

Section 962 Election of The Corporate Tax Rate by Individuals, Trusts and Estates For Global Intangible Low- Taxed Income (GILTI) Income Inclusions

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Introduction

- Fundamentally, IRC § 962 allows a non-corporate US shareholder of a CFC to elect to be taxed on subpart F inclusions at the same rate as a corporate US shareholder.
- Prior to the TCJA, § 962 was not significantly utilized.
- The TCJA gave new importance to § 962:
 - First, the corporate tax rate was reduced from 35% to 21% making the differential between the highest individual tax rate (39.6%) and the corporate rate much more substantial.
 - Second, the introduction of GILTI drastically reduced the ability to defer foreign earnings from US tax by causing all but a modest amount of foreign income to be includible in a US shareholder's income on an annual deemed basis (similar to traditional subpart F inclusions).
- Why not just interpose a US C corporation?
 - Not ideal if future sale of CFC stock anticipated
 - Adverse foreign country consequences of transfer of CFC stock to domestic corporation
 - Likely not viable solution for US persons (not citizens) that will be exiting the United States in the future
 - Also likely not viable for US persons (including citizens) resident in foreign country where foreign country tax will be prohibitive if CFC held through a US corporation

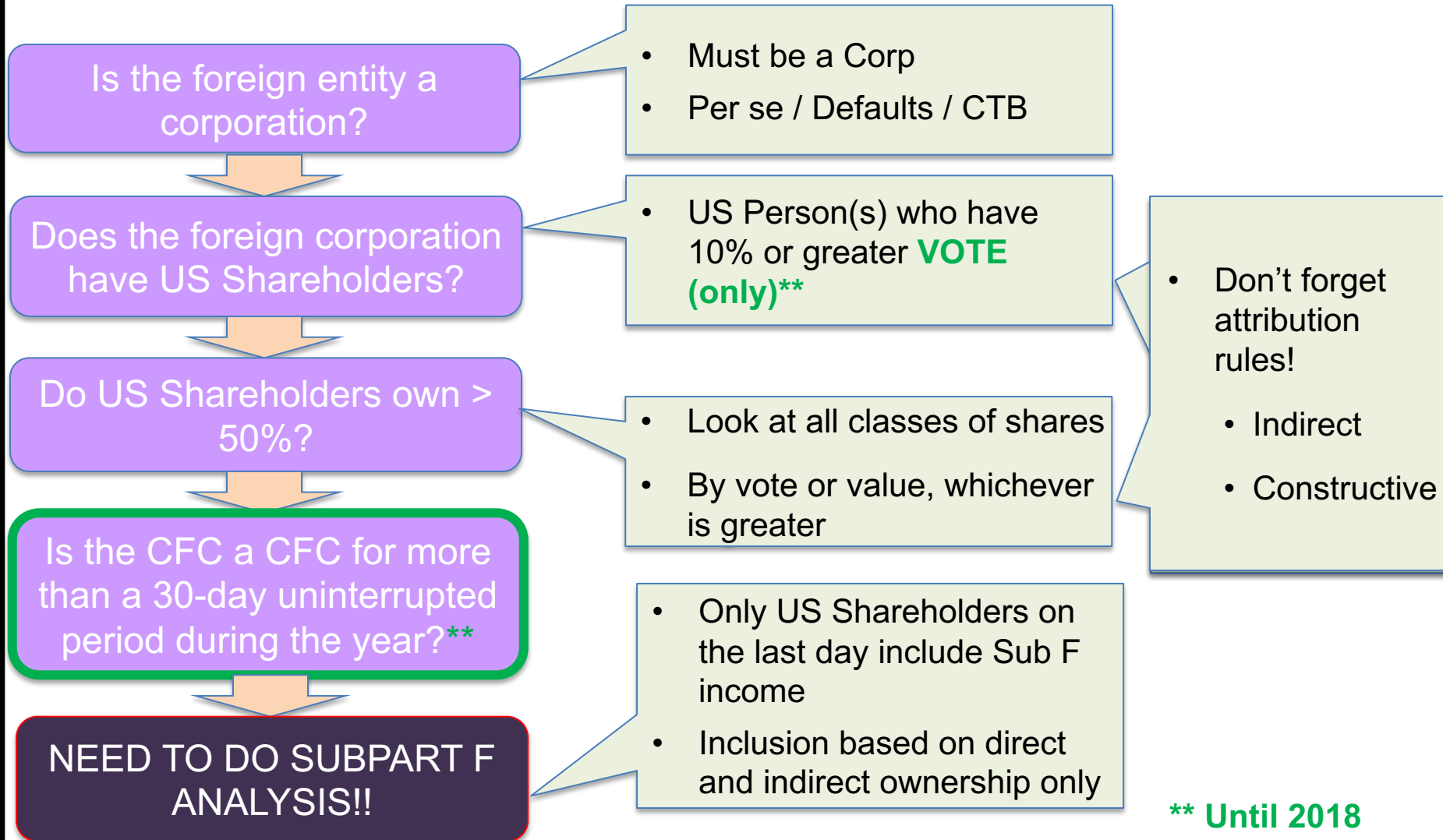
The Old

July 10, 2019

Controlled Foreign Corporations

- Foreign corporations do not pay US tax unless they do business or invest in the United States
 - This is true even if all shareholders are US persons
 - However, US shareholders of foreign corporation are subject to special rules, especially the CFC rules
- Foreign corporation controlled by certain US shareholders is known as a “controlled foreign corporation”, or CFC
- Three major consequences of owning a CFC
 - CFC’s “Subpart F income” taxed to US shareholders every year
 - CFC’s other income taxed to US shareholders when:
 - Income is distributed as a dividend
 - US shareholders sell the shares
 - CFC invests in US assets – especially by lending to its US shareholders

Triggering CFC Status



Subpart F – The Old

U.S.
Individual

CFC

Subpart F income – section 951(a)
(passive income and certain related party
business income, unless taxed at 90% of US
corporate rate (31.5%);)

Other income

- Immediate taxation
- Full rates (individuals cannot treat Subpart F inclusion as qualified dividend)
- Actual dividend not taxed (PTI)
- Basis in CFC increased by PTI (and reduced by distribution of PTI)
- Foreign tax credit available:
 - ◆ Foreign withholding tax when PTI distributed but timing issue
 - ◆ Indirect credit only for C corporations

- Deferred taxation. Deferral ends:
 - ◆ When dividend paid (can qualify as qualified dividends, if CFC in treaty country)
 - ◆ CFC invests in US property (section 956) – treated like Subpart F income
 - ◆ When shares sold (section 1248)
- Foreign tax credit available:
 - ◆ Foreign withholding tax
 - ◆ Indirect credit only for C corporations

The New

July 10, 2019

Expanded Reach of Subpart F

- Definition of “US shareholder” (Old: 10% votes; New: 10% votes or value)
- Downward attribution from foreign person
- Elimination of requirement that foreign corporation be a CFC for at least 30 days during the year

Subpart F – Transition (IRC Section 965)

- One-time tax for the last taxable year beginning before January 1, 2018, applicable to any “United States shareholder” of CFCs and any foreign corporation if has at least one “US shareholder” that is a domestic C corporation (such corporations are known as deferred income foreign corporations (DFIC))
 - To determine if US person is a US Shareholder, direct, indirect and constructive ownership rules are used
- Must include in income its pro rata share of the undistributed, non-previously-taxed post-1986 foreign earnings of the foreign corporation, determined as of November 2, 2017 or as of December 31, 2017, whichever is higher, but only for time when foreign corporation was a “specified foreign corporation”
 - For inclusion purposes, US Shareholder must be direct or indirect owner; constructive ownership not enough
- Tax is 15.5% (17.5% for non-corporate shareholders), to the extent of DFICs’ aggregate “cash position” and 8% (9.05% for non-corporate shareholders) for the balance. Foreign tax credit may be available, subject to allocation rules

