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U.S. Tax Reform
Outbound Cross Border Business Provisions

Presented by:
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Agenda

Outbound Cross Border Business Provisions

- Policy Considerations
- Quasi Territorial Tax System
- Participation Exemption
- Mandatory Repatriation
- Global Intangible Low Taxed Income (GILTI)
- Foreign-Derived Intangible Income (FDII)
- Foreign Tax Credits (FTC)
- Considerations for Foreign Owned U.S. Companies

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Policy Considerations Driving Tax Reform

- High U.S. corporate tax rate
- U.S. = WW tax system; most countries = territorial tax system
- Deferral of U.S. tax on foreign subsidiary profits
- Massive transfer of U.S. intellectual property to foreign subsidiaries
- $2.6 trillion generated and deferred foreign subsidiaries
- Corporate inversions
- Base erosion payments by U.S. subsidiaries to foreign owners
- Stagnate wage growth

Outbound Cross Border Business Provisions

Most provisions effective as of January 1, 2018

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Quasi – Territorial System

New Quasi Territorial Tax System

- Deferral of foreign subsidiary income is no longer possible.
- All income of foreign subsidiaries is either:

1) Exempt from U.S. tax via participation exemption
   - all income of 10/50 foreign subsidiaries
   - tangible income of CFC's (i.e., deemed 10% return on tangible depreciable assets)

2) Taxed immediately
   - CFC subpart F
   - GILTI income

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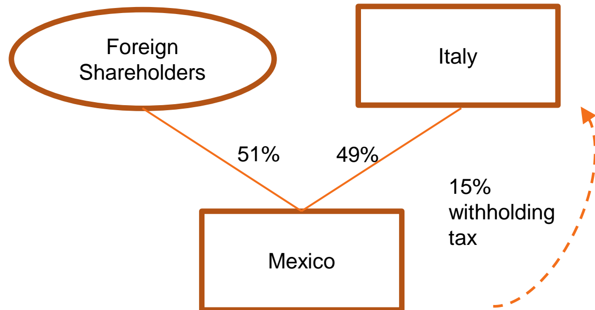
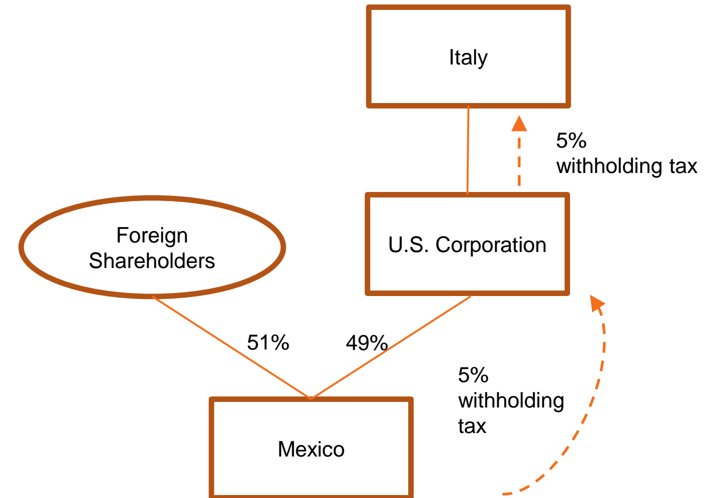
Benefit of Using U.S. Participation Exemption for Mexican Income



Mexican Corp Income		10,000,000
Mexican Corporate Tax	30%	(3,000,000)
Dividend Amount		7,000,000
Italian Company's Share	49%	3,430,000
Mexican Withholding Tax	15%	(514,500)
Italian Net Dividend		**2,915,500**
Total Tax on Italian Share		**1,984,500**
Effective Tax Rate		**40.5%**



