offers credit for any tax attributable to 965 income
39 Pennsylvania		X	X	X	
40 Rhode Island		X	X	X	
41 South Carolina					Does not conform, do not include repatriation on SC-1120
42 South Dakota					No Income Tax
43 Tennessee					Exclude all repatriation amounts
44 Texas					
45 Utah		X		X	Repatriation calculated on form TC-20R. 965(a) less allocated interest expense
46 Vermont		X	X		VT 965 guidance does not reference if 965 income is eligible for DRD
47 Virginia	X				
48 Washington					No Income Tax
49 West Virginia	X				
50 Wisconsin					Does not conform
51 Wyoming					No Income Tax

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Transition Tax (“TT”) – Limited Use of Foreign Tax Credits

FTCs related to TT IRC § 965(a) inclusions should be subject to IRC §§ 861 through 865 and the regulations thereunder for allocating and apportioning deductions to separate categories of income described in IRC § 904(d)(1).

No IRC 965(a) inclusions should be considered to create exempt income or exempt assets. This is so even though IRC § 965(a) inclusions have been reduced by deductions under IRC § 965(b) from E&P Deficit Foreign Corporations and by deductions under IRC § 965(c), which result in a net tax on cash and equivalents E&P of 15.5% and of 8% on other E&P.

IRC §§ 861 – 865, 904(d)(1), and 965 and Treas. Reg. § 1.904-4(m) and -6 and Prop. Treas. Reg. § with 1.861 preface and Prop. Treas. Reg. §§ 1.904-1, -2, -3, -4, -5, and -6

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Transition Tax (“TT”) – Form 965

Form 965 – Inclusion of Deferred Foreign Income Upon Transition to Participation Exemption System

(Filed in 2019 for 2017 amounts)

Schedule A – U.S. Shareholder’s Section 965(a) Inclusion Amount

Schedule B – Deferred Foreign Income Corporation’s Earnings & Profits (E&P)

Schedule C – U.S. Shareholder’s Aggregate Foreign Earnings & Profits Deficit

Schedule D – U.S. Shareholder’s Aggregate Foreign Cash Position

Schedule E – U.S. Shareholder’s Aggregate Foreign Cash Position - Detail

Schedule F – Foreign Taxes Deemed Paid by Domestic Corporation (for US shareholder’s 2017 tax year)

Schedule G - Foreign Taxes Deemed Paid by Domestic Corporation (for US shareholder’s 2018 tax year)

Draft IRS Form 965 Instructions (Rev. Jan. 2019) (Released Dec. 12, 2018)

(Released Aug. 30 and Sept. 5, 2018)

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Transition Tax (“TT”) – Form 965

Form 965-A – **Individual** Report of Net 965 Tax Liability [has an **S Corp. section**] (released Oct. 9, 2018)

Form 965 – Inclusion of Deferred Foreign Income Upon Transition to Participation Exemption System
(**Filed in 2019 for 2017 amounts**)

Schedule A – U.S. Shareholder’s Section 965(a) Inclusion Amount

Schedule B – Deferred Foreign Income Corporation’s Earnings & Profits (E&P)

Schedule C – U.S. Shareholder’s Aggregate Foreign Earnings & Profits Deficit

Schedule D – U.S. Shareholder’s Aggregate Foreign Cash Position

Schedule E – U.S. Shareholder’s Aggregate Foreign Cash Position - Detail

Schedule F – Foreign Taxes Deemed Paid by Domestic Corporation (for US shareholder’s 2017 tax year)

Schedule G - Foreign Taxes Deemed Paid by Domestic Corporation (for US shareholder’s 2018 tax year)

(Released Aug. 30 and Sept. 5, 2018, except Form 965-A)

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Transition Tax (“TT”) – Notices

1/2

Notice 2018-07, 2018-4 I.R.B. 317 and IR-2017-212 – Foreign Cash Position, Accumulated Post-1986 Deferred Foreign Income, Basis Increases for Amounts Treated as Subpart F Income under IRC § 965, Affiliated Group Making a Consolidated Return, & Foreign Currency Gain or Loss under IRC § 986(c).

Notice 2018-13, 2018-6 I.R.B. 341 and IR-2018-09 – SFC as a Deferred Foreign Income Corp. (“DFIC”) or an E&P Deficit Foreign Corporation, Alternative Method for Calculating Post-1986 E&P, Treatment of Deficits, Aggregate Foreign Tax Position, & Translation Rules.

Notice 2018-26 (IR-2018-79), 2018-16 I.R.B. 480 – IRC § 318(a)(3)(A) to Treat a Foreign Corporation as a SFC, Cash Measurement Dates of a SFC with Respect to a US Shareholder, Treatment of Certain Accrued Foreign Income Taxes for Purposes of Determining Post-1986 E&P, Prevention of the Reduction of TT Liability of a US Shareholder, Rules Related to Elections, Reporting, and Payment, & Treatment of IRC § 965(c) Deduction for Purposes of IRC §§ 62(a) and 63(d).

IRC §§ 62(a), 63(d), 318(a)(3)(A), 961, 965, and 986(c) and IR-2018-53

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Transition Tax (“TT”) – Notices

2 / 2

Notice 2018-78, § 2, 2018-42 I.R.B. 604 at 605 – Proposed §1.965-2(f)(2) allows a section 958(a) U.S. shareholder (as defined in proposed §1.965-1(f)(33)) to elect to make certain basis adjustments with respect to each deferred foreign income corporation (as defined in proposed §1.965-1(f)(17)) and each E&P deficit foreign corporation (as defined in proposed §1.965-1(f)(22)) (such election, the “basis election”). Proposed §1.965-2(f)(2)(iii)(B)(1)(i) provides the general rule that the basis election must be made no later than the due date (taking into account extensions, if any) for the section 958(a) U.S. shareholder’s return for the first taxable year that includes the last day of the last taxable year of a deferred foreign income corporation or E&P deficit foreign corporation of the section 958(a) U.S. shareholder that begins before January 1, 2018. If the due date referred to in proposed §1.965-2(f)(2)(iii)(B)(1)(i) occurred before September 10, 2018, proposed §1.965-2(f)(2)(iii)(B)(1)(ii) (the “transition rule”) provides that the basis election must be made by October 9, 2018.

The final regulations will provide that the transition rule will apply with respect to returns due (determined with regard to any extension) before the date that is 90 days after the date that the final regulations are published and that in such cases the basis election must be made no later than 90 days after the publication of the final regulations in the Federal Register. In addition, the final regulations will provide that if a basis election was made on or before the date the final regulations are published, the basis election may be revoked no later than 90 days after the publication of the final regulations in the Federal Register. Relevant tax returns must be filed consistently with an election that has been made and not revoked. [REG-104226-18, RIN 1545-B051, 83 Fed. Reg. __ (Oct. 10, 2018)]

Transition Tax (“TT”) – Proposed Treasury Regulations

§1.962-1 Limitation of tax for individuals on amounts included in gross income under section 951(a)

§1.962-2 Election of limitation of tax for individuals

§1.965-0 Outline of section 965 regulations

§1.965-1 Overview, general rules, and definitions

§1.965-2 Adjustments to earnings and profits and basis

§1.965-3 Section 965(c) deductions

§1.965-4 Disregard of certain transactions

§1.965-5 Allowance of credit or deduction for foreign income taxes

§1.965-6 Computation of foreign income taxes deemed paid and allocation and apportionment of deductions

249 pages with Preamble when released – Aug. 1, 2018

62 pages as sent to the Federal Register – Aug. 9, 2018

REG-104226-18

§1.965-7 Elections and payment rules

§1.965-8 Affiliated groups (including consolidated groups)

§1.965-9 Applicability dates

§1.986(c)-1 Coordination with section 965 - IRC § 965 & Treas. Reg. § 1.441-2(c).

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Transition Tax (“TT”) – Revenue Procedures

Rev. Proc. 2018-17, 2018-9 I.R.B. 384 – SFC seeking to change its taxable year that ends of December 31, 2017. A 52-53-week taxable year is deemed to begin on the first day of the calendar month nearest to the first day of the 52-53 week taxable year, and is deemed to end or close on the last day of the calendar month nearest to the last day of the 52-53-week taxable year.

Rev. Proc. 2018-47, 2018-39 I.R.B. 518 - Regulated Investment Companies (“RICs”) owning $\geq 10\%$ of SFC with deferred foreign income from November and December 2017 can treat it as arising in 2018 for excise tax purposes. This is because the excise tax on undistributed earnings is calculated on a calendar basis for most types of income, but capital gains and other types of unpredictable income are calculated on an October 31 year-end basis.