Subpart F, GILTI and QBAI – The New

U.S.
Individual

CFC

Subpart F income	GILTI – section 951A (most business income)	Qualified business assets income (QBAI) and high taxed FPHC income
<ul style="list-style-type: none"> No change but note high tax kickout income increased due to cut in US rate (i.e., passive and related-party income is not Subpart F income if foreign tax is 90% of 21% (18.9%), down from 90% of 35% (31.5%)) 	<ul style="list-style-type: none"> 10% C corporation shareholders: <ul style="list-style-type: none"> Immediate taxation at 50% (10.5%) 80% foreign tax credit available Individuals <ul style="list-style-type: none"> Full individual rates Must consider section 962 election 	<ul style="list-style-type: none"> QBAI = 10% return on tangible depreciable assets High foreign tax FPHC (threshold now 18.9%) 100% dividends received deduction for 10% C corporation shareholders Other shareholders <ul style="list-style-type: none"> Deferral Sections 956 and 1248 not repealed

GILTI (Very) Basics – 1

- GILTI =
 - CFC net tested Income (computed on a consolidated or aggregate basis)
 - Less net deemed tangible income return
- “Tested income” = CFC gross income, except:
 - ECI
 - Subpart F income
 - High foreign tax FPHC income (effective rate of 90% of US corporate rate)
 - Dividends received from a related person
 - Foreign oil and gas extraction income
 - Less deductions allocable to such gross income
- Net deemed tangible income return =
 - Qualified business asset investment (“QBAI”) x 10%
 - Less interest expense

GILTI (Very) Basics – 2

- Current inclusion as subpart F income
- 80% of foreign tax credits can be used against GILTI for C corporation shareholders
- Calculation of GILTI done at US Shareholder level:
 - **“Net CFC Tested Income:”** Excess of shareholder’s pro rata share of the sum of tested income and tested losses from all of CFCs over
 - **“Net Deemed Tangible Income Return”, i.e.:**
 - Deemed 10% return on shareholder’s pro rata share of adjusted basis of tangible depreciable property of CFCs that earn **tested income**, reduced by
 - **Interest expense** taken into account in determining net tested income to the extent the related interest income is not taken into account in determining the shareholder’s net CFC tested income

Proposed Regulations on High Taxed Income – A Possible Game-Changer?

- On June 21, the IRS proposed regulations under section 951A (84 F.R. 29114-29133)
- Under the regulations, taxpayers would be able to elect for a CFC to exclude under section 954(b)(4), and thus to exclude from gross tested income, gross income subject to foreign income tax at an effective rate that is greater than 90 percent of the rate that would apply if the income were subject to the maximum rate of tax specified in section 11 (18.9 percent based on the current rate of 21 percent). See Prop. Reg. section 1.951A-2(c)(6)(i)
- The proposed regulations state that this is consistent with the legislative history of GILTI

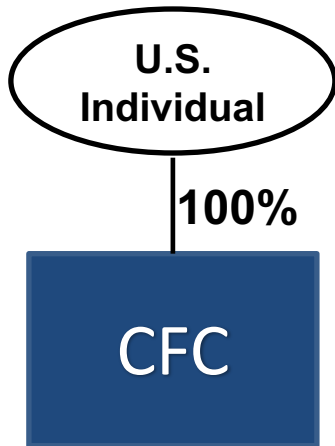
Proposed Regulations on High Taxed Income

- The “principles” of section 960 are to be used to determine the amount of foreign taxes paid
- Although section 960 only allows a deemed paid credit to domestic corporations, an individual should be permitted to take the benefit of an election under the proposed regulations
- The effective date of the proposed regulations is a mystery

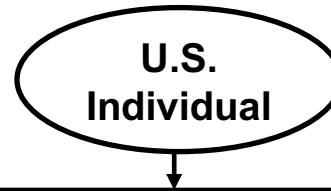
The Problems and the Reasons for Renewed Interest in Section 962

Application of GILTI

- Individual US Shareholders of CFCs subject to harsh treatment on GILTI income:
 - Ordinary income treatment
 - Section 250 deduction not available to US Shareholders
 - No indirect foreign tax credit
 - Uncertainty with respect to withholding taxes on later distributions of PTI arising from GILTI inclusion



Typical Business Profile (Especially Individually–Owned)



CFC

Subpart
F
income

GILTI

QBAI

Holding Stock Directly



As the next slide shows, the combined effective tax rate for a US individual can be in the 60% to 70% range using realistic assumptions

Most of the tax will be due when income earned

CFC

Individual Holding Stock Directly

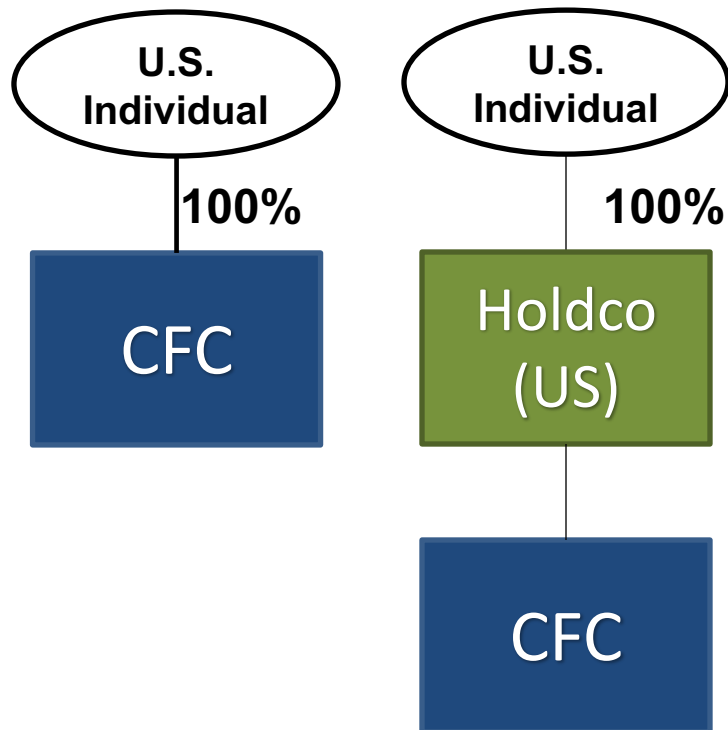
	Income (Deduction)	Tax
Gross Income – GILTI	\$1,000,000	
Foreign Tax (20%)		\$200,000
Federal Tax (37%)		\$296,000
Distribution from CFC	\$800,000	
PTI	(\$800,000)	
Foreign withholding tax (15%)	\$120,000	\$120,000
State Tax (8%)		\$64,000
Net Investment Income Tax (3.8%)		\$30,400
Total Taxes		\$710,100

