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U.S. Tax Reform

Presented by: Fernando Lopez | February, 2019

Key Considerations for Tax Reform

- 35% corporate tax rate was among world's highest
- Reduced global competitiveness
- Corporate inversions
- Transfer of intangible assets to low-tax foreign jurisdictions
- $2.6 million of profits parked in foreign subsidiaries
- High use of base erosion payments
- Stagnate wage growth

Domestic Individual Provisions

- Top individual rate reduced - 39.6% to 37%
- Standard deduction doubled to $12,000/$24,000
- Mortgage interest deduction limited to $750,000
- Limit deduction for state & local tax, and property tax to $10,000

Domestic Business Provisions

- 40% reduction in corporate rate (From 35% to 21%)
- Immediate and total expensing of capital expenditures
- NOLs limited to 80% of taxable income
- 20% deduction for qualified income of pass through businesses
- Limitation on interest deduction– 30% of EBITDA

Cross Border Business Provisions

- Quasi-territorial tax system
- End of US tax deferral on income of controlled foreign corporations
- Immediate taxation of $2.6 trillion of CFC earnings
- Most income of CFCs is subject to US tax an effective rate of 10.5% on CFC intangible income (GILTI)
- US tax exemption for certain foreign income (deemed 10% return on tangible depreciable assets)
- Domestic corporate income related to selling products and providing services abroad is taxed an effective rate of 13.125%

Cross Border Business Provisions

- CFC anti-deferral rules broadened such that virtually all CFC income is subject to current inclusion at the level of the US shareholder.
- Limitation on business interest expense
- Foreign person's sale of U.S. partnership with active trade or business taxed as ordinary income
- Change in CFC attribution rules expose certain foreign based companies to U.S. CFC reporting

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Domestic Business Provisions

Most provisions effective as of January 1, 2018

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Corporate Rate Reduction

- Prior law - graduated rates, maximum of 35%
- New law - flat rate of 21%
  - Below the individual capital gains rate - 23.8%
  - Below the worldwide average corporate rate of 22.96%
  - Reduced tax rate on most foreign income (0% to 13.125%)

Reduced US tax rates on domestic and foreign income

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full expensing of plant and equipment

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Increased foreign investment into the US and opportunity to use US corporations as global holding companies

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Full Expensing

Section 179 Expensing of Depreciable Business Assets

- Immediate expensing of plant and equipment up to $1 million
- Applies to both new and used property
- Reduced after property placed in service during year exceeds $2.5 million

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Full Expensing

Bonus Depreciation under Section 168(k)

- Increased from 50% to 100% for property placed in service through 2023
- Useful for very large businesses that exceed Section 179 limit

NOLs

- Limits NOL deduction to 80% of taxable income
- No carryback, unlimited carryforward
- No impact on pre-existing NOLs (including for 2017) 2-year carryback, 20-year carryforward, 100% offset

20% Deduction on Pass Through Income

- Applies to businesses operated via US limited liability companies, partnerships and S corporations, trusts or estates
- Maximum effective rate of 29.6% for qualifying trade or business income (QBI) of pass through entities
- Includes active foreign income
- Does not include wage income or investment income
- Rental income from the active conduct of a rental real estate trade or business is QBI
- Income from the renting out of buildings where the owner is not engaged in a real estate trade or business is not QBI
- Excludes investment income

20% Deduction on Pass Through Income

- Threshold amounts for full deduction:
  - $157,500 single
  - $315,000 married
- Professional services income phased out above threshold amounts
- Others subject to limitation based either on wages paid or wages paid plus a capital element
- 20% deduction cannot exceed the greater of
- (1) 50 percent of his/her share of W-2 Wages paid with respect to the QBI or
- (2) the sum of 25 percent of his/her share of W-2 Wages plus 2.5 percent of the unadjusted basis of qualified property

Limitation on Business Interest Expense

- Net interest expense deduction limited to the sum of (1) business interest income, plus 30% of EBITDA
- Exemption for corporations and pass throughs with gross income below $15 million
- In 2022, interest will be limited 30% of EBIT (i.e., after depreciation & amortization)
- Impacts businesses with significant debt levels
- Reduces the incentive to borrow

