

# Abbott, Stringham & Lynch Tax Group



## U.S. Tax Reform: The Big Shake-Up In International Tax Law

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# Upcoming Webinars

## All at 12:00-1:00 PST



Tuesday, February 6, 2018 –  
Tax Reform and the Impact on Real Estate

Wednesday, February 7, 2018 –  
Tax Reform for Pass-Through Entities

# Agenda

- Introduction to New Tax Regime
- Participation Exemption for Dividends from Foreign Subsidiaries
- Transition Tax - Repatriated Earnings
- Global Intangible Low Taxed Income (GILTI)
- Deduction for Foreign-Derived Intangible Income (FDII)
- Other International Tax Provisions and Considerations

# Introduction

- Review of old world-wide tax system
- Review of new hybrid territorial tax system



# Participation Exemption for Dividends From Foreign Subsidiaries



- The Act provides a 100% dividends received deduction (DRD) to a U.S. corporate shareholder for the foreign-source portion of dividends received from a “specified 10-percent owned foreign corporation.”
- Deduction is available to a U.S. C corporation.
- Specified 10% (vote or value) owned foreign corporation is any foreign corporation (other than a passive foreign investment company (PFIC)) that is not a controlled foreign corporation with respect to which there is at least one domestic corporate shareholder which owns at least 10% of the stock.
- Holding period – 1 year
- The foreign-source portion of dividends includes only undistributed earnings and profits (E&P) that are not attributable to U.S. effectively connected income (ECI) or dividends from an 80%-owned U.S. corporation, determined on a pooling basis.

# Participation Exemption for Dividends From Foreign Subsidiaries (continued)

- No foreign tax credit or deduction will be allowed for any foreign taxes, including withholding taxes, paid (or any entity-level foreign taxes that are deemed paid) with respect to a dividend for which a Foreign-Source DRD is allowed.
- The DRD is not available for any dividend received by a U.S. shareholder from a CFC if the dividend is a “hybrid dividend.” Hybrid dividend is defined as a dividend with respect to which the foreign corporation received a deduction or tax benefit from a foreign country.
- Effective for tax years of foreign corporations that begin after December 31, 2017 and for tax years of U.S. shareholders in which such tax years of foreign corporations end. (In other words distributions made after December 31, 2017.)

# Transition Tax



- **U.S. shareholders of specified foreign corporations** to include in income their pro rata share of the –
  - Undistributed,
  - Non previously taxed foreign earnings of the corporation
- One time, mandatory tax on “deemed repatriation” of accumulated earnings of a foreign corporation.
- Effective Date – 2017 tax year for calendar year taxpayers that own foreign corporations with a calendar year end.

# Transition Tax



- The greater of accumulated earnings and tax pool as of 11/02/17 or 12/31/17
- Cash and other liquid assets on the foreign corporation's balance sheet are taxed at a 15.5% rate; measured as the greater of:
  - Average of the cash balance of 2015 and 2016; or
  - 2017 year-end balance
- All other accumulated earnings are taxed at an 8% rate.
- Reduced foreign tax credit available



# Transition Tax Example

EXAMPLE OF TRANSITION TAX			Calculation	
	<b>Accumulated E&amp;P</b>	<b>Tax Pool</b>	Repatriation Income (E&P as of 12.31.17)	<b>1400 (b)</b>
<b>CFC 1</b>	1400	150	Amount subject to 15.5% rate	1200 (a)
<b>(b)</b>	1400	150	<i>(Aggregate foreign cash position)</i>	
			Participation Exemption Cash - (.557)	-669
			Subtotal	<b>531 A</b>
<i>(In this example, assume E&amp;P as of 12/31/2017 is 1400)</i>				
			Amount subject to 8% rate (Remainder)	200 (b)-(a)
			Participation Exemption Non Cash - (.771)	-154
			Subtotal	<b>46 A</b>
<b>Cash balance of CFC 1</b>				
12/31/2015	1100		Inclusion w/o sec. 78 gross up	577 <b>Sum of A</b>
12/31/2016	600		Sec. 78 gross up	62
	1700		Total inclusion amount	639
Average	850		Tax @ 35%	224
12/31/2017	1200 (a)		Foreign tax credit	-62
			Total tax	162
			Effective tax rate	12%

# Transition Tax (continued)

- Election to Pay Transition Tax Liability in Eight Installments
  - 8% of tax in each of the first five installments
  - 15% of the tax in the sixth installment
  - 20% of the tax in the seventh installment and
  - 25% of the tax in the eighth installment

If election is made, the first installment must be paid by the original due date of the relevant tax return.

- Election to disregard/exclude deferred foreign income for NOL purposes
- A U.S. shareholder with deferred income from a foreign corporation and an NOL carryforward can elect to not use the NOL against low taxed income and pay tax at the reduced rate on that income.

# Transition Tax (continued)

- Special Rules for S corporation shareholders
- Any shareholder of a S corporation which in turn is a U.S. shareholder of a foreign corporation may elect to defer tax liability until the occurrence of a triggering event.
- The triggering event is any event below that occurs first –
  - The shareholder of the S corporation transfers any of its shares of stock in the S corporation;
  - a liquidation or sale of substantially all the assets of the S corporation, a cessation of business by the S corporation, the S corporation ceases to exist, or any similar circumstance; or,
  - the corporation ceases to be an S corporation.

# Global Intangible Low-Taxed Income (GILTI)



- GILTI applies to 10% or more shareholder of any controlled foreign corporation (CFC).
- Each 10% U.S. Shareholder of a CFC, whether such shareholder is an individual or an entity, is required to include currently in its income its GILTI in the applicable tax year.
- GILTI regime is effective for taxable years beginning after December 31, 2017.
- It is calculated in the aggregate for a U.S. person with respect to the CFCs for which it is a 10% U.S. shareholder.