IRC §§ 852, 951, 965, 988, 1296, 4982 & Treas. Reg. § 1.441-2(c) and IR-2018-53 ⁵⁵

Transition Tax (“TT”) – Publication 5292

1 / 2

Publication 5292, How to Calculate Section 965 Amounts and Elections Available to Taxpayers – For use in preparing **2017** Returns. Apr. 06, 2018 –

Worksheet 1.1 – 965 Workbook:

Part I – Section 965(a) Inclusion

Part II – Section 965(c) Deduction

Worksheet A – US Shareholders IRC § 965(a) Amount;

Worksheet B – DFIC E&P;

Worksheet C – US Shareholder’s Aggregate Foreign E&P Deficit;

Worksheet D – US Shareholder’s Aggregate Foreign Cash Position;

Worksheet E – US Shareholder’s Aggregate Cash Position – Detail;

Worksheet F (Omitted);

Worksheet G – Foreign Taxes Deemed Paid by Domestic Corporation for 2017 Tax Year; &

Worksheet H, Section 1 Disallowance of FTC and Amounts Reported on Forms 1116 and 1118

IRC § 965

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Transition Tax ("TT") – Publication 5292

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Worksheet 2.1 – 965 Deferral Worksheet for Individuals:

Part I – Report of Net 965 Tax Liability and Election to Pay in Installments

Part II – Record of Amount of Net 965 Tax Liability Paid by the Taxpayer

Worksheet 2.2 – 965 Deferral Worksheet for Individuals:

Part III – S Corporation Shareholder Computation of Net 965 Tax Liability Related to 965 Related Amounts

Worksheet 2.3 – 965 Deferral Worksheet for Individuals:

Part IV – Annual Report of Deferred net 965 Tax Liability related to 965 Inclusions from S Corporations

Worksheet 3.1 – 965 Deferral Worksheet for Corporations:

Part I - Report of Net 965 Tax Liability and Election to Pay in Installments

Part II – Record of Amount of Net 965 Tax Liability Paid by the Taxpayer

Part III – Real Estate Investment Trust Deferral of Net Section 965(a) Inclusion

IRC § 965

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Transition Tax ("TT") – Frequently Asked Questions

1 / 5

Questions and Answers about Reporting Related to Section 965 on **2017** Tax Returns

<https://www.irs.gov/newsroom/questions-and-answers-about-reporting-related-to-section-965-on-2017-tax-returns> Updated: 03/13/2018 & 04/13/2018

Q1. Who is required to report amounts under section 965 of the Code on a 2017 tax return?

Q2. How are amounts under section 965 of the Code reported on a 2017 tax return?

Q3. Is there any other reporting in connection with section 965 of the Code required on a 2017 tax return?

Q4. What elections are available with respect to section 965 of the Code on a 2017 tax return?

Q5. Who can make an election with respect to section 965 of the Code on a 2017 tax return?

Q6. When must an election with respect to section 965 of the Code be made?

IRC § 965

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Transition Tax (“TT”) – Frequently Asked Questions 2 / 5

Questions and Answers about Reporting Related to Section 965 on **2017** Tax Returns

<https://www.irs.gov/newsroom/questions-and-answers-about-reporting-related-to-section-965-on-2017-tax-returns> Updated: 03/13/2018 & 04/13/2018

Q7. How is an election with respect to section 965 of the Code made on a 2017 tax return?

Q8. Is a Form 5471 with respect to all specified foreign corporations with respect to which a person is a United States shareholder required to be filed with the person’s 2017 tax return, regardless of whether the specified foreign corporations are CFCs?

Q9. Are domestic partnerships, S corporations, or other passthrough entities required to report any additional information to their partners, shareholders, or beneficiaries in connection with section 965 of the Code?

Q10. How should a taxpayer pay the tax resulting from section 965 of the Code for a 2017 tax return?

IRC § 965

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Transition Tax (“TT”) – Frequently Asked Questions 3 / 5

Questions and Answers about Reporting Related to Section 965 on **2017** Tax Returns

<https://www.irs.gov/newsroom/questions-and-answers-about-reporting-related-to-section-965-on-2017-tax-returns> Updated: 03/13/2018 & 04/13/2018

Q11. If not already filed, when should an individual taxpayer electronically file a 2017 tax return?

Q12. If a person has already filed a 2017 tax return, what should the person do?

Q13. How will the IRS apply 2017 estimated tax payments (including credit elects from 2016) to a taxpayer’s net tax liability under section 965?

Q14. If a taxpayer’s 2017 payments, including estimated tax payments, exceed its 2017 net income tax liability described under section 965(h)(6)(A)(ii) (its net income tax determined without regard to section 965) and the first annual installment (due in 2018) pursuant to an election under section 965(h), may the taxpayer receive a refund of such excess amounts or credit such excess amounts to its 2018 estimated income tax? [Also, see PMTA 2018-16 (Aug. 2, 2018)]

IRC § 965

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Transition Tax (“TT”) – Frequently Asked Questions 4 / 5

Questions and Answers about Reporting Related to Section 965 on **2017** Tax Returns

<https://www.irs.gov/newsroom/questions-and-answers-about-reporting-related-to-section-965-on-2017-tax-returns> Posted: 06/04/2018

Q15: If a taxpayer that has made a section 965(h) election for 2017 filed a 2017 income tax return that calculated an overpayment without including the taxpayer’s total net tax liability under section 965, and the taxpayer attempted to elect to credit the calculated overpayment to its estimated tax liability for 2018, will the IRS determine an addition to tax for an underpayment of taxpayer’s 2018 estimated taxes because the credit elect won’t be available for the first required 2018 estimated tax installment?

Q16: If an individual fails to timely pay his or her first installment of tax due under section 965(h), will the IRS assess an addition to tax for failure to pay? Will the taxpayer’s requirement to pay all subsequent installments be accelerated under section 965(h)(3)?

IRC § 965

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Transition Tax (“TT”) – Frequently Asked Questions 5 / 5

Questions and Answers about Reporting Related to Section 965 on **2017** Tax Returns

<https://www.irs.gov/newsroom/questions-and-answers-about-reporting-related-to-section-965-on-2017-tax-returns>

Q17: If an individual has filed his or her 2017 tax return, but has not made the section 965(h) election, may the individual file another 2017 return on which he or she makes the election? Posted: 06/04/2018

Appendix: Q&A - 2

- Individual Taxpayer - Updated: 04/13/2018
- S corporation or Partnership Taxpayer - Updated: 04/13/2018
- Estate or Trust Taxpayer – Posted: 3/18/18 & Updated: 04/13/2018
- Form 1120 Corporate Taxpayer - Posted: 03/13/18
- Exempt Organization Taxpayer - Posted: 03/13/18

IRC § 965 – Last Reviewed or Updated: 08-Oct-2018

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Transition Tax (“TT”) – Frequently Asked Questions 1 / 4

Questions and Answers about Reporting Related to Section 965 on **2018** Tax Returns

<https://www.irs.gov/newsroom/questions-and-answers-about-tax-year-2018-reporting-and-payments-arising-under-section-965> Updated: 12/12/2018

Q1: I made a section 965(h) election on my 2017 tax return, electing to pay the section 965(h) net tax liability portion of my 2017 income tax liability in eight annual installments. How was the section 965(h) net tax liability portion of my 2017 income tax liability assessed and how do I make the second installment payment?

Q2: I made a section 965(h) election on my 2018 tax return, electing to pay the section 965(h) net tax liability portion of my 2018 income tax liability in eight annual installments. How is the section 965(h) net tax liability portion of my 2018 income tax liability assessed and how do I make the first installment payment?

IRC § 965

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Transition Tax (“TT”) – Frequently Asked Questions 2 / 4

Questions and Answers about Reporting Related to Section 965 on **2018** Tax Returns

<https://www.irs.gov/newsroom/questions-and-answers-about-tax-year-2018-reporting-and-payments-arising-under-section-965> Updated: 12/12/2018

Q3: I made a section 965(h) election for the 2017 tax year and have an unsatisfied but properly deferred payment obligation for my 2017 section 965(h) net tax liability. My 2018 income tax payments, including estimated tax payments, exceed my 2018 tax year income tax liability and I have also fully paid all of my 2017 section 965(h) net tax liability annual installment payment obligations that are due. May I receive a refund of, or credit to my 2019 tax year, my 2018 income tax overpayment?

IRC § 965

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Transition Tax (“TT”) – Frequently Asked Questions 3 / 4

Questions and Answers about Reporting Related to Section 965 on **2018** Tax Returns

<https://www.irs.gov/newsroom/questions-and-answers-about-tax-year-2018-reporting-and-payments-arising-under-section-965> Updated: 12/12/2018

Q4: I made a section 965(h) election on my 2018 tax return. If my 2018 payments, including estimated tax payments, exceed my 2018 net income tax liability described under section 965(h)(6)(A)(ii) (my net income tax determined without regard to section 965) and my first annual installment (due in 2019) pursuant to an election under section 965(h), may I receive a refund of such excess amounts or credit such excess amounts to my 2019 estimated income tax?

IRC § 965

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Transition Tax (“TT”) – Frequently Asked Questions 4 / 4

Questions and Answers about Reporting Related to Section 965 on **2018** Tax Returns

<https://www.irs.gov/newsroom/questions-and-answers-about-tax-year-2018-reporting-and-payments-arising-under-section-965> Updated: 12/12/2018

Q5: I made a section 965(h) election on my 2018 tax return. How will the IRS apply my 2018 estimated tax payments (including amounts elected to be applied as a credit against estimated tax from the 2017 tax year) to my 2018 net tax liability under section 965?

Q6: I reported income under section 965 on either my 2017 or 2018 tax returns (or both). What forms am I required to complete and attach to my 2018 income tax return?