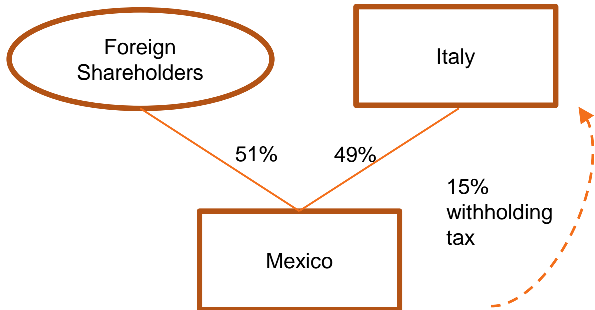
Cross Border Provisions

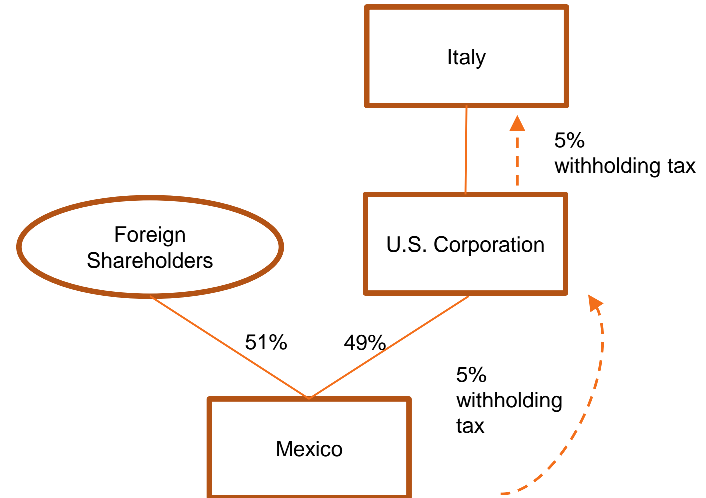
Most provisions effective as of January 1, 2018

Territorial System – Limited Exemption of Foreign Earnings

- Available to U.S. corporations only
- For CFCs, applies to deemed 10% return on CFC tangible depreciable business assets
- For foreign subsidiaries owned 50% or less by US shareholders, applies to US shareholder(s) pro rata share.
- Applied via a 100% dividend received deduction
- Not applicable to hybrid dividends
- No foreign tax credit

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%**

Mandatory Repatriation

- Applies to $2.6 trillion held by foreign subs
- 15.5% for cash and 8% for non-cash earnings
- Regulations were issued – complex calculation
- Election available to pay tax over 8 years
- Requires current verification of accuracy of foreign earnings and related foreign tax credit tax pools
- Based upon the greater of E&P measured at November 2, 2017 or December 31, 2017

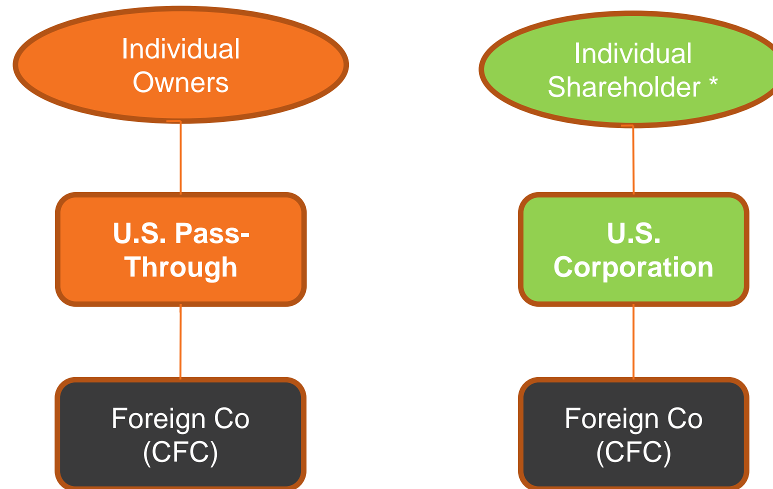
Global Intangible Low-Taxed Income (GILTI)

- GILTI = residual income of a CFC in excess of a fixed 10% return on tangible assets
- Immediately includible in U.S. shareholder's gross income
- U.S. corporations - effective rate of 10.5% tax after applying a 50% deduction; may be offset by up to 80% of FTCs
- Individuals subject to maximum rate of 37% on GILTI
- Partial relief - 962 election to be taxed as a corporation
- Complicated formula - not based on actual CFC intangible assets