# GILTI Calculation



## Step 1. Calculate CFC's tested income

CFC' total gross income

Less CFC's U.S. effectively connected income

Less CFC's Subpart F Income

Less CFC's dividends from related person's

Less CFC's foreign oil and gas extraction income

Less CFC's high taxed income

Less other deductions (including taxes)

CFC tested income

# GILTI Calculation (continued)

## Step 2. Calculate QBAI(Qualified Business Asset Invest.)

QBAI is the quarterly average tax basis(using straight-line depreciation) in depreciable tangible property used in the production of the relevant income/loss.

## Step 3. Calculate Net Deemed Tangible Income Return

10% QBAI (of each relevant CFC)

Less: The net amount of interest expense taken into account in determining the net tested income.

Net Deemed Tangible Income Return

# GILTI Calculation (continued)

## Step 4. Calculate GILTI

GILTI is the excess (if any) of the U.S. person's aggregate net tested income over aggregate net deemed tangible income return, or:

$$\text{GILTI} = \text{Tested income} - \text{Net deemed tangible income return}$$

# GILTI (continued)

- **GILTI Deduction**

For taxable years 2018-2025, a deduction is allowed equal to 50% of GILTI.

Only C corporations are allowed a deduction of 50%.

At the new 21% corporate tax rate, this results in an effective tax rate of 10.5% on GILTI (without taking into account foreign taxes).

- **GILTI Foreign tax credit**

Limited to 80% of foreign income taxes paid attributable to GILTI.

With foreign tax rates of 13.125% or higher, C Corporations will owe no residual tax with respect to their GILTI.

Foreign tax credits are only allowed for C corporations even though all 10% shareholders are subject to GILTI.

No carryforward or carryback of credits



# GILTI Example

	CFC	
Tested Income	\$900	(a)
Tax	\$100	(b)
Asset Tax Basis(QBAI)	\$4,500	(c)
GILTI		
Tested Income	\$900	
10% return on its tangible assets (4500*10%)	\$ (450)	10% of (c)
GILTI	\$450	(d)
FTC Calc		
Inclusion percentage (GILTI/Tested Income)	50%	(d)/(a)=(e)
Sec. 78 gross up (inclusion percentage * tax)	\$50	(e)*(b)
Deemed paid credit (FTC) (80% inclusion percentage * tax)	\$40	
sec. 956A inclusion		
GILTI+ sec. 78 Gross up	\$500	
50% GILTI deduction	\$(250)	
Taxable amount	\$250	
Corp tax rate	21%	
Tax before foreign tax credit	\$52.50	
FTC	\$40	
Tax	\$12.50	

- Who does this impact?
- GILTI impacts the shareholders of CFCs that have low levels of depreciable assets as compared to their income.
- Typically this would be the tech companies and service providers who have a significant amount of intangible assets and low levels of fixed and depreciable assets.
- An individual shareholder or an investor in a flow-through entity with GILTI, is taxed at the highest ordinary income tax rate applicable to such individual.

# Foreign-Derived Intangible Income (FDII)



- FDII is generally the portion of the U.S. corporation's net income that exceeds a deemed rate of return of tangible depreciable business assets.
- Eligible C Corporations are allowed a deduction equal to 37.5% of FDII for tax years 2018-2025 and 21.875% for years thereafter.
- It reduces the effective U.S. tax rate for Eligible C Corporations on foreign derived income treated as attributable to intellectual property and other intangible assets.

# FDII Calculation – Step 1

## Calculate the Deductible Eligible Income(DEI)

- Gross income of the corporation without regard to the following:
  - Subpart F
  - GILTI
  - Dividends received from 10% owned CFC
  - Foreign branch income
- Reduced by the deductions(including taxes) allocable to such gross income.

# FDII Calculation – Step 2

## Calculate the Foreign Derived Deductible Eligible Income(FD-DEI)

- DEI is considered foreign derived if it is derived in connection with:
  - Property sold to a non-U.S. person for foreign use.
  - Services provided to any person or property outside the U.S.

# FDII Calculation – Step 3

## Calculate the Deemed Intangible Income(DII)

- DEI(calculated on previous slide)
- Reduced by 10% of the tax basis of the qualified business asset investment(QBAI)
  - QBAI is the quarterly average tax basis(using straight-line depreciation) in depreciable tangible property used in the production of the relevant income/loss.

# FDII Calculation – Step 4

Calculate FDII(Foreign Derived Intangible Income)

$$\text{FDII} = \text{DII} * (\text{FD-DEI}/\text{DEI})$$

- Deduction is equal to 37.5% of FDII
- Effective tax rate of FDII is 13.125% or (21%(1-37.5%))

# FDII Calculation - Example

$$\underline{\text{FDII} = \text{DII} * (\text{FD-DEI}/\text{DEI})}$$

- Example
  - U.S. Co facts:
    - Net taxable income: \$1,000,000
    - Foreign derived portion: \$200,000
    - Qualified business asset basis: \$2,500,000
  - $\text{DII} = \$750,000$ 
    - $\$1,000,000(\text{DEI}) - 10\% * \$2,500,000(10\% * \text{QBAI})$
  - $\text{FDII} = \$150,000$ 
    - $\$750,000(\text{DII}) * (\$200,000(\text{FD-DEI})/\$1,000,000(\text{DEI}))$
  - FDII deduction
    - $\$150,000 * 37.5\% = \$56,250$
  - Effective tax rate on FDII
    - $21\%(\$150,000 - \$56,250)/\$150,000 = 13.125\%$

# Other International Tax Provisions



- Base erosion & anti-abuse tax (BEAT)
- Other foreign tax credit changes
- State implications?



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- Questions?