Effective Tax Rate: 71%

Holding Stock Through US Corporation

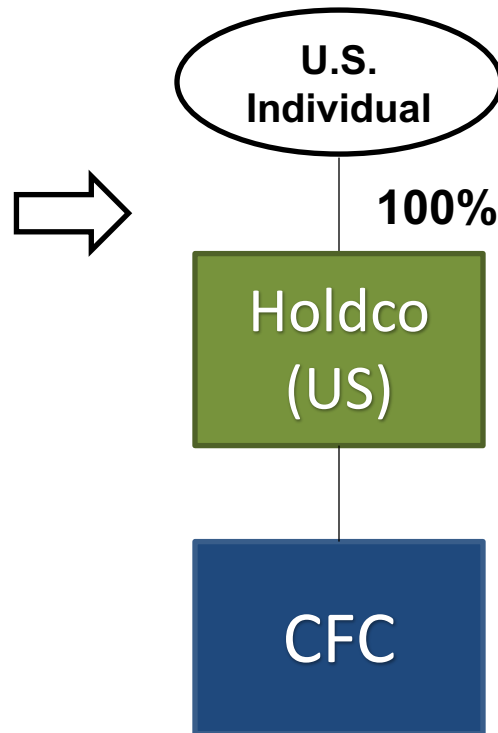
	Income (Deduction)	Tax (Credit)	
Gross Income – GILTI	\$1,000,000		
Foreign Tax (20%)		\$200,000	
GILTI Deduction (until 2026) (Sec. 78 gross up)	(500,000)		
Net GILTI	\$500,000		
Federal Tax (21%)		\$105,000	
Deemed Paid Credit (80% \times 20% = \$160,000)		(\$105,000)	
Total tax before CFC makes distribution			\$200,000
Distribution from CFC to US Corp.	\$800,000		
Federal tax (\$0 because PTI)		0	
Foreign tax withholding (5%)		\$40,000	
State Tax (7%)		\$56,000	
Total taxes on distribution from CFC			\$96,000
Distribution from US Corp	\$704,000		
Federal Tax (20%)		\$140,800	
State Tax (8%)		\$56,320	
Net investment Income Tax (3.8%)		\$26,752	
Total Tax on distribution from C corporation			\$223,872
Total taxes at all levels			\$519,872
Effective Tax Rate: 51.9%			

Foreign Country Limitations



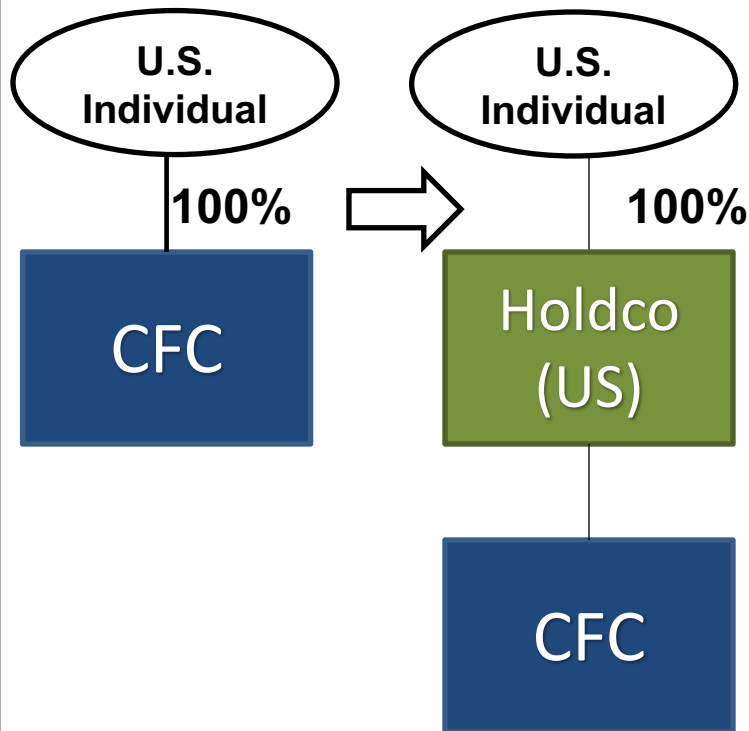
- To mitigate harsh individual treatment, interposing a US corporation as a holding company may seem like a logical solution
 - But, such reorganizations may have tax consequences in the CFC home country making such planning cost prohibitive

Planning for Eventual Sale of CFC



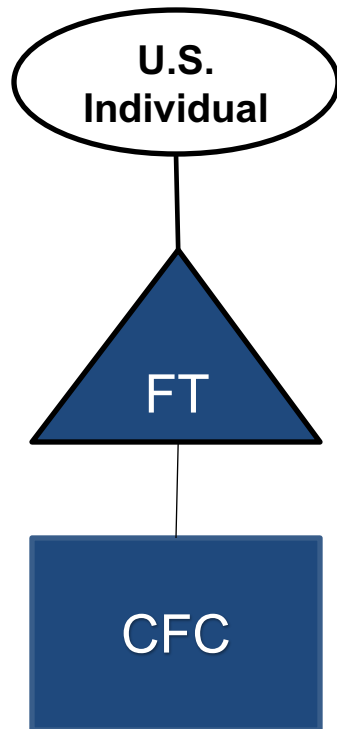
- Interposing US corporation holding vehicle to mitigate GILTI adds a second level of tax on sale of CFC stock that was directly held by US individual shareholder

Expats and Temporary US Persons



- US expats income tax resident in a foreign country may not be able to utilize a US corporation holding company vehicle, which may create a sandwich for foreign country purposes
- Temporary US persons exiting in the short-to-medium term also may find it overly costly to utilize a US corporation holding company vehicle, which is not attractive once that individual ceases to be a US person

What about US Beneficiaries of Foreign Trusts?



- Attribution rules may result in a foreign corporation being a CFC if there are US beneficiaries that can be attributed control of the corporation
- Likely impractical to interpose a US corporation as a holding company of the CFC, especially if there are also foreign beneficiaries
- What happens with US beneficiaries of discretionary trusts?

The 962 Solution

IRC § 962

- A US shareholder of a CFC who is an individual (including a trust or estate (see treas. reg. § 1.962-2(a))) can make a 962 election, which provides:
 - Tax imposed on subpart F inclusions of said individual, including GILTI inclusions (see § 951A(f)(1)), will be subject to tax as calculated under section 11 (i.e., taxes imposed on corporations).
 - A deemed paid credit under IRC § 960 shall be allowed on such amounts.
 - Basis step-up under § 961 allowable to the extent of tax paid

IRC § 962 – Legislative History (S. Rep. No. 1881, 87th Cong., 2d Sess. (1962))

- “The purpose of this provision is to avoid what might otherwise be a hardship in taxing a U.S. individual at high bracket rates with respect to earnings in a foreign corporation which he does not receive. This provision gives such individuals assurance that their tax burdens, with respect to these undistributed foreign earnings, will be no heavier than they would have been had they invested in an American corporation doing business abroad.”