Mexican Corp Income		10,000,000
Mexican Corporate Tax	30%	(3,000,000)
Dividend Amount		7,000,000
U.S. Company's Share	49%	3,430,000
Mexican Withholding Tax	5%	(171,500)
U.S. Corporation's Share		3,258,500
U.S. Tax	Exempt	
U.S. Withholding Tax	5%	(162,925)
Dividend Received by Italian Corp		**3,095,575**
Effective Tax Rate		**36.8%**

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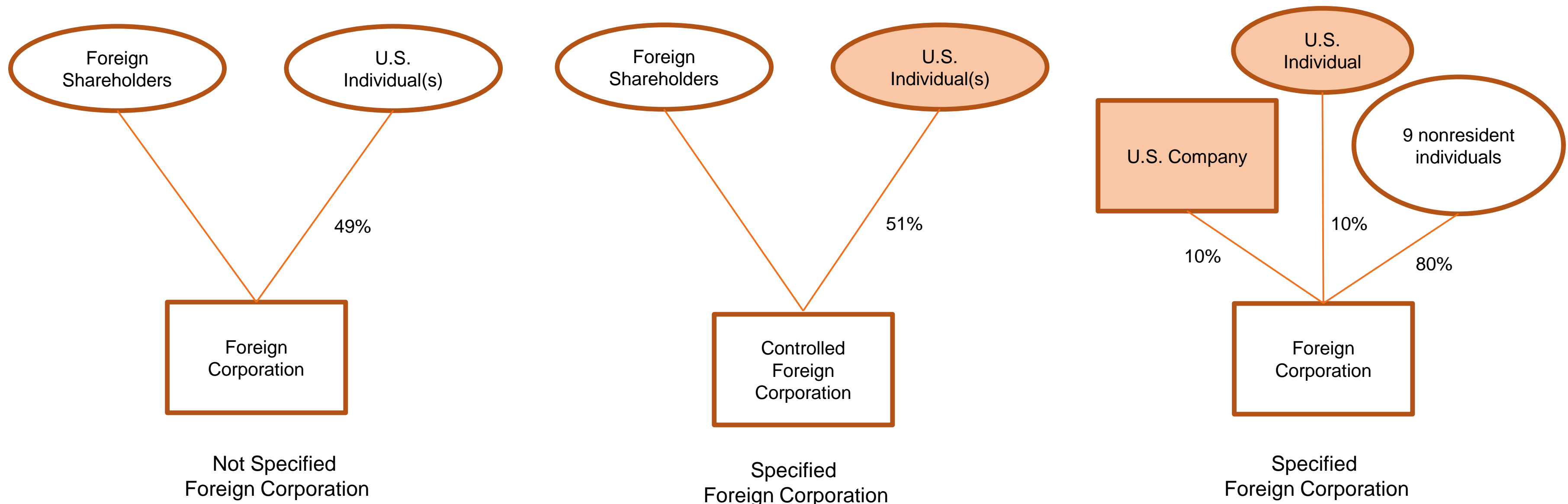
Section 965 Mandatory Repatriation: Specified Corporation Examples

- **“Section 965 specified foreign corporation”** means
  (A) any CFC, and
  (B) any foreign corporation with respect to which one or more domestic corporations is a United States shareholder (“10-percent corporation”). Section 965(e)(1).



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Downward Attribution from Foreign Companies

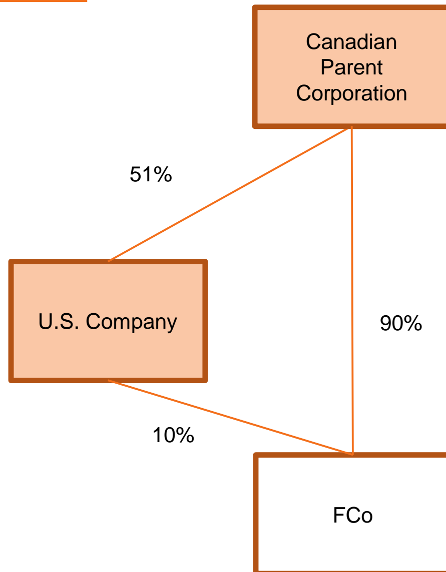
Repeal of Section 958(b)(4)