IRC § 965

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Overview – Global Intangible Low-Taxed Income (“GILTI”)

- GILTI - Theory
- GILTI and Subpart F
- GILTI – IRC § 951A(c)(2) – Tested Income or **Tested Loss**
- GILTI – Similar to Subpart F, But Different
- GILTI
- GILTI Computation
- 50% of GILTI Deduction Limiters
- 37.5% of FDII and 50% of GILTI Deductions
- GILTI and Qualified Business Asset Investment (“QBAI”)
- GILTI & Pro Rata Share Rules
- GILTI & Basis for Tested Loss CFCs
- GILTI and FTCs
- GILTI & Reporting Requirements
- GILTI Consolidated Computations
- GILTI Draft Forms
- GILTI – Proposed Treasury Regulations
- GILTI – Individuals Taxed As Corporations
- 100% Dividends Received Deduction

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Global Intangible Low-Taxed Income (“GILTI”) - Theory

Theory - Can avoid GILTI, if pay foreign country taxes of at least 13.125% (16.4% after 2025) – 80% creditable netting to 10.5%

Reality – A corporation can owe US tax on GILTI even though its foreign effective tax rate is above 13.125% because of GILTI’s interaction with existing expense allocation and apportionment rules, which limit FTCs a company can claim to offset taxable foreign source income

For tax consolidated groups, the GILTI tax obligation is computed on a consolidated basis

Applies to taxable years beginning **after December 31, 2017**

IRC §§ 250, 861 – 865 [old law], and 951A; Act § 14201(d); and Treas. Reg. §§ with 1.861 preface and Prop. Treas. Reg. §§ 1.951A-1(e)(2) & (4) & -7 & 1.1502-51

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GILTI and Subpart F

GILTI and Subpart F are two separate tracks of taxation

GILTI borrows many subpart F concepts – Treats CFC as a domestic corporation for computing gross income, taxable income, & pro rata share of hypothetical year-end distributions, but no GILTI HTE

When recapturing suspended subpart F losses due to E&P deficit limitations under IRC § 952(c), both GILTI tested income and Subpart F income can result in tax based on the same positive E&P

For purposes of IRC § 952(c)(1)(A) [limits subpart F inc. to E&P], the E&P of a tested loss CFC are increased by an amount equal to the tested loss of the tested loss CFC for the CFC inclusion year

GILTI is computed by individual tax period and is not limited by E&P

Subpart F is based on E&P, which can be measured over multiple tax periods

IRC §§ 951(a)(2), 951A, 952(c), and 954(b)(4) and Treas. Reg. §§ 1.951-1(b) and (e), 1.952-2, and 1.954(d)(5) and Prop. Treas. Reg. §§ 1.951A-1(d)(1), -2(c)(4) and -6(d)

GILTI – IRC § 951A(c)(2) - Tested Income or (Tested Loss)

IRC § 951A(c)(2)(A) or (B) - Tested Income or (Tested Loss):

IRC § 951A(c)(2)(A)(i) or (B) - Gross Income XXX

IRC § 951A(c)(2)(A)(i) or (B) - **Exclusions** from Gross Income:

- i. Effectively Connected Income with U.S. Trade or Business – IRC § 952(b),
- ii. Gross income taken into account in determining Subpart F income,
- iii. Gross income excluded from FBCI (IRC § 954) or the insurance income (IRC § 953) solely by reason of an election made under IRC § 954(b)(4) and Treas. Reg. § 1.954-1(d)(5) (High Tax Exception (“HTE”)),
- iv. Dividends received from related persons (IRC § 954(d)(3)), and
- v. Foreign oil and gas extraction income (IRC § 907(c)(1))

IRC § 951A(c)(2)(A)(ii) or (B) - Deductions (Including Taxes) Properly Allocable to Such Gross Income - Similar to IRC § 954(b)(5) (XXX)

IRC § 951A(c)(2) - Tested Income or (Tested Loss) for Named CFC XX

Prop. Treas. Reg. § 1.951A-2(c)

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GILTI – Similar to Subpart F, But Different

Subpart F income inclusions by a US shareholder are made on a **separate** CFC by **separate** CFC basis – solely at the level of each CFC

GILTI inclusions by a US shareholder are made by **combining** GILTI tax attributes of all of a US shareholder's CFCs – solely at the level of the US shareholder

GILTI tax attributes include tested income, tested loss, specified tangible property, and specified interest expense [based on interest expense and interest income] of each CFC owned by the US shareholder at the US shareholder level

Tested income and tested loss are determined without regard to the E&P limitation in IRC § 952(c)

IRC §§ 951 and 951A and proposed treasury regulations Preamble, **Special Analyses**, Regulatory Planning and Review – Economic Analysis, B. Economic Analysis of the Proposed Regulations, 1. Background & Prop. Treas. Reg. § 1.951A-6

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Global Intangible Low-Taxed Income (“GILTI”)

CFC tested gross income, less related deductions, equals CFC **Tested Income**

Less

CFC related deductions, less tested gross income, equals CFC **Tested Loss**

Equals **Net CFC Taxable Income**

Less

Net Deemed Tangible Income Return (“NDTIR”) [**Only for CFCs with Tested Income**] (10% of Qualified Business Asset Investment (“QBAI”), less certain interest expense)

Equals GILTI

Multiply GILTI times 50%, equals 50% of GILTI deduction with certain limiters

IRC §§ 250 and 951A

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GILTI Computation

- A. Controlled Foreign Corporation ("CFC") Tested Gross Income ("TGI") (IRC § 951A(c)(2)(A)(i))
 - B. Minus Deductions (Including Taxes) (Similar to IRC § 954(b)(5)) (IRC § 951A(c)(2)(A)(ii))
 - C. CFC **Tested Income** ("TI") (IRC § 951A(c)(1)(A)) [A – B]
 - D. Deductions (Including Taxes) (Similar to IRC § 954(b)(5)) (IRC § 951A(c)(2)(B)(i))
 - E. Minus CFC TGI (IRC § 951A(c)(2)(B)(i))
 - F. CFC **Tested Loss** (IRC § 951A(c)(1)(B)) [D – E]
 - G. **Net CFC TI** (IRC § 951A(c)(1)) [C – F]
 - H. Qualified Business Asset Investment ("QBAI") – CFC Quarterly Average of Depreciable Assets under IRC § 167 Specified Tangible Property with Adjusted Basis Determined under IRC § 168(g) Alternative Depreciation System ("ADS") (IRC § 951A(d))
 - I. QBAI X 10% (IRC § 951A(b)(2)(A)) [H X 10%]
 - J. Minus Interest Expense Related to CFC TI (IRC § 951A(b)(2)(B)) [General Rule – But Not Always Deductible from QBAI]
 - K. Net Deemed Tangible Income Return ("NDTIR") (IRC § 951A(b)(2)) – (No deduction for NDTIR [K], unless CFC TI [C] is positive) [I – J]
 - L. GILTI - Excess of Net CFC TI Minus NDTIR (IRC § 951A(b)(1)) [G – K]
 - M. 50% of GILTI Deduction– **Lesser** of (a) 50% of GILTI + 37.5% of Foreign Derived Intangible Income ("FDII") or (b) 50% of Taxable Income before GILTI and FDII Deductions, Assuming FDII is 0 (IRC § 250) [50% X L]
- Treas. Reg. § 1.952-2 and Prop. Treas. Reg. §§ 1.951A-1(c) and (d), -2, -3, and -4

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50% of GILTI Deduction Limiters

GILTI is assessed annually with no GILTI US tax attribute (especially FTCs) C/B to prior years or C/O to future years.

A deduction is permitted for 50% of GILTI, which cannot exceed the **lesser** of (a) 50% (37.5% after 2025) of GILTI and 37.5% (21.875% after 2025) of Foreign Derived Intangible Income ("FDII") or (b) 50% of taxable income before the GILTI and FDII deductions, assuming that there is no FDII. The deductions permitted for 50% of GILTI and 37.5% of FDII are provided under IRC § 250 and are permitted only in the current year (year in which they occur with no C/B and with no C/O).

GILTI and FDII deductions are available only for US C corporations, (not available for individuals, S Corporations, RICs, or REITs).

FDII is discussed on subsequent slides.

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37.5% of FDII and 50% of GILTI Deductions

Foreign Derived Intangible Income ("FDII") X 37.5% =	FDII Deduction
(Global Intangible Low-Taxed Income ("GILTI") + IRC § 78 gross-up) X 50% =	<u>GILTI Deduction</u>
Total	<u>IRC § 250 Deduction</u>

IRC § 250 deduction for FDII and GILTI is limited to taxable income of a domestic corporation (calculated without regard to the IRC § 250 deduction, but with regard to a deduction for an NOL carryover under IRC § 172(a))

IRC § 250 deductions are taken into account in computing taxable income for interest expense deductions limits under IRC § 163(j) [may add back GILTI deduct.]

IRC §§ 78, 163(j), and 250 and Prop. Treas. Reg. § 1.78-1

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GILTI & Qualified Business Asset Investment ("QBAI") 1 / 8

Tested income CFC's QBAI for any taxable year is the average for the CFC's aggregate adjusted bases as of the close of each quarter in specified tangible property that is used in a trade or business of the CFC and of a type with respect to which a depreciation deduction is allowable under IRC § 167(a).

QBAI determined at the close of each quarter of the partnership's taxable year that ends with or within the CFC's taxable year.

The adjusted basis in any property is determined by using the Alternative Depreciation System ("ADS") under IRC §168(g) from the date placed in service and allocating the depreciation deduction with respect to the property ratably to each day during the period in the taxable year to which the depreciation relates.

ADS applies for purposes of determining QBAI irrespective of whether the basis of the property is determined using another depreciation method for other purposes of the IRC.