CFC Income Categories After Tax Reform

	Category	CFC Income Description	U.S. Tax Rate	Foreign Tax Credit
	Category 1	GILTI Exclusions: passive income, US business income	21%	100% limited to current year taxes paid
	Category 2	Deemed Tangible Income: 10% return on tangible assets	Exempt	N/A
	Category 3	Deemed GILTI (residual amount in excess Categories 1 and 2)	10.5% until 2028, then 13.125%	80% in separate FTC basket with no carryback or carryover of excess taxes

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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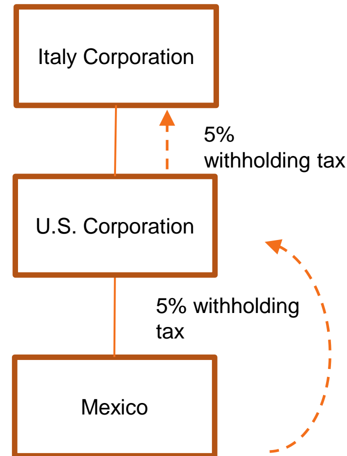
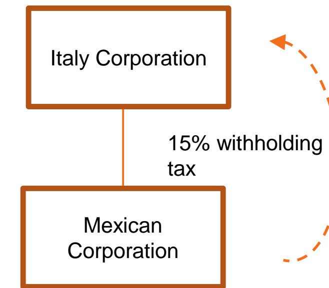
Maximizing GILTI





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%**

Export Income "FDII"

- Foreign-derived intangible income (FDII) 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

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Export Income "FDII"

- Formulaic calculations divide domestic company income in two tax categories:
  1. Deemed Tangible Income Return taxed at 21%
     - Relates to deemed 10% return on tangible depreciable business assets
  2. FDII taxed at 13.125%
- FDII tax rate is only available to corporations

FDII

- Policy - incentivize U.S. companies to exploit intangible assets from U.S. rather than transferring abroad
- Retaining productive intangibles in U.S. should generally permit a domestic company to generate a greater amount of residual income eligible for the reduced FDII rate

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FDII regime vs GILTI regime

Foreign companies setting up subsidiaries in the U.S. have the option of earning foreign income under two methods

1. Direct sales or services to foreign customers from US company such that foreign earnings are taxed in the US at 13.125%
2. Setting up subsidiaries under US holding company so that foreign subsidiary income is taxed in the US at rates of 0% to 12.5%

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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

Base Erosion Anti-Abuse Tax (BEAT)

- Effectively applies a 10% minimum tax for taxable income adjusted for base erosion payments
- Targets large multinational corporations making large deductible payments to foreign related parties
- The tax only affects businesses where U.S. gross receipts are in excess of $500m (aggregated on a global group basis) and so has limited application for multinational groups without a significant U.S. presence
- Base erosion payments = deductible amounts paid or accrued by to a foreign related party or paid or in relation to acquisition of depreciable or property
- Includes royalties, interest, and also service fees made at arm's length; cost of goods sold is generally excluded

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Sale of Partnership by Non-Resident

- Gain or loss on the sale, exchange or disposition of a partnership interest is treated as effectively connected with a U.S. trade or business to the extent a foreign partner would have had effectively connected gain or loss if the partnership sold all its assets at fair market value on the date of such transaction
- The transferee of the partnership interest must withhold 10% of the amount realized on the transaction (unless the transferor certifies it is not a foreign person)
- If the transferee fails to withhold, the partnership is required to withhold from distributions to the transferee partner

Change in CFC Attribution

Repeal of Section 958(b)(4)

- Foreign subsidiary that is more than 50% owned (by vote and value) by a foreign parent corporation would be treated as a CFC if the foreign parent corporation also owns more than 50% of the value of the stock of a domestic subsidiary
- Per Section 318(a)(3)(C) constructive ownership rules, the domestic subsidiary of the foreign parent corporation would be treated as constructively owning more than 50% of the foreign subsidiary (through attribution from the foreign parent corporation)

Thank You!

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