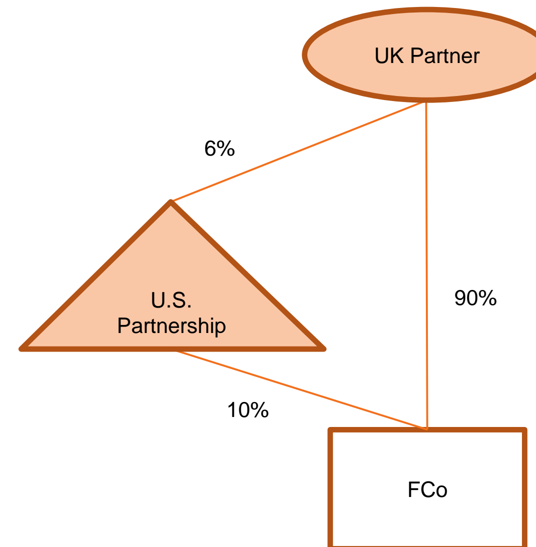
- As a result of the repeal of section 958(b)(4), section 958(b) now provides for “downward attribution”
- Per constructive ownership rules, a **U.S. subsidiary** that is more than 50% **owned by a foreign parent company** is treated as constructively owning any foreign subsidiary stock owned by the foreign parent company. Section 318(a)(3)(C)
- Foreign corporations that were not previously treated as CFCs may be treated as CFCs.

Attribution from Foreign Partners

- Stock owned, directly or indirectly, by or for a partner (tested partner) **will not be considered as being owned by a partnership** under sections 958(b) and 318(a)(3)(A) **if such partner owns less than five percent** of the interests in the partnership’s capital and profits.

Downward Attribution - Example

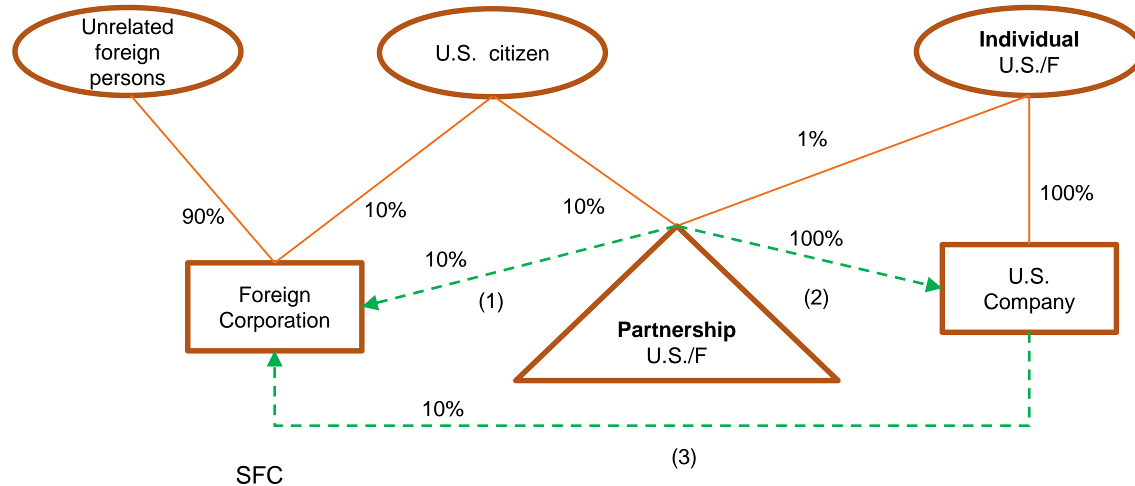




Example: Where an Canadian parent company (P) owns over 50% of a U.S. company (U.S.Co) and over 50% of a foreign company (FCo), U.S.Co is treated as constructively owning over 50% of FCo via attribution and FCO would be treated as a controlled foreign corporation.