IRC § 962 – Application

- Application of section 11 for inclusions subject to a 962 election (treas. reg. § 1.962-1(b)(1)):
 - Section 11 is limited under 962 and the above cited regulation. Specifically, for 962 purposes, “taxable income” means the sum of:
 - The amounts required to be included in gross income as traditional subpart F income and GILTI; plus
 - The section 78 “gross-up” with respect to those amounts.
 - “such sum shall not be reduced by any deduction of the United States shareholder even if such shareholder’s deductions exceed his gross income”
- “Taxable Income” under Section 11 refers to section 63, which provides taxable income means gross income minus allowable deductions

IRC § 962 – Foreign Tax Credit (Treas. Reg. § 1.962-1(b)(2))

- Allowance of foreign tax credit:
 - There shall be allowed a foreign tax credit under § 960(a)(1) for amounts which are the subject of a § 962 election (subject to the applicable limitation of § 904)
 - To the extent the foreign tax credit exceeds the § 904 limitation, the excess can be carried back or carried forward, except can only offset other income for which a 962 election is in place

IRC § 962 – Treatment of Actual Distributions

(IRC § 962(d); Treas. Reg. § 1.962-3)

- § 962 E&P less Excludable § 962 E&P are included in gross income
 - § 962 E&P = the E&P of a foreign corporation that were included in the gross income of a the taxpayer under § 951(a) in a prior year and for which a § 962 election is in effect; includes Excludable § 962 E&P and Taxable § 962 E&P
 - Excludable § 962 E&P = the amount of income tax paid by the taxpayer with respect to the § 962 election in the prior year
 - Taxable § 962 E&P = the excess over Excludable § 962 E&P.
- Source of distributions:
 - § 962 E&P generally is distributed after regular PTI
 - Excludable § 962 E&P is distributed first and then Taxable § 962 E&P

IRC § 962 – Procedure (Treas. Reg. § 1.962-2)

- Only individuals, trusts or estates may make the election.
- Election made by filing a statement with taxpayer's return:
 - Name, address, and taxable year of each CFC with respect to which the electing shareholder is a US shareholder and all other corporations, partnerships, trusts, or estates in any applicable chain of ownership described in § 958(a)
 - The amounts, on a corporation-by-corporation basis, which are included in such shareholder's gross income for his taxable year under § 951(a)
 - Taxpayer's pro rata share of E&P of such CFC with respect to which the taxpayer as an inclusion under § 951(a) and the foreign taxes with respect to such E&P
 - The amount of distributions received by the taxpayer from each CFC which are (1) excludable § 962 E&P; (2) taxable § 962 E&P; and (3) E&P other than § 962 E&P, showing the source of such amounts by taxable year
- Effect of election
 - A § 962 election when made is applicable to all CFCs owned by the taxpayer and is binding for the taxable year for which the election is made
 - An election may be revoked with the approval of the Commissioner. Approval will not be granted unless a material and substantial change in circumstances occurs which could not have been anticipated.

IRC § 962 – Trusts & Estates

- In addition to elections by domestic trusts and estates who are U.S. shareholders consider:
 - U.S. individual who is treated as an owner of a grantor trust (foreign or domestic) under § 671 and is a U.S. shareholder; and
 - U.S individual who is beneficiary of a nongrantor foreign trust but is deemed a U.S. shareholder under § 958(a).

IRC § 962 – Trusts & Estates

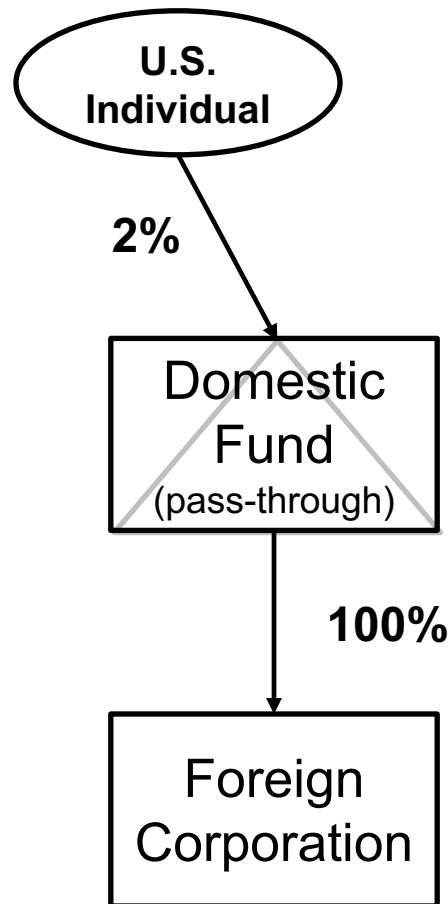
Considerations in making a § 962 election for domestic trusts and estates:

- Compressed income tax rates § 1(e)
 - Reach highest rate of 37% at \$12,750 of TI (2019)
 - Reach 24% rate at \$2,600 of TI (2019)
 - Rev. Proc. 2018-57
- May be difficult to carry-out § 951A inclusions to beneficiaries §§ 651/652, 661/662
 - FAI vs taxable income
 - Distributable net income
 - Composition of trust estate and trust objectives may limit trustee's ability to shift such income to beneficiary

IRC § 962 – Recent Developments

- Can individuals who own CFC through an S corporation or partnership make a § 962 election?
- Availability of § 250 Deduction for GILTI Inclusions
- Are subsequent distributions qualified dividends if distributed from a foreign corporation not located in a treaty jurisdiction?

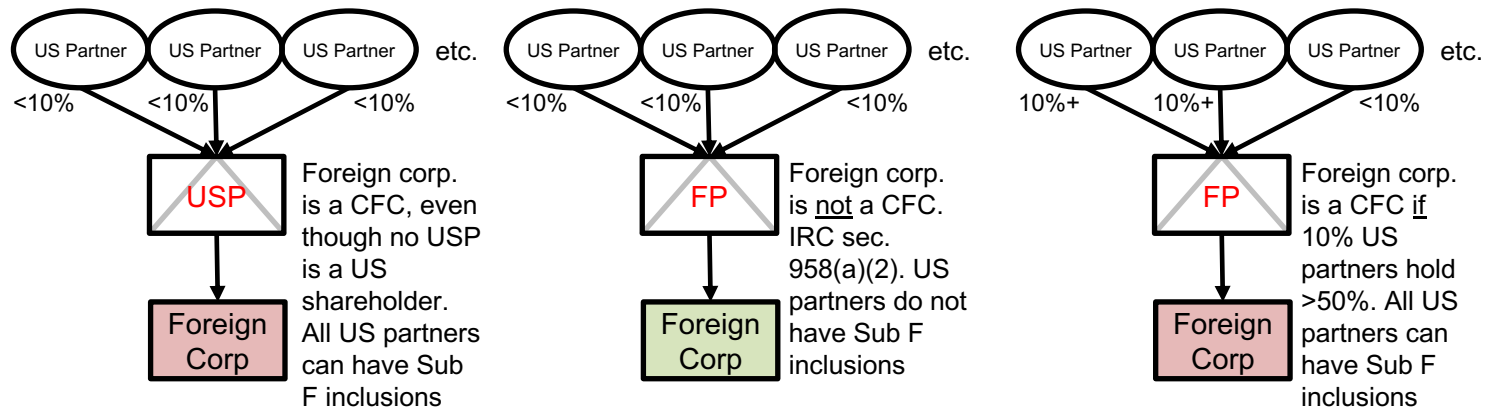
Can Individuals Who Own CFC through an S Corporation or Partnership make a § 962 Election? (Prior Law)



- Domestic Fund, a U.S. shareholder, has GILTI or Subpart F income or an investment in U.S. property
- U.S. Individual would like to elect section 962
- However, only U.S. shareholder, as defined in section 951(b), may elect
- In this case, U.S. Individual does not qualify
- Note: If Domestic Fund was a foreign partnership, Foreign Corporation status as a CFC would depend on other U.S. investors' percentage shares in the Fund

Treatment of Partnerships (Proposed Regulations)

- June 21, 2019 proposed regulations, dealing with the high-tax exception, also address the treatment of partnerships
- Current law: A domestic partnership treated as an entity to determine if a corporation is a CFC and who has the Subpart F inclusions; look-through for foreign partnerships