IRC §§ 167(a), 168(g), and 951A(d) and Prop. Treas. Reg. §§ 1.951A-1(c)(3) and (d)(1) and -3

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GILTI & QBAI – Consider Accounting Method Change 2 / 8

Consider accounting method change for depreciation from an unacceptable method to Alternative Depreciation System (“ADS”) under IRC § 168(g)

Compute IRC 481(a) adjustment amount

Prepare Form 3115, Application for Change in Accounting Method

IRC §§ 167(a), 168(g), 446(e), 481(a), and 951A(d) and Prop. Treas. Reg. §§ 1.951A-1(c)(3) and (d)(1) and -3

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GILTI & Qualified Business Asset Investment (“QBAI”) 3 / 8

QBAI is available only for CFCs with tested income – Reduced by specified interest expense

QBAI is **NOT** available for CFCs with tested **loss**

Tax Planning – Parent – Subsidiary Relationship:

CFC with tested income files a Check-the-Box (“CTB”) election to become a disregarded entity of an entity with tested loss to make CFC with tested loss profitable – Enhance QBAI

CFC with tested loss files a CTB election to become a disregarded entity of an entity with tested income to make CFC with tested loss profitable – Enhance QBAI

Tax Planning – Brother – Sister Relationship:

Mergers of CFCs – Cover CFC tested losses with CFC tested income - Enhance QBAI

IRC §§ 167(a), 168(g), 368(a), and 951A(d) and Prop. Treas. Reg. §§ 1.951A-1(c)(3) and (d)(1) and -3

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GILTI & QBAI – Dual Use Property

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Dual use property produces both gross tested income and gross income that is not gross tested income

Dual use ratio for specified tangible property is the ratio of gross tested income produced by the property to the total amount of gross income produced by the property

Adjusted basis of tangible property multiplied by the dual use ratio for gross tested income produced by the property = basis in specified tangible property applicable to gross tested income

IRC §§ 167(a), 168(g), and 951A(d)(2)(B) and Prop. Treas. Reg. §§ 1.951A-1(c)(3) and (d)(1) and -3(d)

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GILTI & QBAI – Short Taxable Years

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A short taxable year has less than 12 months

- A. The adjusted basis of QBAI at the end of **each full** quarter is divided by 4
- B. The adjusted basis of QBAI at the end of **each short** quarter is multiplied by the number of days in each short quarter and divided by 365

The sum of A. + B. equals the QBAI for the short taxable year

IRC §§ 167(a), 168(g), and 951A(d) and Prop. Treas. Reg. §§ 1.951A-1(c)(3) and (d)(1) and -3(f)

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GILTI-QBAI – Anti-Abuse Rules for Certain Transfers of Ppty.

The benefit of stepped-up basis in specified property, for which a deduction is allowable under IRC §§ 167 or 197, transferred between related CFCs during the period before the transferor CFC's first inclusion year (before January 1, 2018 for calendar year CFCs) for purposes of calculating the transferee CFC's GILTI tested income or tested loss is disregarded 6 / 8

Basis stepped-up for specified tangible property is disregarded for determining QBAI if the specified tangible property is acquired and **held temporarily**, but over at least the close of 1 quarter and less than a 12 month period, with a **principal purpose** of reducing the GILTI inclusion amount of the US shareholder. To the extent that gain on the transfer is taxed in the US, that stepped-up basis is not disqualified in computing QBAI

IRC §§ 167(a), 168(g), 197, and 951A(d) and Prop. Treas. Reg. §§ 1.951A-1(c)(3) and (d)(1), -2(c)(5), and -3(h) 81

GILTI & QBAI – QBAI Exceeds 10 Times Tested Income 7 / 8

If a CFC's QBAI exceeds 10 times its tested income, so that the amount of QBAI allocated to preferred stock would exceed 10 times the tested income allocated to the preferred stock under the general proportionate allocation rule, the excess amount of QBAI is allocated solely to the CFC's common stock

IRC §§ 167(a), 168(g), and 951A(d) and Prop. Treas. Reg. §§ 1.951A-1(c)(3) and (d)(3)(ii) and (iii) 82

GILTI & QBAI – Specified Interest Expense

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Specified interest expense* = Tested interest expense - Tested interest Income

* - Reduces QBAI

Interest expense of certain lender CFCs and insurance company CFCs as defined under IRC § 954(h) and (i) do not reduce QBAI:

Qualified interest expense - Qualified interest income

IRC §§ 951A and 954(h) and (i) and Prop. Treas. Reg. §§ 1.951A-1(c)(3)(iii) and -4

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GILTI & Pro Rata Share Rules

Tested income, tested loss, & QBAI determined similar to subpart F income under pro rata share rules of IRC § 951(a)(2) and Treas. Reg. § 1.951-1(b) and (e) with appropriate modifications to account for the differences between subpart F income and tested income, tested loss, and QBAI

GILTI inclusions are based on ownership of CFC (IRC § 958(a)) as of the close of the CFC's taxable year

GILTI determined using average exchange rates for the taxable year of the foreign corporation

IRC §§ 951(a)(2), 951A(d), 958(a), and 989(b)(3) and Treas. Reg. § 951-1(b) and (e) and Prop. Treas. Reg. §§ 1.951A-1(d)(1) and -6(b)(2)(iii)

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GILTI & Basis for Tested Loss CFCs

In the case of a corporate US shareholder (excluding RICs and REITs), for purposes of determining the gain, loss, or income on the direct or indirect disposition of stock of a CFC, the basis of the stock is reduced by the amount of tested loss that has been used to offset tested income in calculating net CFC tested income of the US shareholder

The basis reduction is only made at the time of the disposition and therefore does not affect the stock basis prior to a disposition – avoids double deductions

A portion of a tax consolidated group member's offset tested income amount is treated as tax-exempt income and all of a tax consolidated group member's used tested loss amount is treated as a noncapital, nondeductible expense

IRC §§ 245A and 1059 and Prop. Treas. Reg. §§ 1.951A-6(e), 1.1502-32(b)(3)(ii)(E) and (F) and (iii)(C), and 1.1502-51(c) and (d)

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GILTI and Foreign Tax Credits ("FTCs")

Proposed regulations relating to FTCs will provide rules for assigning the IRC § 78 gross-up attributable to foreign taxes deemed paid under IRC § 960(d) to the separate category described in IRC § 904(d)(1)(A) (e.g. GILTI basket)

IRC §§ 78, 250, 904(d)(1)(A), 951A, and 960(d) and Prop. Treas. Reg. §§ 1.78-1 and 1.904-4

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GILTI and Reporting Requirements

Subpart F income inclusion and reporting requirements formerly required ownership of a CFC for an uninterrupted period of at least 30 days

IRC § 951(a)(1) was amended to **remove** such **30 day requirement** for subpart F income and GILTI

For a CFC at any time during taxable year, US shareholder, who owns stock of CFC on **last day** of CFC's taxable year, must include pro rata shares of subpart F income, GILTI, and QBAI of CFC

IRC §§ 951(a)(1), 951A(e) and 6038(a)(1) and Prop. Treas. Reg. § 1.6038-2(a)

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GILTI Consolidated Computations

Calculation of net CFC tested income within a consolidated group
if no all CFCs are wholly owned by a member

Prop. Treas. Reg. § 1.1091-1(d)(5)(i)

F owns all of US1, US2, US3 - all members of P consolidated group

US1 owns all of CFC1

US2 owns all of CFC2 and CFC3

US3 owns all of CFC4

CFC1 = tested loss of (\$100)

CFC2 = tested income of \$200

CFC3 = tested loss of (\$300)

CFC4 = tested income of \$100

CFC	Consolidated Group		Consolidated Group		Net CFC		
	Tested Income	GILTI Allocation	Tested Loss	Tested Loss	Tested Income		
US1 / CFC1		0%	(\$100)	\$0	\$0		
US2 / CFC2	\$200	10%		(\$15)	\$185	\$185	
US2 / CFC3		0%	(\$300)	\$0	\$0	\$185	
US3 / CFC4	\$100	10%		(\$15)	\$85	\$270	
Total	\$300	100%	(\$400)	(\$30)	\$250	\$250	
Assume that no entity has QBAI					Final	\$200	

Continued on next slide

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GILTI Consolidated Computations

Calculation of net CFC tested income within a consolidated group when all CFCs are wholly owned by a member Prop. Treas. Reg. § 1.1502-51(f)Ex.3

P owns all of USS1, USS2, USS3 - all members of P consolidated group
 USS1 owns all of CFC1
 USS2 owns all of CFC2 and CFC3
 USS3 owns all of CFC4
 CFC1 = tested loss of (\$100) *, QBAI of \$0, tested interest expense of \$25, tested interest income of \$0
 CFC2 = tested income of \$200, QBAI of \$500, tested interest expense of \$0, tested interest income of \$0
 CFC3 = tested loss of (\$200), QBAI of \$0, tested interest expense of \$0, tested interest income of \$0
 CFC4 = tested income of \$600 *, QBAI of \$2000, tested interest expense of \$25, tested interest income of \$0
 * - Net of \$25 interest expense

Entity	Consolidated Group		Allocable Shares Consolidated Group		Net CFC	Allocable Shares 10%			Tested Interest Expense	Tested Interest Income	Specified Interest Expense	Allocable Shares Specified Interest Expense	Net Deemed Tangible Income	GILTI Inclusion Amount	Used Tested Loss Amount	Offset Tested Income Amount
	Tested Income	GILTI Allocation Ratio	Tested Loss	Allocable Loss		Qualified Business Asset Investment	Qualified Business Asset Investment	Deemed Tangible Income								
USS1 / CFC1		0%	(\$100)	\$0	\$0	\$0	\$0	\$0.00	\$25	\$0	\$25	\$0.00	\$0	\$0	(\$100)	\$0
USS2 / CFC2	\$200	25%		(\$75)	\$125	\$500	\$625	\$62.50	\$0	\$0	\$0	\$12.50	\$30	\$75	\$0	\$75
USS2 / CFC3		0%	(\$200)	\$0	\$0	\$0	\$0	\$0.00	\$0	\$0	\$0	\$0.00	\$0	\$0	(\$200)	\$0
USS3 / CFC4	\$600	75%		(\$225)	\$375	\$2,000	\$1,875	\$187.50	\$25	\$0	\$25	\$37.50	\$150	\$225	\$0	\$225
Totals:	\$800	100%	(\$300)	(\$300)	\$500	\$2,500	\$2,500	\$250.00	\$50	\$0	\$50	\$50.00	\$200	\$300	(\$300)	\$300
				Proof	\$500											