Example: Where a UK Partner (P) owns over 5% interest in the capital and profits of a U.S. Partnership (USP) USP is treated as constructively owning over 50% of FCo via attribution and FCO would be treated as a controlled foreign corporation.

Change in CFC Attribution



- Under sections 958(b) and 318(a)(3)(A), partnership would be treated as owning 100 percent of the stock of U.S. Company and 10 percent of the stock of Foreign Corporation.
- As a result, under sections 958(b), 318(a)(5)(A), and 318(a)(3)(C), U.S. Company would be treated as owning the stock of Foreign Corporation treated as owned by Partnership, and thus Domestic Corporation would be a U.S. shareholder with respect to FC, causing FC to be a specified foreign corporation within the meaning of section 965(e)(1)(B).

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Downward Attribution – Reporting Implications

- Generally, US 10% shareholders of a CFC must file Form 5471
- The IRS will amend Form 5471 Instructions to provide an exception from Category 5 filing (owned CFC stock on last day of year) for a U.S. person that is a U.S. shareholder of a CFC due to downward attribution if no U.S. shareholder owns CFC stock directly or indirectly,
- So downward attribution will not cause Form 5471 compliance if stock is not held directly.

Entity Choice Pre-Tax Reform

	Pre-Tax Reform	
	Corporation	**Passthrough**
Entity Tax	35%	Exempt
Shareholder/Owner Tax	23.8%	39.6%

- Pre tax reform, it was typically more tax efficient to generate business income via a partnership than a corporation.

- Following tax reform, it may be more efficient to generate cross border business income via a corporation as opposed to a passthrough, depending on the circumstances.

Section 951A
CFC Global Intangible Low-Taxed Income (GILTI)

- Inspired by massive transfer of IP out of the U.S.
- New CFC income type that is immediately includible in U.S. shareholder's gross income
- GILTI = CFC residual income in excess of a deemed 10% return on tangible, depreciable business assets
- Domestic corporate shareholders taxed at effective rate of 10.5% tax after applying a 50% deduction
- Reduced tax may be offset by up to 80% of FTCs; GILTI tax fully offset where foreign tax rate exceeds 13.125%
- Individuals subject to maximum rate of 37% on GILTI; option to make Section 962 election to be taxed as a corporation

Sections 951A & 250
GILTI

GILTI Category	Category	CFC Income Description	U.S. Tax Rate *	Foreign Tax Credit
Non Tested Income	Category 1	GILTI Exclusions: Subpart F, 956, ECI, foreign oil/gas, related dividends, certain subpart F amounts taxed in excess of 18.9%	21%	100% limited to current year taxes paid
Net CFC Tested Income	Category 2	Deemed Tangible Income: 10% return on tangible assets	Exempt	N/A
	Category 3	Deemed GILTI (residual amount in excess of bucket two amount)	10.5% until 2028 via 50% DRD, then 13.125%	80% in separate FTC basket with no carryback or carryover of excess taxes

** Tax Treatment Above Applies to U.S. Corporate Shareholders Only*

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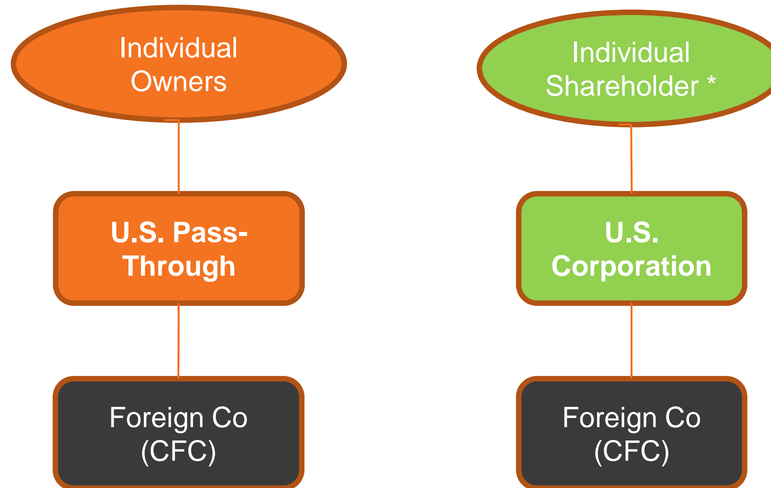
U.S. Tax Comparison: Use of U.S. Passthrough vs. U.S. Corporation as Owner of Foreign Companies