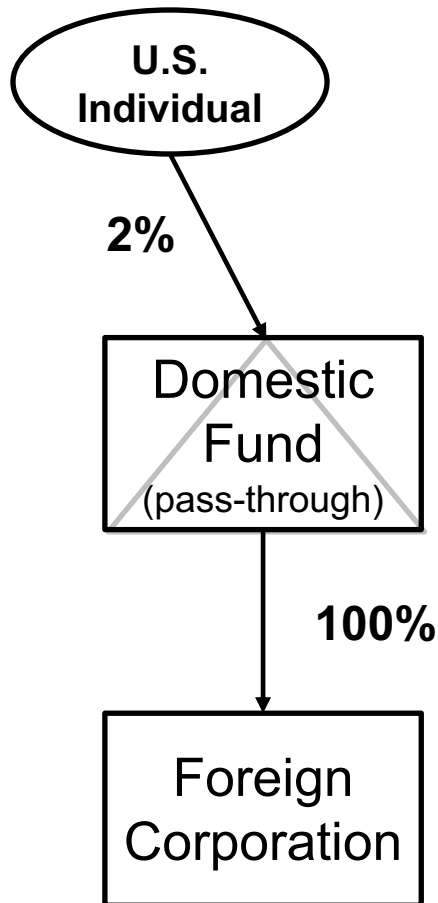


- October 2018 GILTI proposed regs: Hybrid approach – where foreign corporation is a CFC but partner in domestic partnership is not a U.S. shareholder, partner has a distributive share of partnership GILTI; if partner is a U.S. shareholder, GILTI calculated as if partnership were foreign

Treatment of Partnerships (Proposed Regulations)

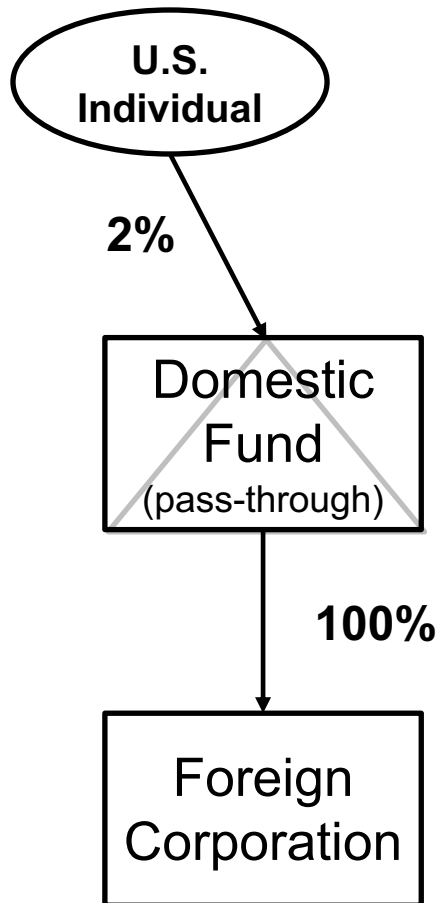
- June 2019 GILTI final regs: Pure aggregate approach – stock owned by domestic partnership is treated as owned by partners for purposes of determining GILTI. Result: Entity approach for Subpart F continues, but aggregate approach adopted for GILTI
- June 2019 GILTI proposed regs: Aggregate approach extended to Subpart F for most purposes. Result:
 - Domestic partnership not treated as owning stock of foreign corporation within the meaning of section 958(a)
 - For purposes of determining stock owned under section 958(a) by partner of a domestic partnership, domestic partnership is treated in the same manner as foreign partnership
 - But rule does not apply for purposes of determining whether any U.S. person is a U.S. shareholder, whether U.S. shareholder is a “controlling domestic shareholder”, or whether foreign corporation is a CFC
- “[T]reating domestic partnerships inconsistently for subpart F and GILTI purposes would be inconsistent with legislative intent.”

Treatment of Partnerships (Example)



- Under prior rules, Domestic Fund is a U.S. Shareholder for purposes of section 958(a)
- Thus, Foreign Corporation is a CFC
- Domestic Fund was required to allocate its share (100%) of Foreign Corporation's subpart F and GILTI allocated among its partners
- U.S. Individual, therefore, would have an inclusion
- Moreover, U.S. Individual was not a U.S. Shareholder and could not make a 962 election

Treatment of Partnerships (Example)

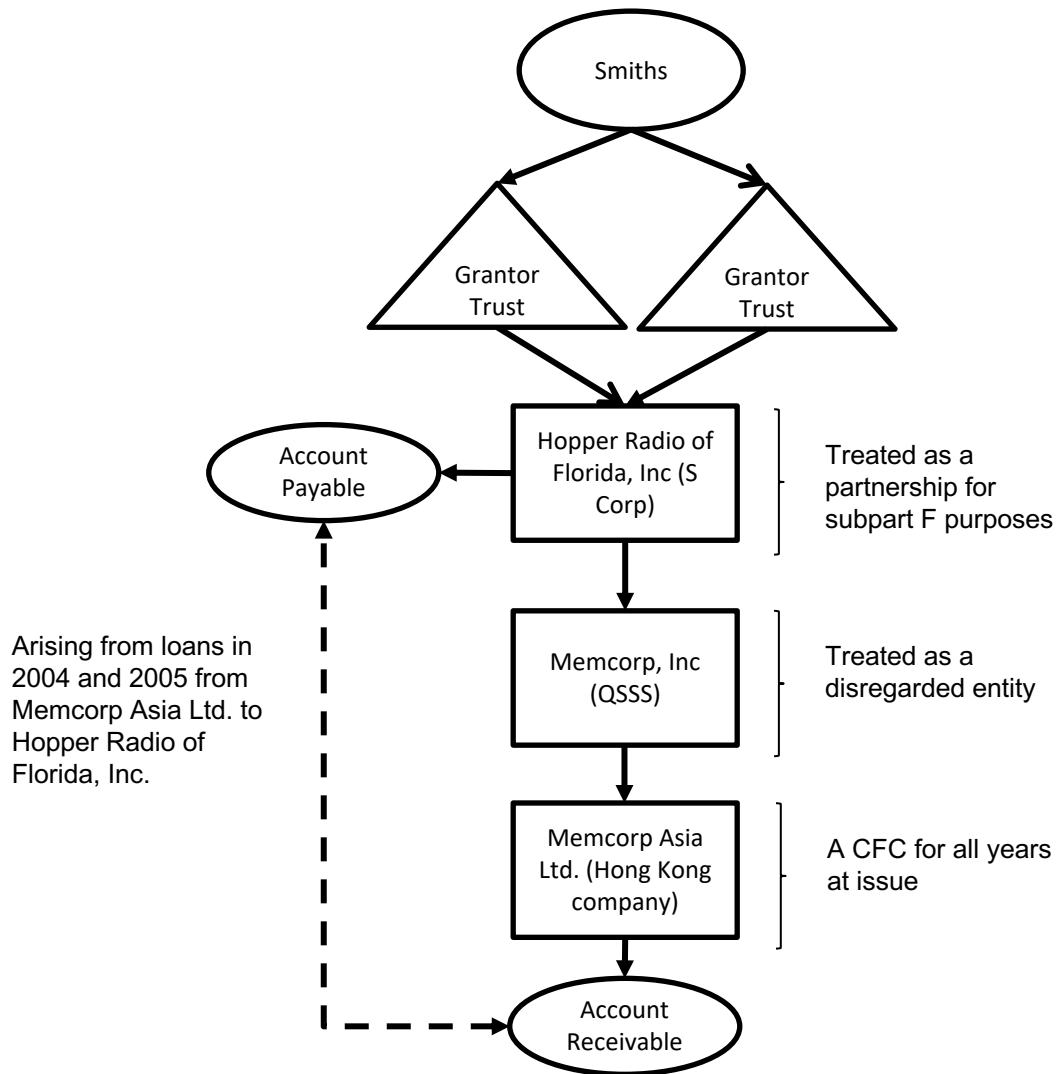


- Under proposed regulations, for purposes of section 958(a), Domestic Fund is treated as a foreign partnership and thus the partners calculate their inclusions based on whether they are U.S. Shareholders (the aggregate approach)
- For purposes of determining whether a foreign corporation is a CFC and who is a U.S. Shareholder, Domestic Fund is treated as an entity
- In this example, U.S. Individual will not have a subpart F or GILTI inclusion, but Domestic Fund is a U.S. Shareholder for purposes of determining whether Foreign Corporation is a CFC