** - Requires basis adjustment (decrease) in year of disposition pursuant to Prop. Treas. Reg. Sec. 1.1502-32(b)(3)(iii)(C)(9)

GILTI Draft Forms

Schedule I-1 (Form 5471), Information for Global Intangible Low-Taxed Income

<https://www.irs.gov/pub/irs-dft/f5471s11-dft.pdf>

Form 8992, U.S. Shareholder Calculation of Global Intangible Low-Taxed Income (GILTI) (Released Aug. 22, 2018) [4 pages]

<https://www.irs.gov/pub/irs-dft/f8992-dft.pdf>

Form 8993, Section 250 Deduction for Foreign-Derived Intangible Income (FDII) and Global Intangible Low-Taxed Income (GILTI) (Released Aug. 22, 2018) [1 page]

<https://www.irs.gov/pub/irs-dft/f8993-dft.pdf>

The above named forms will be attachments to Form 5471, Information Return of U.S. Persons With Respect To Certain Foreign Corporations

Existing Forms 1065 - Schedule K, 1120S - Schedule K, and 5471 (30 days) will be revised

IRC §§ 250, 951(a)(1), and 951A and Prop. Treas. Reg. §§ 1.951-1(a) (CFCs), (g) (definition of U.S. shareholder), and (h) (partnership blocker structure) and 1.6038-2 and -5

GILTI Draft Forms

Form 8990, Limitation on Business Interest Expense Under Section 163(j)
(Released Oct. 25, 2018) [3 pages]

<https://www.irs.gov/pub/irs-dft/f8990—dft.pdf>

Draft IRS Instructions to Form 8990 (Dec. 2018) (Released Dec. 10, 2018)

IRC § 163(j)

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GILTI – Proposed Treasury Regulations

§1.951-1 Amounts included in gross income of United States shareholders

§1.951A-0 Outline of section 951A regulations

§1.951A-1 General provisions

§1.951A-2 Tested income and tested loss

§1.951A-3 Qualified business asset investment

§1.951A-4 Tested interest expense and tested interest income

§1.951A-5 Domestic partnerships and their partners

§1.951A-6 Treatment of GILTI inclusion amount and adjustments to earnings and profits and basis related to tested loss CFCs

§1.951A-7 Applicability dates

§1.1502-12 Separate Taxable Income

§1.1502-13 Intercompany transactions

§1.1502-32 Investment adjustments

§1.1502-51 Consolidated section 951A

§1.6038-2 Information returns required of United States persons with respect to annual accounting periods of certain foreign corporations

§1.6038-5 Information returns required of certain United States persons to report amounts determined with respect to certain foreign corporations for global intangible low-taxed income (GILTI) purposes

157 pages with Preamble when released – Sep. 13, 2018
39 pages as sent to the Federal Register – Oct. 10, 2018
REG-104390-18

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GILTI – Individuals – Taxed as Corporations

Individuals taxed as corporations regarding income and related FTCs

No 50% of GILTI deduction under IRC § 250

No dividends received deduction under IRC § 245A

Election is based on IRC § 962 enacted by Revenue Act of 1962 with some minor amendments

See IRC § 1248(b)(1) and (d)(1) for FTC & E&P for sales by an individual of a CFC

IRC §§ 11, 245A, 250, 961, 962, 965, and 1411 & Prop. Treas. Reg. §§ 1.956-1(a)(2) and (3) and (g)(4) and (5), 1.962-1(b) & -2(a) and 1.965-3(e)

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100% Dividends Received Deduction (“DRD”)

1/2

100% DRD (participation exemption system) on foreign income is allowed to a ≥ 10% US shareholder of a foreign corporation held ≥ 365 days of 731 days before the dividend is paid

DRD available only to domestic C corporations, **NOT** to REITs, RICs, or individuals

Passive Foreign Investment Company (“PFIC”) dividends are **NOT** eligible for DRD

DRD **NOT** available for Effectively Connected Income (“ECI”) from conduct of a trade or business within the US or ≥ 80% owned domestic corporation

IRC §§ 245A and 951(b)

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100% Dividends Received Deduction (“DRD”) 2/2

IRC § 1248 deemed dividends on sale of foreign shares are eligible for 100% DRD

Losses in shares of foreign corporations from which a US shareholder has received a DRD are reduced by as much as the DRD amount, but does **NOT** cause taxable income

DRD **NOT** available for hybrid dividend received by a CFC, which received a deduction or other tax benefit from a foreign country

Foreign source portion of a dividend (eligible for DRD) equals the same proportion of the dividend as the foreign corporation’s undistributed **foreign** earnings bears to its total undistributed earnings

IRC §§ 245A, 951(b), 964(e), and 1248

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CFC Investments in US Property and 100% DRD

CFC investments in US property (including certain pledges and guarantees) at quarter-end (for > 30 days) X $\frac{1}{4}$ are taxed currently in the US as subpart F income under IRC § 956 and provide basis in CFC shares under IRC § 961

Beginning generally in 2018, US shareholder’s pro rata share of IRC § 956 investments in US property at quarter end (for > 30 days) X $\frac{1}{4}$ are deemed dividends (**tentative IRC § 956 amount**), but only to the extent that they exceed the CFC’s foreign source income entitled to a **100% DRD on a hypothetical distribution under IRC § 245A** (participation exemption system)

IRC §§ 245A, 246, 951(b), 956, 959, 961, 964(e), and 1248, Notice 88-108, 2008-91, 2008-43, 2009-10, and 2010-12, and Prop. Treas. Reg. § 1.956-1(a)(2) and (3) and (g)(4) and (5)

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Overview – Business Interest Expense Deduction Limiters

- Business Interest Expense Deduction Limiters
- Business Interest Expense - IRC § 163(j) – Special Rules
- Interest Expense Defined for Purposes of IRC § 163(j) – General Rules + Prop. Treas. Reg. § 1.163(j)-1(b)(20)
- Interest Deductions – International Prop. Treas. Regs.
- Interest Deductions – Prop. Treas. Reg. § 1.163(j)-7
- Interest Deductions – Prop. Treas. Reg. § 1.163(j)-8
- Interest Deductions – Proposed Treasury Regulations

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Business Interest Expense Deduction Limiters

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30% of Earnings Before Interest, Taxes, Depreciation, and Amortization (“EBITDA”) 2018 – 2021 & 30% of Earnings Before Interest and Taxes (“EBIT”) from 2022 – Amended IRC §163(j) - Applies at the consolidated group level – Notice 2018-28 & IR-2018-82 - Before NOLs – Prop. Treas. Reg. § 1.163(j)-1(b)(1). Computed for US shareholder without regard to gross income attributable to IRC §§ 78, 951(a), & 951A(a) to prevent double counting. Prop. Treas. Reg. § 1.163(j)-7(d)(1)(i).

Applies to CFCs

Exemption for certain trades or businesses:

- Average annual gross receipts do not exceed \$ 25 M for the 3-taxable year period ending with the taxable year which precedes the current taxable year,
- Performing services as an employee,
- Electing (irrevocable) real property trade or business,
- Electing (irrevocable) farming business,

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Business Interest Expense Deduction Limiters

2 / 3

Exemption for certain trades or businesses (continued):

Applies to CFCs

- Sale or furnishing of electrical energy, water, or sewage disposal services; gas or steam through a local distribution system; or transportation of gas or steam by pipeline, or
- Floor plan interest for financing motor vehicles for sale or lease

Depreciation and amortization that is capitalized into inventory under IRC § 263A (recovered thru cost of goods sold) is NOT added back

IRC §§ 263A and 263(g) capitalizing interest apply before IRC § 163(j) and such interest is not interest for purposes of IRC § 163(j)

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Business Interest Expense Deduction Limiters

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Applies to CFCs

Foreign related parties are on the cash method of accounting for deductions for certain payments, including interest expense. Treas. Reg. § 1.267(a)-3(b)(1).

Cash method of accounting rule applies to subpart F income, but not to GILTI for IRC §§ 163(e)(3)(B)(i) [OID] & 267(a)(3)(B) [item payable to a CFC or PFIC]. Prop. Treas. Reg. §§ 1.163(j)-1(b)(1)(iii) and -3(b)(5) & 1.951A-6(c)(1).

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Business Interest Expense - IRC § 163(j) – Special Rules

Properly allocable to a non-excepted trade or business

Floor planning interest expense

Business interest expense carryforwards – Prop. Treas. Reg. § 1.163(j)-1(b)(2)(9)

Special rules – Prop. Treas. Reg. § 1.163(j)-1(b)(2):

Disallowed interest expense – Prop. Treas. Reg. § 1.163(j)-3(b)(2)

Regarding C corporations – Prop. Treas. Reg. § 1.163(j)-4(b)

Regarding consolidated groups – Prop. Treas. Reg. § 1.163(j)-4(d)(2)(iii)

Regarding foreign persons engaged in a U.S. trade or business – Prop. Treas. Reg. § 1.163(j)-8(b)(3)

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Interest Expense Defined for Purposes of IRC § 163(j) 1 / 2

Debt versus Equity – Notice 94-47, 1994-1 C.B. 357

General Rules

Interest is defined as compensation for the use or forbearance of money -
Deputy v. Dupont, 308 U.S. 488 (1940)

Instrument or contractual arrangement, including a series of transactions, that is treated as a debt instrument for purposes of IRC § 1275(a) and Treas. Reg. § 1.1275-1(d)

Prop. Treas. Reg. §§ 1.163(j)-1(b)(20)

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Interest Expense Defined for Purposes of IRC § 163(j) 2 / 2

General Rules

Conventional debt instruments, as well as transactions that are indebtedness in substance although not in form. *Schering-Plough Corp. v. U.S.*, 651 F.Supp. 2d 219 (N.J. Dist. Ct. 2009), *aff'd sub non. Merck & Co., Inc. v. U.S.*, 652 F.3d 475 (3d Cir. 2011); *Mapco Inc. v. U.S.*, 556 F.2d 1107 (Ct Cl. 1977).