Foreign Co Income Categories:	Max U.S. Pass-Through Rate Non-Treaty Country	Max U.S. Pass-Through Rate Treaty Country	U.S. Corporate Rate	Tax on Distribution to U.S. Individual	Total ETR on Corporate Structure
Deemed Tangible Income	40.8%	23.8% *	Exempt	23.8%	23.8%
Deemed Intangible Income	40.8%	40.8%	10.5%	23.8%	31.8%
Subpart F Income	40.8%	40.8%	21%	23.8%	39.8%

*40.8 percent = 37% statutory rate plus 3.8% Medicare surtax.

Note: Pass-Through owners qualify for lower rate (maximum of 23.8%) on distribution of deemed tangible income from a foreign corporation located in a treaty country.

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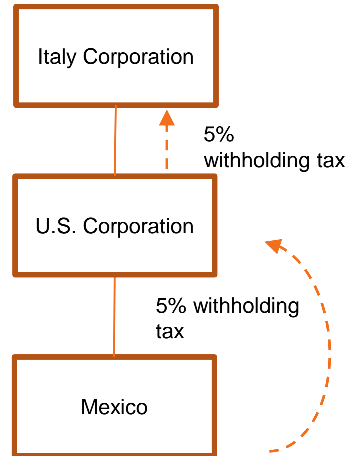
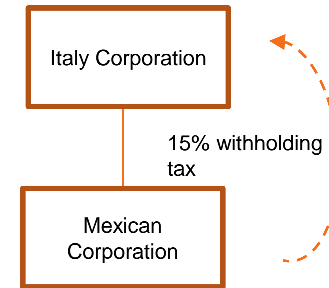
Maximizing GILTI





Foreign Corp Income		1,000,000
Mexican Corporate Tax	30%	(3,000,000)
Dividend Amount		7,000,000
Mexican Withholding Tax	5%	(350,000)
U.S. Corporation's Share		6,650,000
U.S. Tax (10.5% fully offset by FTC)		o
U.S. Net Income		6,650,000
U.S. Withholding Tax	5%	(332,500)
Italy Dividend Received		**6,317,500**
Effective Tax Rate		**36.8%**

Mexican Corp Income		10,000,000
Mexican Corporate Tax	30%	(3,000,000)
Dividend Amount		7,000,000
Mexican Withholding Tax	15%	(1,050,000)
Italian Company's Share		**5,950,000**
Effective Tax Rate		**40.5%**