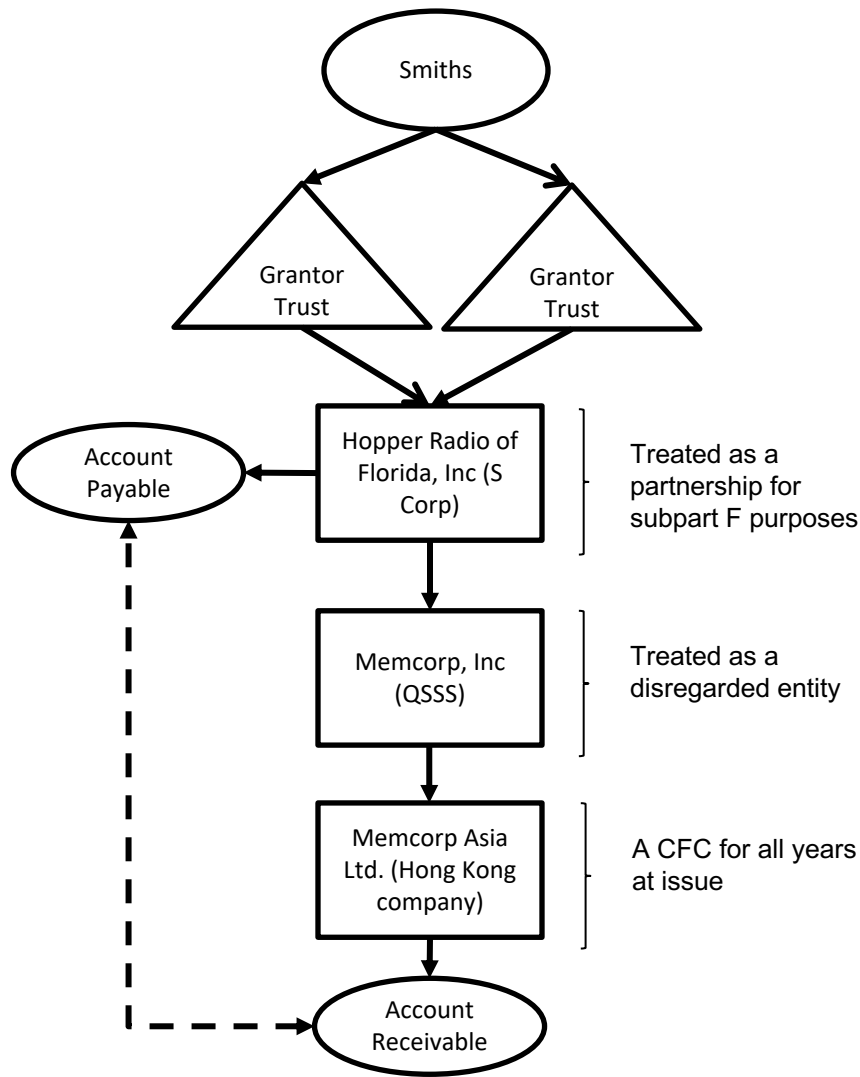
Availability of Section 250 Deduction

- Prop. Reg. § 1.962-1(b)(1)(i)(B)(3) provides that individuals making § 962 election eligible for § 250 deduction. Allowable deductions include:
 - (3) The portion of the deduction under section 250 and §1.250(a)-1 that would be allowed to a domestic corporation equal to the percentage applicable to global intangible low-taxed income for the taxable year under section 250(a)(1)(B) (including as modified by section 250(a)(3)(B)) multiplied by the sum of the amount described in paragraph (b)(1)(i)(A)(2) of this section and the amount described in paragraph (b)(1)(i)(A)(3) of this section that is attributable to the amount described in paragraph (b)(1)(i)(A)(2) of this section.