Original Issue Discount ("OID"), accrued market discount, and amounts with respect to an integrated transaction - Treas. Reg. § 1.1275-6, not stock under Treas. Reg. § 1.385-3

Deferred payments treated as interest under IRC § 483

Prop. Treas. Reg. §§ 1.163(j)-1(b)(20)

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Interest Expense Defined for Purposes of IRC § 163(j) 1 / 13

(20) **Interest.** The term interest means any amount described in paragraph (b)(20)(i), (ii), (iii), or (iv) of this section.

(i) **In general.** Interest is an amount paid, received, or accrued as compensation for the use or forbearance of money under the terms of an instrument or contractual arrangement, including a series of transactions, that is treated as a debt instrument for purposes of section 1275(a) and §1.1275-1(d), and not treated as stock under §1.385-3, or an amount that is treated as interest under other provisions of the Internal Revenue Code (Code) or the regulations thereunder. Thus, for example, interest includes—

(A) Original issue discount (OID), as adjusted by the holder for any acquisition premium or amortizable bond premium;

(B) Qualified stated interest, as adjusted by the holder for any amortizable bond premium or by the issuer for any bond issuance premium;

Prop. Treas. Reg. §§ 1.163(j)-1(b)(20)

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Interest Expense Defined for Purposes of IRC § 163(j) 2 / 13

(i) **In general** (continued)

(C) Acquisition discount;

(D) Amounts treated as taxable OID under section 1286 (relating to stripped bonds and stripped coupons);

(E) Accrued market discount on a market discount bond to the extent includible in income by the holder under either section 1276(a) or 1278(b);

(F) OID includible in income by a holder that has made an election under §1.1272-3 to treat all interest on a debt instrument as OID;

(G) OID on a synthetic debt instrument arising from an integrated transaction under §1.1275-6;

Prop. Treas. Reg. §§ 1.163(j)-1(b)(20)

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Interest Expense Defined for Purposes of IRC § 163(j) 3 / 13

(i) **In general** (continued)

(H) Repurchase premium to the extent deductible by the issuer under §1.163-7(c);

(I) Deferred payments treated as interest under section 483;

(J) Amounts treated as interest under a section 467 rental agreement;

(K) Amounts treated as interest under section 988;

(L) Forgone interest under section 7872;

Prop. Treas. Reg. §§ 1.163(j)-1(b)(20)

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Interest Expense Defined for Purposes of IRC § 163(j) 4 / 13

(i) In general (continued)

(M) De minimis OID taken into account by the issuer;

(N) Amounts paid or received in connection with a sale-repurchase agreement treated as indebtedness under Federal tax principles; in the case of a sale-repurchase agreement relating to tax-exempt bonds, however, the amount is not tax-exempt interest;

(O) Redeemable ground rent treated as interest under section 163(c); and

(P) Amounts treated as interest under section 636.

Prop. Treas. Reg. §§ 1.163(j)-1(b)(20)

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Interest Expense Defined for Purposes of IRC § 163(j) 5 / 13

(ii) Swaps with significant nonperiodic payments—

(A) Non-cleared swaps. A swap other than a cleared swap with significant nonperiodic payments is treated as two separate transactions consisting of an on-market, level payment swap and a loan. The loan must be accounted for by the parties to the contract independently of the swap. The time value component associated with the loan, determined in accordance with §1.446-3(f)(2)(iii)(A), is recognized as interest expense to the payor and interest income to the recipient.

(B) Cleared swaps. [Reserved]

Prop. Treas. Reg. §§ 1.163(j)-1(b)(20)

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Interest Expense Defined for Purposes of IRC § 163(j) 6 / 13

(iii) Other amounts treated as interest—

(A) Treatment of premium—

(1) Issuer. If a debt instrument is issued at a premium within the meaning of §1.163-13, any ordinary income under §1.163-13(d)(4) is treated as interest income of the issuer.

(2) Holder. If a taxable debt instrument is acquired at a premium within the meaning of §1.171-1 and the holder elects to amortize the premium, any amount otherwise deductible under section 171(a)(1) as a bond premium deduction under §1.171-2(a)(4)(i)(A) or (C) is treated as interest expense of the holder.

Prop. Treas. Reg. §§ 1.163(j)-1(b)(20)

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Interest Expense Defined for Purposes of IRC § 163(j) 7 / 13

(iii) Other amounts treated as interest— (continued)

(B) Treatment of ordinary income or loss on certain debt instruments. If an issuer of a contingent payment debt instrument subject to §1.1275-4(b), a nonfunctional currency contingent payment debt instrument subject to §1.988-6, or an inflation indexed debt instrument subject to §1.1275-7 recognizes ordinary income on the debt instrument in accordance with the rules in §1.1275-4(b), §1.988-6(b)(2), or §1.1275-7(f), whichever is applicable, the ordinary income is treated as interest income of the issuer. If a holder of a contingent payment debt instrument subject to §1.1275-4(b), a nonfunctional currency contingent payment debt instrument subject to §1.988-6, or an inflation-indexed debt instrument subject to §1.1275-7 recognizes an ordinary loss on the debt instrument in accordance with the rules in §1.1275-4(b), §1.988-6(b)(2), or §1.1275-7(f), whichever is applicable, the ordinary loss is treated as interest expense of the holder.

Prop. Treas. Reg. §§ 1.163(j)-1(b)(20)

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Interest Expense Defined for Purposes of IRC § 163(j) 8 / 13

(iii) Other amounts treated as interest— (continued)

(C) Substitute interest payments. A substitute interest payment described in §1.861-2(a)(7) is treated as interest expense to the payor or interest income to the recipient; in the case of a sale-repurchase agreement or a securities lending transaction relating to tax-exempt bonds, however, the recipient of a substitute payment does not receive tax-exempt interest income.

(D) Section 1258 gain. Any gain treated as ordinary gain under section 1258 is treated as interest income.

Prop. Treas. Reg. §§ 1.163(j)-1(b)(20)

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Interest Expense Defined for Purposes of IRC § 163(j) 9 / 13

(iii) Other amounts treated as interest— (continued)

(E) Amounts affecting a taxpayer's effective cost of borrowing. Income, deduction, gain, or loss from a derivative, as defined in section 59A(h)(4)(A), that alters a taxpayer's effective cost of borrowing with respect to a liability of the taxpayer is treated as an adjustment to interest expense of the taxpayer. For example, a taxpayer that is obligated to pay interest at a floating rate on a note and enters into an interest rate swap that entitles the taxpayer to receive an amount that is equal to or that closely approximates the interest rate on the note in exchange for a fixed amount is, in effect, paying interest expense at a fixed rate by entering into the interest rate swap. Income, deduction, gain, or loss from the swap is treated as an adjustment to interest expense. Similarly, any gain or loss resulting from a termination or other disposition of the swap is an adjustment to interest expense, with the timing of gain or loss subject to the rules of §1.446-4.

Prop. Treas. Reg. §§ 1.163(j)-1(b)(20)

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Interest Expense Defined for Purposes of IRC § 163(j) 10 / 13

(iii) Other amounts treated as interest— (continued)

(F) Yield adjustments. Income, deduction, gain, or loss from a derivative, as defined in section 59A(h)(4)(A), that alters a taxpayer's effective yield with respect to a debt instrument held by the taxpayer is treated as an adjustment to interest income by the taxpayer.

(G) Certain amounts labeled as fees—

(1) Commitment fees. Any fees in respect of a lender commitment to provide financing are treated as interest if any portion of such financing is actually provided.

(2) [Reserved]

Prop. Treas. Reg. §§ 1.163(j)-1(b)(20)

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Interest Expense Defined for Purposes of IRC § 163(j) 11 / 13

(iii) Other amounts treated as interest— (continued)

(H) Debt issuance costs. Any debt issuance costs subject to §1.446-5 are treated as interest expense of the issuer.

(I) Guaranteed payments. Any guaranteed payments for the use of capital under section 707(c) are treated as interest.

Prop. Treas. Reg. §§ 1.163(j)-1(b)(20)

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Interest Expense Defined for Purposes of IRC § 163(j) 12 / 13

(iii) Other amounts treated as interest— (continued)

(J) Factoring income. The excess of the amount that a taxpayer collects on a factored receivable (or realizes upon the sale or other disposition of the factored receivable) over the amount paid for the factored receivable by the taxpayer is treated as interest income. For this purpose, the term factored receivable includes any account receivable or other evidence of indebtedness, whether or not issued at a discount and whether or not bearing stated interest, arising out of the disposition of property or the performance of services by any person, if such account receivable or evidence of indebtedness is acquired by a person other than the person who disposed of the property or provided the services that gave rise to the account receivable or evidence of indebtedness.

Prop. Treas. Reg. §§ 1.163(j)-1(b)(20)

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Interest Expense Defined for Purposes of IRC § 163(j) 13 / 13

- (iv) **Anti-avoidance rule for amounts predominantly associated with the time value of money.** Any expense or loss, to the extent deductible, incurred by a taxpayer in a transaction or series of integrated or related transactions in which the taxpayer secures the use of funds for a period of time is treated as interest expense of the taxpayer if such expense or loss is predominantly incurred in consideration of the time value of money.

Prop. Treas. Reg. §§ 1.163(j)-1(b)(20)

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Interest Deductions – International Prop. Treas. Regs.