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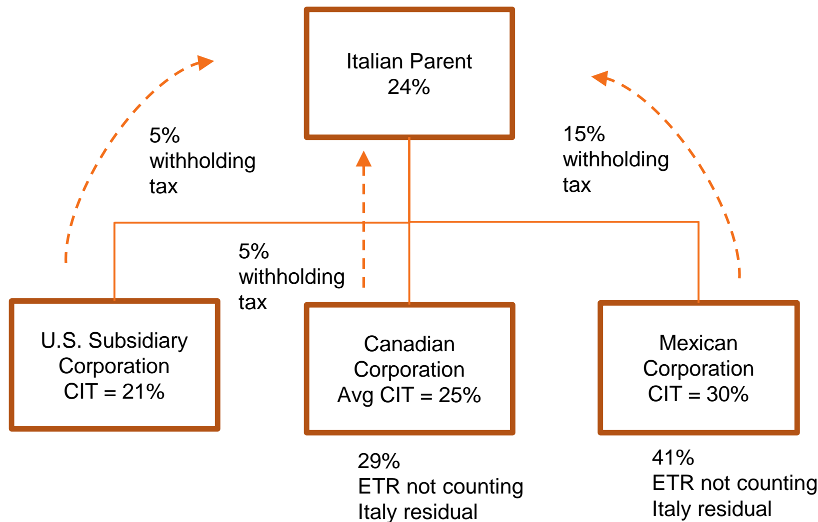
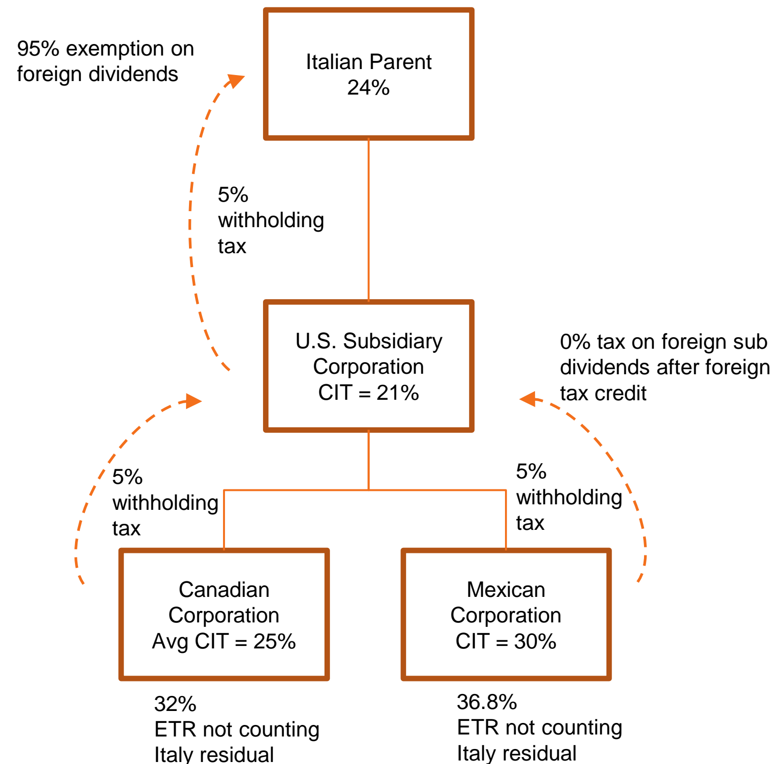
Section 951A GILTI





Under CFC GILTI rules, effective rate on foreign sub earnings should be between 0% and 10.5 percent with 80% credit for foreign taxes paid

Under CFC GILTI rules, effective rate on foreign sub earnings should be between 0% and 10.5 percent with 80% credit for foreign taxes paid

Section 962 Election
Election to be Taxed as a Corporation

- Individuals, trusts & estates are taxed at 37% on deemed inclusions from foreign subsidiaries:
  - Section 965 mandatory repatriation
  - GILTI inclusions
  - Subpart F inclusions
- Individuals, trusts & estates may make a Section 962 election to be taxed as corporations.
- Policy of election is to avoid a hardship to individuals by taxing them at a high bracket on foreign subsidiary earnings which are not actually distributed.

Section 962 Election
Election to be Taxed as a Corporation

- Individual is taxed on deemed inclusions from foreign subsidiaries at the corporate tax rate of 21%.
- Individual entitled to foreign tax credit as if individual was a corporation.
- When actual distribution is made, the earnings are included in gross income at the applicable individual rate to they extent they exceed the amount of U.S. income tax paid at the time of the 962 election.
- Unclear if actual distribution is treated as from a domestic corporation, which would entitle individual to qualified dividend rate of 23.8%.