Smith v. Comm'r – Initial Structure

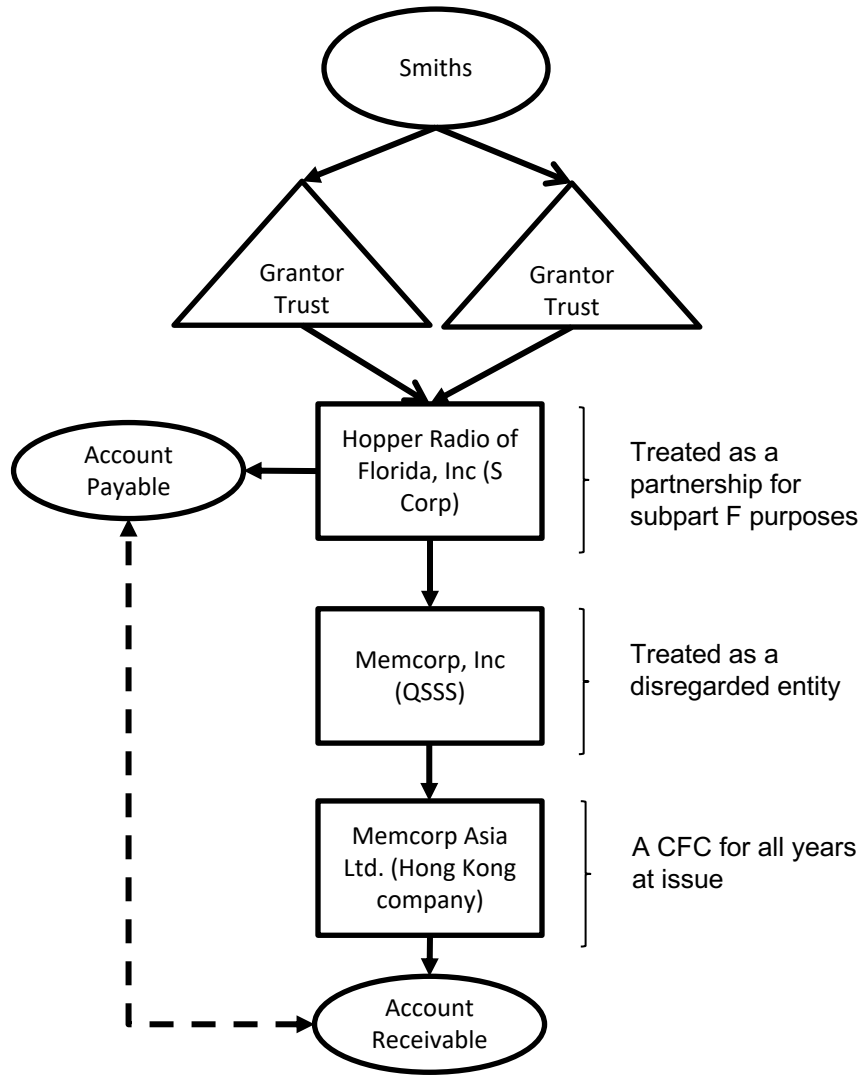


Smith v. Comm'r – Audits



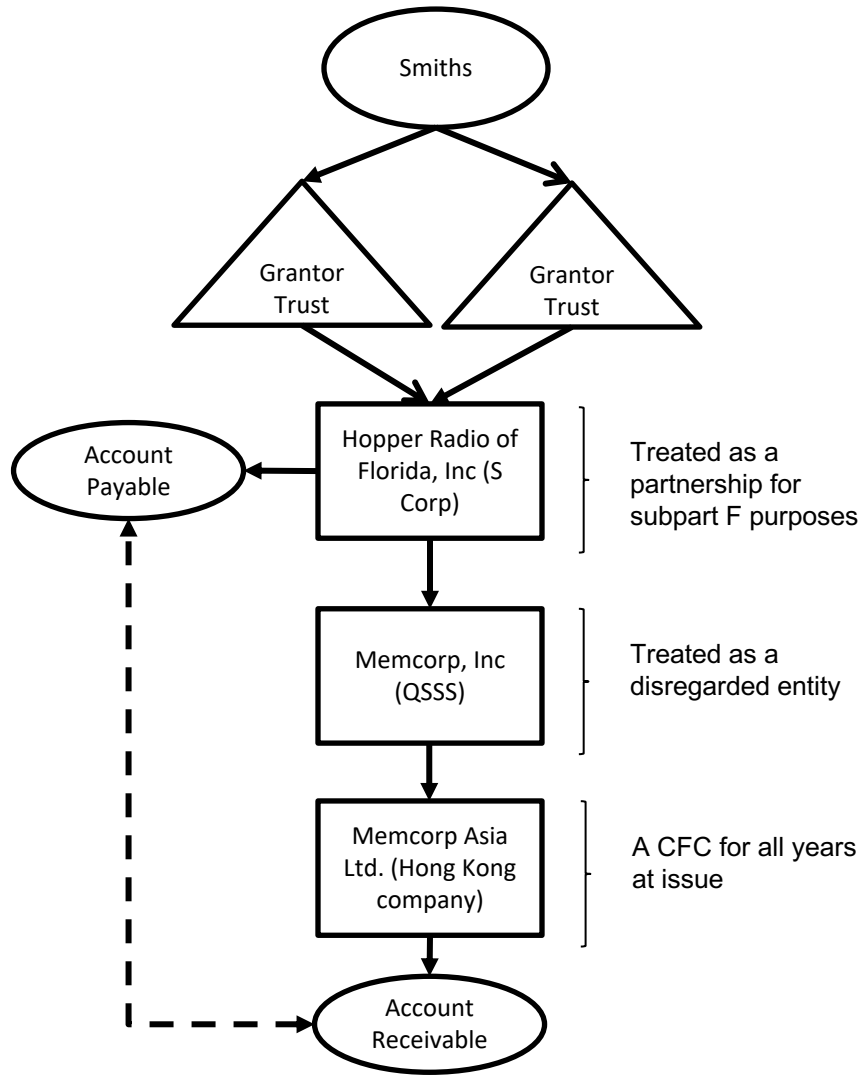
- Under examination, the IRS concluded, and the Taxpayers agreed, that the loans in 2004 and 2005 by Memcorp Asia Ltd. to Hopper Radio of Florida, Inc. were investments in US property under IRC sec. 956 and accordingly resulted in subpart F inclusions under section 951(a).
- Thus, Taxpayers amended their returns for 2004 and 2005 to pick-up the subpart F inclusion and concurrently made a section 962 election.
 - The total subpart F inclusion for both years equaled \$18,378,680.
 - The total “corporate” tax paid as a result of the 962 election for both years equaled \$6,071,089.
- In mid-2008, prior to a corporate reorganization, Taxpayers received a distribution from Memcorp Asia Ltd. of \$18,378,680
- Taxpayers did not include any of this distribution in their gross income for 2008.
- Taxpayers 2008 return was audited and the IRS determined that \$12,307,591 (\$18,378,680 less \$6,071,089) of the distribution should have been reported as an ordinary dividend under section 962(d).
- Taxpayers petitioned the Tax Court for a redetermination.

Smith v. Comm'r – 962 Issue and Holding



- Taxpayers, having acquiesced that the distribution was taxable in the amount of \$12,307,591, contended that the dividend was from a “notional” domestic corporation and thus constituted a qualified dividend.
- IRS contended that the dividend was an ordinary dividend because it was from a Hong Kong company.
- Tax Court held the dividend was an ordinary dividend taxable at ordinary-income rates. In so holding, and considering the Taxpayers’ argument that they may be worse off for having made the 962 election, the Court stated:
 - “By making these elections petitioners got what they bargained for: immediate deemed-paid FTCs and a lower current tax rate on the section 951(a) inclusions. By requiring [Taxpayers] to forfeit in large part the benefits of section 951(a), these elections may ultimately cause them to include more gross income than they would otherwise have had to include. Unfortunately, that is sometimes how the cookie crumbles.”

Smith v. Comm'r – Analysis and Takeaways



- The IRS did not seem to argue that the dividend was not, in fact, a dividend at all.
 - Recall, the 5th Circuit in *Rodriguez v. Comm'r* found that a Subpart F inclusion is not a dividend and consequently does not qualify for the lower rate of tax under I.R.C. § 1(h)(11). See also, Notice 2004-70.
- Thus, taxable 962 E&P appears to be converted into E&P subject to dividend treatment.
 - No analysis on this point, but the Tax Court does state that in the legislative history for 962, Congress stated its understanding that taxable 962 E&P, when actually distributed by the CFC, would be treated as “a dividend” and be taxed “at individual income tax rates.”
 - Accordingly, likely that dividend from a qualified foreign corporation would be taxed at preferred rates
- The Tax Court also explicitly provides that 962 E&P refers to the foreign corporation’s E&P; “there is no suggestion that this E&P has previously ‘moved up’ to a notional domestic corporation.”
 - Thus, the dividend remains foreign source, which may be important to temporary US residents.
- It appears a 962 election can be made late with the filing of an amended return if the IRS determines an unreported subpart F inclusion.



§962 ELECTION TO BE TAXED AT CORPORATE RATES ON §951 INCOME

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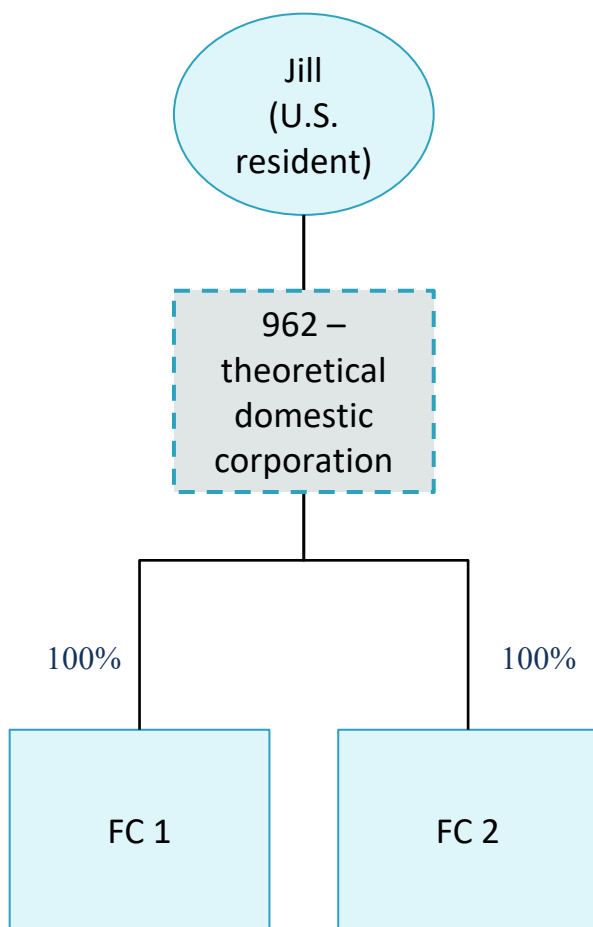
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§962 ELECTION- TOPICS COVERED