§ 1.163(j)-7 *Application of the business interest deduction limitation to foreign corporations and United States shareholders.* [also issued under 26 U.S.C. 163(j)(8)(B) and 26 U.S.C. 1502.]

Applies to CFCs in computing GILTI and Subpart F income

§ 1.163(j)-8 *Application of the business interest deduction limitation to foreign persons with effectively connected income.* [also issued under 26 U.S.C. 163(j)(8)(B).]

Applies to foreign persons with ECI

Prop. Treas. Reg. §§ 1.163(j)-7 and -8

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Interest Deductions – Prop. Treas. Reg. § 1.163(j)-7 1/2

Under the **general rule**, **each** CFC with business interest expense would **separately** apply IRC § 163(j) to determine the extent to which that expense is:

- i. Deductible for purposes of computing subpart F income as defined under IRC § 952
- ii. Tested income as defined under IRC § 951A(c)(2)(A)
- iii. Income which is effectively connected with the conduct of a US trade or business (“ECI”)

IRC § 163(j) and Prop. Treas. Reg. §§ 1.163(j)-7

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Interest Deductions – Prop. Treas. Reg. § 1.163(j)-7 2 / 2

Alternative method election (same as prior slide plus):

Aggregate groups of CFCs with common ownership (80% by value) for IRC § 163(j) deduction determination

Goal of alternative method election is smaller interest expense when netted with CFC group member interest income and reduced disallowed interest expense deductions

In identifying CFC group members, members of a consolidated tax group are treated as a single person

Financial services group is considered to be a separate subgroup

IRC § 163(j) and Prop. Treas. Reg. §§ 1.163(j)-7

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Interest Deductions – Prop. Treas. Reg. § 1.163(j)-8

In general, a non-resident alien individual and non-CFC foreign corporations with ECI will apply IRC § 163(j) subject to certain modifications

A CFC with ECI first applies the general rules for determining its disallowed interest expense, which is then allocated between ECI and non-ECI at the CFC level

Treas. Reg. § 1.882-5 continues to apply regarding the determination of interest deductions. The definition of interest has been expanded to include guaranteed payments for use of capital (“GPUcs”), factoring income, certain hedging items and many other items. Converts IRC § 988 gains and losses on hedges of debt instruments into interest for purposes of IRC § 163(j)

IRC § 163(j) and Prop. Treas. Reg. §§ 1.163(j)-1(b)(20) and -8

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GILTI Draft Forms

Form 8990, Limitation on Business Interest Expense Under Section 163(j)
(Released Oct. 25, 2018) [3 pages]

<https://www.irs.gov/pub/irs-dft/f8990—dft.pdf>

Draft IRS Instructions to Form 8990 (Dec. 2018) (Released Dec. 10, 2018)

IRC § 163(j)

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Interest Deductions – Proposed Treasury Regulations 1 / 2

§ 1.163(j)-0 Table of contents.

§ 1.163(j)-1 *Definitions*. [also issued under 26 U.S.C. 163(j)(8)(B) and 26 U.S.C. 1502.]

§ 1.163(j)-2 *Deduction for business interest expense limited*. [also issued under 26 U.S.C. 1502.]

§ 1.163(j)-3 *Relationship of business interest deduction limitation to other provisions affecting interest*. [also issued under 26 U.S.C. 1502.]

§ 1.163(j)-4 *General rules applicable to C corporations (including REITs, RICs, and members of consolidated groups) and tax-exempt corporations*. [also issued under 26 U.S.C. 163(j)(8)(B) and 26 U.S.C. 1502.]

§ 1.163(j)-5 *General rules governing disallowed business interest expense carryforwards for C corporations*. [also issued under 26 U.S.C. 1502.]

§ 1.163(j)-6 *Application of the business interest deduction limitation to partnerships and subchapter S corporations*. [also issued under 26 U.S.C. 163(j)(8)(B) and 26 U.S.C. 1502.]

§ 1.163(j)-7 *Application of the business interest deduction limitation to foreign corporations and United States shareholders*. [also issued under 26 U.S.C. 163(j)(8)(B) and 26 U.S.C. 1502.]

§ 1.163(j)-8 *Application of the business interest deduction limitation to foreign persons with effectively connected income*. [also issued under 26 U.S.C. 163(j)(8)(B).]

§ 1.163(j)-9 *Elections for excepted trades or businesses; safe harbor for certain REITs*. [also issued under 26 U.S.C. 163(j)(7)(B) and (C) and 26 U.S.C. 1502.]

§ 1.163(j)-10 *Allocation of interest expense, interest income, and other items of expense and gross income to an excepted trade or business*. [also issued under 26 U.S.C. 163(j)(8)(B) and 26 U.S.C. 1502.]

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§ 1.163(j)-11 *Transition rules*. [also issued under 26 U.S.C. 1502.]

Interest Deductions – Proposed Treasury Regulations 2 / 2

***** §1.1502-12 Separate Taxable Income

§ 1.263A-8 through -15 also issued under 26 U.S.C. 263A(j).

§ 1.382-1 also issued under 26 U.S.C. 382(m).

§ 1.383-0 also issued under 26 U.S.C. 382(m) and 26 U.S.C. 383.

§ 1.383-1 also issued under 26 U.S.C. 382(m) and 26 U.S.C. 383.

§ 1.860C-2 also issued under 26 U.S.C. 860C(b)(1).

§ 1.1502-90 also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

439 pages with Preamble when released – Nov. 27, 2018
 XX pages as sent to the Federal Register – Dec. XX, 2018
 REG-106089-18

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Overview – Base Erosion Anti-Abuse Tax (“BEAT”)

- BEAT - Overview
- BEAT - Exception
- BEAT - Modified Taxable Income (“MTI”)
- BEAT - Proposed Treasury Regulations
- BEAT – Draft Form

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Base Erosion Anti-Abuse Tax ("BEAT") - Overview

Only C corps. liable for BEAT - pay a tax of 10% (5% in 2018 and 12.5% after 2025) of modified taxable income [Banks and security dealers rate is 1% higher per year]

BEAT applies to US corporations which make deductible payments and accruals, including basis for depreciable property, to related foreign entities (for other than inventory, cost of goods sold, and derivatives contracts)

If the base erosion payments to related foreign entities (shifting profits overseas) do not exceed 3% [2% for banks and security dealers] of deductions (a safe harbor), BEAT does not apply. Deductions exclude NOLs, FDII, GILTI, & DRD

Fixed or determinable annual or periodical ("FDAP") income subject to US WHT at 30% is excluded from BEAT or partially excluded if WHT is reduced from 30% under treaty

Group US gross receipts for the prior 3 years must exceed USD 500 M

IRC § 59A

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Base Erosion Anti-Abuse Tax ("BEAT") - Exception

Payments by a US affiliate of a related foreign entity for services that are eligible for the services cost method ("SCM"), which allows for certain services to be charged at cost with no markup, can escape the BEAT. Treas. Reg. § 1.482-9(b)(5) and Rev. Proc. 2007-13

Can cost of eligible services be separated from markup (bifurcation) so that only the markup is subject to BEAT?

A floor colloquy between Sen. Rob Portman (R-Ohio) and Senate Finance Committee Chairman Orrin G. Hatch (R-Utah) that occurred before the tax law's enactment suggests it was Congress's intent to allow for that taxpayer-favorable approach.

Does BEAT violate certain US Double Taxation Treaties and / or World Trade Organization ("WTO") rules?

IRC § 59A

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BEAT – Modified Taxable Income (“MTI”)

Start with taxable income

+ base erosion tax benefits (“BETB”)

+ portion of NOL related to BETB

= MTI

IRC § 59A(c)

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BEAT – Proposed Treasury Regulations

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§ 1.59A-1 Base erosion and anti-abuse tax [also issued under 26 U.S.C. 59A(i).]

§ 1.59A-2 Applicable taxpayer [also issued under 26 U.S.C. 59A(i).]

§ 1.59A-3 Base erosion payments and base erosion tax benefits [also issued under 26 U.S.C. 59A(i).]

§ 1.59A-4 Modified taxable income [also issued under 26 U.S.C. 59A(i).]

§ 1.59A-5 Base erosion minimum tax amount [also issued under 26 U.S.C. 59A(i).]

§ 1.59A-6 Qualified derivative payment [also issued under 26 U.S.C. 59A(i).]

§ 1.59A-7 Application of base erosion and anti-abuse tax to partnerships [also issued under 26 U.S.C. 59A(i).]

§ 1.59A-8 Application of base erosion and anti-abuse tax to certain expatriated entities. [Reserved] [also issued under 26 U.S.C. 59A(i).]

§ 1.59A-9 Anti-abuse and recharacterization rules [also issued under 26 U.S.C. 59A(i).]

§ 1.59A-10 Applicability Date [also issued under 26 U.S.C. 59A(i).]