Tax Reform – Foreign Derived Intangible Income FDII

Foreign Derived Intangible Income (FDII)

- FDII refers to income of a domestic company that is earned by providing services to any non-U.S. person or in is income that U.S. corporation derives in connection with:

  (1) selling, leasing or licensing property to non-U.S. persons for foreign use, or
  (2) services provided to any non-U.S. person

- FDII tax rate is only available to corporations

- FDII benefits from a 37.5% deduction, resulting in a reduced effective U.S. corporate tax rate of 13.125% until 2025, then 16.406%.

- The policy intent of the favorable FDII rate is to give U.S. companies an incentive to exploit their intangible assets from the U.S. rather than transferring them to a foreign low-tax jurisdiction.

- Because productive intangible assets are typically the most valuable items on a company’s balance sheet, keeping them in the U.S. should generally permit a domestic company to generate a greater amount of residual income eligible for the reduced FDII rate.

- U.S. exporters with low amounts of fixed assets should be able to generate higher amounts of FDII, regardless of balance sheet intangible assets.

Tax Reform - FDII

Foreign Derived Intangible Income (FDII)

Deduction eligible income (DEI) is the starting point for computing FDII

DEI = *Domestic corporation's gross income (excluding subpart F and GILTI inclusions from CFCs) reduced by allocable deductions and taxes.*

FDII of a domestic corporation is then determined under a four step process:

Step 1: Determine the deemed tangible income return, which is the portion of DEI equal to 10% of the U.S. company's depreciable tangible assets. The law assumes a 10% return on qualified business assets.

Step 2: Determine the deemed intangible income, which is the DEI amount remaining after subtracting the deemed tangible income return. The formula is:

Deemed Intangible Income = DEI - Deemed Tangible Income Return

Step 3: Calculate foreign-derived deduction eligible income, which is the portion of a domestic company's DEI derived in connection with services provided to any non-U.S. person or in connection with non U.S. property.

Step 4: Once the deemed intangible income and foreign-derived deduction eligible income amounts have been calculated, the third and final step is determining FDII, which is calculated using the following formula:

*FDII = Deemed Intangible Income * (Foreign-Derived Deduction Eligible Income/DEI)*

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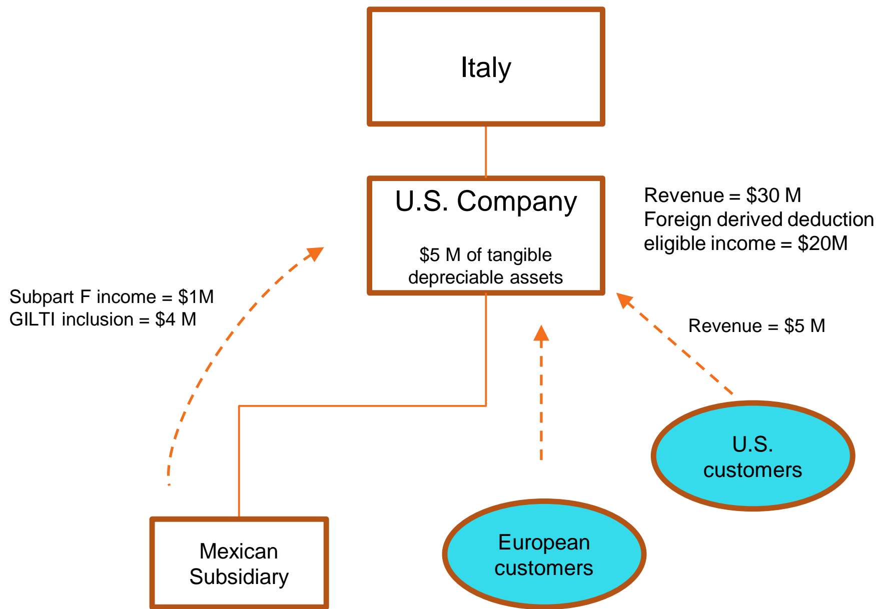
Tax Reform – Foreign Derived Intangible Income FDII