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BEAT – Proposed Treasury Regulations

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- § 1.383-1(d)(3)(i) Special limitations on certain capital losses and excess credits
- § 1.1502-2 Computation of tax liability
- § 1.1502-4(d)(3) Consolidated foreign tax credit
- § 1.1502-43(b)(2)(i)(A) Consolidated accumulated earnings tax
- § 1.1502-47(f)(7)(iii) Consolidated returns by life-nonlife groups
- § 1.1502-59A Application of section 59A to consolidated groups [also issued under 26 U.S.C. 1502.]
- § 1.1502-100(b) Corporations exempt from tax [also issued under 26 U.S.C. 1502.]
- § 1.6038A-1(n)(2) and (3) General requirements and definitions
- § 1.6038A-2(a)(3) and (b)(5) Requirement of return [also issued under 26 U.S.C. 6001, 6038A, and 6038C.]
- § 1.6038A-4 [Amended]
- § 1.6655-5 [Amended]

193 pages with Preamble when released – Dec. 13, 2018
 XX pages as sent to the Federal Register – Dec. XX, 2018
 REG-104259-18, RIN 1545-B056

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BEAT Draft Form

Form 8991, Tax on Base Erosion Payments of taxpayers With Substantial Gross Receipts (Released Sept. 5, 2018) [5 pages]

<https://www.irs.gov/pub/irs-dft/f8991—dft.pdf>

Schedule A – Base Erosion Payments and Base Erosion Tax Benefits

Schedule B – Credits Reducing Regular Tax Liability in Computing Base Erosion Minimum Tax Amount (BEMTA)

IRC § 59A

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Overview – Foreign Derived Intangible Income (“FDII”)

- Foreign Derived Intangible Income (“FDII”)
- 37.5% of FDII & 50% of GILTI Deductions
- FDII - Proposed Treasury Regulations
- FDII – Draft Form
- BEAT & FDII – European Union (“EU”) Reaction

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Foreign Derived Intangible Income (“FDII”)

1/2

US C corporations (not available for individuals, S Corporations, RICs, or REITs) entitled to a FDII deduction may deduct 37.5% (21.875% after 2025) of FDII, effective tax rate of 13.125% (16.406% after 2025) on FDII with 21% corporate tax rate

FDII is income derived from:

- Sales or other dispositions of property to a foreign person for a foreign use,
- A license of IP to a foreign person for a foreign use, and
- Services provided to a person located outside the US

IRC §§ 250 and 951A

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Foreign Derived Intangible Income ("FDII")

2/2

Related party transactions qualify for FDII deduction, if property or services are for use by a third party outside the US, established to the satisfaction of the Secretary

For FDII deduction compute US version of QBAI deduction in computing GILTI

The deductions permitted for 50% of GILTI and 37.5% of FDII are provided under IRC § 250 and are permitted only in the current year (year in which they occur with no C/B and with no C/O).

IRC §§ 250 and 951A

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Foreign Derived Intangible Income ("FDII")

Deduction Eligible Income ("DEI") = Gross Income – (GILTI + Subpart F Inc. + Financial Services Inc. + Div. From CFC + Dom. O&G Extraction Inc. + Foreign Branch Income) – (Deductions (including Interest Exp.) and Taxes Allocated to Gross Income)

Deemed Tangible Income Return ("DTIR") = QBAI X 10% - Specified Interest Expense (Interest Expense in Allocable Deductions without Interest Income inclusions)

Deemed Intangible Income ("DII") = DEI – DTIR

All computations are on a US tax consolidated basis

Foreign Derived Deduction Eligible Income ("FDDEI") = Foreign Revenue – Foreign Revenue Related Cost of Goods Sold = Gross Income – (Allocable Deductions + Taxes)

Initial FDII = DII X (FDDEI / DEI)

If there is no taxable income, there is no deduction

FDII = Initial FDII [Limited by 50% GILTI Deduction & Taxable Income]

IRC §§ 250 & 951A

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37.5% of FDII and 50% of GILTI Deductions

Foreign Derived Intangible Income ("FDII") X 37.5% =	FDII Deduction
(Global Intangible Low-Taxed Income ("GILTI") + IRC § 78 gross-up) X 50% =	<u>GILTI Deduction</u>
Total	<u>IRC § 250 Deduction</u>

IRC § 250 deduction for FDII and GILTI is limited to taxable income of a domestic corporation (calculated without regard to the IRC § 250 deduction, but with regard to a deduction for an NOL carryover under IRC § 172(a))

IRC § 250 deductions are taken into account in computing taxable income for interest expense deductions limits under IRC § 163(j) [may add back GILTI deduct.]

IRC §§ 78, 163(j), and 250 and Prop. Treas. Reg. § 1.78-1

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FDII – Proposed Treasury Regulations

§ 1.250-1 Not yet issued

XXX pages with Preamble when released – Dec. XX, 2018
 XX pages as sent to the Federal Register – Dec. XX, 2018
 REG-10XXXX-18

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FDII Draft Form

Form 8993, Section 250 Deduction for Foreign-Derived Intangible Income (FDII) and Global Intangible Low-Taxed Income (GILTI) (Released Aug. 22, 2018) [1 page]

<https://www.irs.gov/pub/irs-dft/f8993--dft.pdf>

The above named form will be an attachment to Form 5471, Information Return of U.S. Persons With Respect To Certain Foreign Corporations

IRC § 250

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BEAT & FDII – European Union (“EU”) Reaction

BEAT legislation is designed to discourage payments to related foreign entities that decrease the US tax base

FDII legislation is designed to encourage exports of US goods and services to foreign purchasers

The EU has indicated that it will file a complaint with the WTO that BEAT discriminates against foreign trade and FDII provides an unfair subsidies to domestic (US) producers of exported goods and services

US will argue that FDII and GILTI together lead to “tax neutrality” for business decisions on whether to conduct foreign activities thru a CFC or US corp. at OECD Harmful Tax Practices Forum Oct. 15, 2018

IRC §§ 59A and 250

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Branch Income

Branch income is a new separate category of income attributable to a Qualified Business Unit

FTC against branch category of income must from branch category of income – no cross crediting of FTCs

IRC §§ 904(d)(1)(B) and 989(a)

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Hybrid Transactions

Hybrid transaction with related persons result in disallowed deductions

Hybrid entity transaction with related entity may result in disallowed deductions

Deduction disallowed for interest or royalties paid or accrued to a related party

IRC § 267A

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Miscellaneous Changes – Transfer of Branch Losses

Certain branch with losses transferred from domestic corporation to Specified 10% Owned Foreign Corporations

Include in gross income deductible losses incurred by foreign branch after December 31, 2017 over taxable income after year loss incurred and gain recognized on account of transfer

Income treated as sourced in US (income cannot be offset with FTCs)

IRC § 91

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Miscellaneous Changes – Source of Income

50% of income sourced at place of production and 50% sourced at place of sale repealed

Now income is sourced based on place of production activities

IRC § 863(b)

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TCJA – Staff Accounting Bulletin (“SAB”) 118

Record effects of Act (Pub. L. No. 115-97) in period that law is enacted – Dec. 22, 2017

Good faith effort to complete timely – update provisional estimates when known – do not wait until finalized

Optional responses: 1. Accounting Complete, 2. Reasonable Estimate, 3. No Estimate

Record adjustments to provisional amounts as a discrete adjustment during period

Update required disclosures every quarter during measurement period

Measurement period ends December 22, 2018

Securities and Exchange Commission, 17 CFR Part 221, SAB 118 and ASC Topic 740, *Income*¹⁴³ Taxes

TCJA – Financial Accounting Standards Advisory Council

On September 25, 2018, FASAC held its quarterly meeting to discuss Tax Reform and Income Tax Disclosures. Discussion focused on:

- Whether new disclosures surrounding Tax Reform (GILTI/BEAT/FDII) are needed,
- Views on existing APB 23 disclosures,
- Tax Attribute expirations and
- Whether any current disclosures are irrelevant

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EDUCATION:

Robert Morris University – M.S., Taxation, 1980
West Virginia University College of Law – J.D., Law, 1972
Wheeling Jesuit University - B.S., Accounting, 1967

PROFESSIONAL ADMISSIONS & AFFILIATIONS:

Supreme Courts of Ohio, Pennsylvania, West Virginia, and United States
Other United States Courts: Tax, Claims, Southern District of WV and Western District of PA
Certified Public Accountant in Pennsylvania (Active) and in West Virginia (Inactive)
State Bar Associations – Pennsylvania and West Virginia
Tax Executives Institute, Inc. – Pittsburgh Chapter
Allegheny Tax Society – President – 1992-1993

EMPLOYMENT:

Arconic Inc.-Alcoa Inc.	Senior Tax Attorney – 2000 – present General Tax Attorney – 1983 – 2000 Tax Attorney – 1980 – 1983 Administrator – State Taxes – 1978 – 1980
National Steel Corporation	Tax Accountant – 1975 – 1978
Arthur Andersen & Co.	Senior Tax Accountant – 1972 – 1975

WORK EXPERIENCE:

US State and Local: Many states and taxing jurisdictions – sales & use, gross receipts, property, surplus lines insurance, franchise, income (separate, combined, unitary)
US Federal and International: Excise, windfall profit, employee benefits, technology transfer, tax effective multinational purchasing and sales, acquisitions, dispositions
Foreign: Multinational structuring, hybrid entities, many countries, especially in Europe

OUTSTANDING ACCOMPLISHMENT:

Taxpayer and litigating attorney in *Marchlen v. Mt. Lebanon*, 746 A.2d 566 (2000) – Landmark PA Local Tax Enabling Act earned income tax stock option case at Pennsylvania Supreme Court
Robert Morris University Alumni Achievement Award – 09/28/2001
Wheeling Jesuit University Distinguished Alumni Award - 2003

MILITARY SERVICE:

Served under Col. George S. Patton III – 11th Armor Cavalry Regiment - Republic of Vietnam in US Army armor intelligence – 1968 - 69

COMMUNITY INVOLVEMENT:

John Carroll University Member of Board of Directors – 2009 – 2018
Wheeling Jesuit University Member of Board of Directors – 1986 – 2008 (22.5 yrs.) – Chair from 2000 – 2004 – Emeritus 2008 – present
West Virginia University College of Law Dean's Partner and Member of National Advisory Council – 3 year term
Penn State University – Greater Allegheny CPA Academic Committee – 1985 - present

PERSONAL:

Born – October 31, 1945 in Wheeling, WV
Married – October 17, 1986 to Judith Breedlove Marchlen
Child – Amy Elizabeth Marchlen – Born February 2, 1988