U.S. Company Revenue		$30,000,000
Non Deduction Eligible Income	Taxed at 21%	$5M (sub F & GILITI) Tax = $1,050,000
Deduction Eligible Income	Revenue minus Subpart F and GILTI inclusions	$25,000,000
Tangible Income Return	(10% of qualified business assets)	($500,000) Taxed at 21% = $105K
Deemed Intangible Income		$24,500,000
Foreign derived deduction eligible income	Deemed Intangible Income X (Foreign-Derived Deduction Eligible Income/DEI)	$20,000,000
FDII	Deemed Intangible Income x (Foreign-Derived Deduction Eligible Income/DEI)	$19,600,000
FDII Deduction	37% deduction	($7,252,000)
FDII Before Tax		$12,348,000
Corporate Tax	21%	($2,593,080)
Net FDII Income		$17,006,920

Deduction Eligible Income (DEI) = Gross income (excluding subpart F and GILTI inclusions from CFCs) reduced by allocable deductions and taxes.

Deemed tangible income return = 10% return on the U.S. company's depreciable tangible assets.

Deemed Intangible Income = DEI minus Deemed Tangible Income Return

FDII = Deemed Intangible Income * (Foreign-Derived Deduction Eligible Income/DEI)

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Foreign Tax Credits (FTC)

- Repeal of corporate indirect FTC on distributions from foreign subsidiaries
- Separate FTC limitation basket for foreign branch income
- Separate FTC basket for GILTI
- FTC available for taxable portion of the mandatory inclusion, but reduced to account for lower tax rates on such inclusions
- CFC intangible (GILTI) inclusions are eligible for FTC on 80% of foreign tax paid
- Allowable FTC based on current-year taxes attributable to subpart F income rather than prior “pooling” approach

Considerations for Foreign Owned U.S. Companies

- NOL value reduction. $100 NOL yields $21 of tax benefit compared to $35 pre tax reform.
- After tax cash flows should increase due to corporate rate drop.
- May not make sense to load U.S. subsidiaries with intercompany deductions when parent company is in a country with an effective tax rate higher than 21%.
- Canadian and Mexican companies should consider and compare whether incorporating in Mexico provides more overall tax efficiency
- Manage deductions to reduce NOL carryovers - $1 of expense claimed as a current deduction is worth more than an NOL which can not offset more than 80% of taxable income in succeeding years.
- Full expensing in U.S. may lead to situation where U.S. subsidiaries of foreign companies have minimal U.S. taxable income, but large earnings and profits from a foreign perspective, which could result in minimal foreign tax credits available on repatriation.
- Full expensing will make asset acquisitions of U.S. businesses more attractive.

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Professional Experience

Fernando R. Lopez is a Director of International Tax at Prager Metis CPAs, LLC, a member of Prager Metis International Group. He has been a practicing accountant since 1998.

Fernando advises his clients on a full range of cross-border tax planning and compliance matters aimed at efficient cross-border structures and operations. He counsels businesses in various industries regarding U.S. and foreign tax considerations related to overseas activities and expansion. This includes foreign clients regarding inbound considerations, U.S. permanent establishment considerations, entity selection and considerations related to investments in real property. Fernando is also knowledgeable on tax-efficient restructuring; M&A, dispositions; joint ventures; global trading structures; tax deferral; foreign currency transactions; repatriation; foreign tax credits, IP migration; transfer pricing; tax accounting, FIN 48 reporting; and international compliance.

Fernando always makes it his initial objective to establish a personal relationship with all his clients that promotes a healthy and strong understanding of their businesses and operations. Prior to joining Prager Metis, he worked with Big 4 firms in the Silicon Valley, Stamford, Atlanta, South Florida and Paris.

Professional Affiliations
- International Fiscal Association
- American Bar Association
- **Education**
- BA, Stanford University, Stanford California
- JD, Temple University School of Law, Philadelphia Pennsylvania
- International MBA, Darla Moore School of Business, University of South Carolina, Columbia South Carolina