- I. Quantifying the benefit or cost of the §962 election
- II. Making the §962 Election
- III. Reporting the §962 Tax

QUANTIFYING THE BENEFIT OR COST OF THE §962 ELECTION



- A §962 election is an election by an individual, estate, or trust to be taxed at the corporate rates under §11 on all §951(a) income from all CFCs in which the taxpayer is a U.S. shareholder.
- At a high level the §962 election imposes tax 'as if' a domestic corporation received all §951(a) income only.
- §962 earnings are subject to double tax.
 - When an actual distribution is made from income previously taxed under a §962 election the distribution, less any U.S. taxes actually paid under the election, will be subject to tax again.
 - Distributions come first out of excludable 962 E&P and then out of taxable 962 E&P
- §962 has received renewed interest with GILTI, the §250 deduction, and the reduced corporate rate.

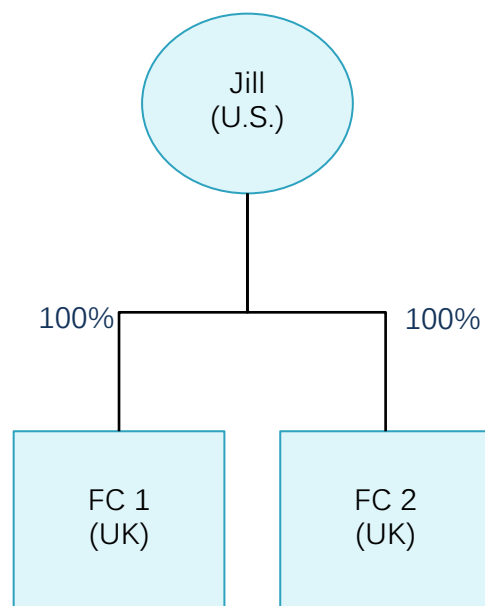
QUANTIFYING THE BENEFIT OR COST OF THE §962 ELECTION

- The election is made on a year by year basis. For any year made it applies to all CFCs and all §951(a) income
 - Includes: Subpart F (FPHCI), 956, 965, and §951A (GILTI)
- For purposes of computing the §962 tax due - a credit for income taxes paid at the CFC level is allowed under §960.
 - The limitations under §904 apply as they regularly would to a corporation – See Reg 1.962-1(b)(2)
 - Foreign tax credit in GILTI basket cannot offset §962 tax due in other baskets (general, passive)

QUANTIFYING THE BENEFIT OR COST OF THE §962 ELECTION

- A gross up for indirect foreign taxes is required under §78
- Taxpayers making the election have an increase in basis under §961 only for the U.S. tax actually paid under the election
- The election does not change the payor of the dividend.
 - For purposes of determining whether the dividend is qualified (see *Smith* case) or source.

QUANTIFYING THE BENEFIT OR COST OF THE §962 ELECTION – EXAMPLE 1



FC 1 and FC 2

- Each have \$1,000 of pre tax earnings and no fixed assets.
- Both FC 1 and FC 2 pay 19% CIT in the UK
- All of the earnings are treated as 951A earnings

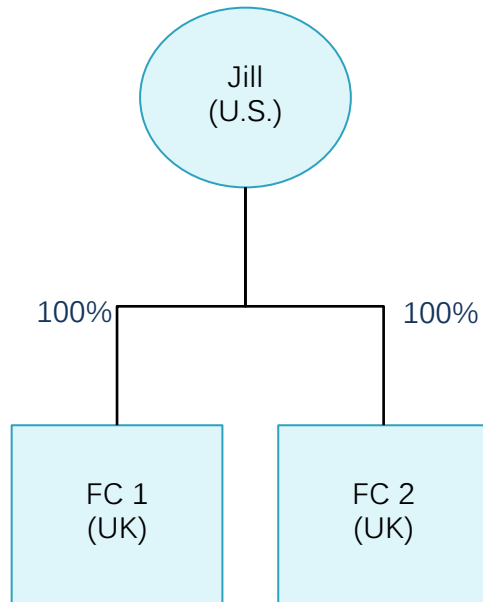
• Background facts:

- Jill is a U.S. person subject to tax at the highest marginal tax rates in the U.S.
- Jill owns 100% of FC 1 and FC 2. FC 1 and FC 2 are UK service companies and do not own any fixed assets.
- Jill does not own any other CFCs directly or indirectly.
- FC 1 and FC 2 each have \$1,000 of pre tax earnings, no fixed assets, and pay 19% CIT in the UK.

• Neither FC 1 or FC 2 make any distributions during

Results of FC 1 and FC 2	FC 1	FC 2
Pretax earnings and profits	1000	1000
Foreign income taxes	190	190
Earnings and profits	810	810
951A / 951(a) inclusion	810	810

QUANTIFYING THE BENEFIT OR COST OF THE §962 ELECTION – EXAMPLE 1

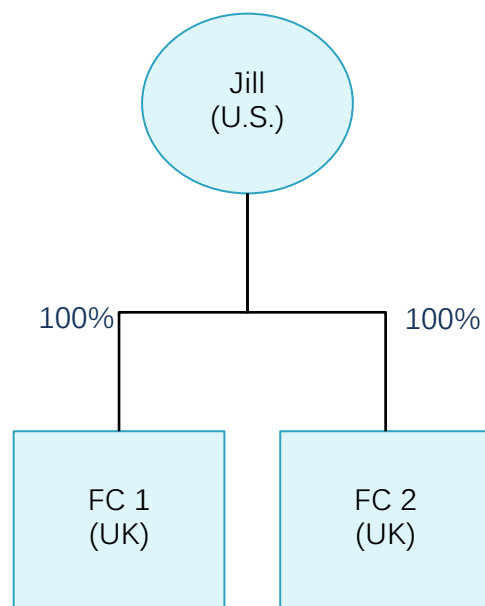


FC 1 and FC 2

- Each have \$1,000 of pre tax earnings and no fixed assets.
- Both FC 1 and FC 2 pay 19% CIT in the UK
- All of the earnings are treated as §951A earnings

- All of the earnings from FC 1 and FC 2 are GILTI to Jill
- Jill does not make any elections and picks up the deemed income from FC 1 and FC 2 on her U.S. income tax return.
- Jill pays \$599 of tax on the §951A income
 - $\$1,620 \times 37\% = \underline{\$599}$
 - Jill is not able to claim a foreign tax credit on the \$380 of corporate income taxes paid by FC 1 and FC 2 in the UK.
- When the \$1,620 of earnings are distributed in a future year then the distributions will be treated as PTI and not subject to income tax.
 - The distributions will be subject to NIIT

QUANTIFYING THE BENEFIT OR COST OF THE §962 ELECTION – EXAMPLE 2



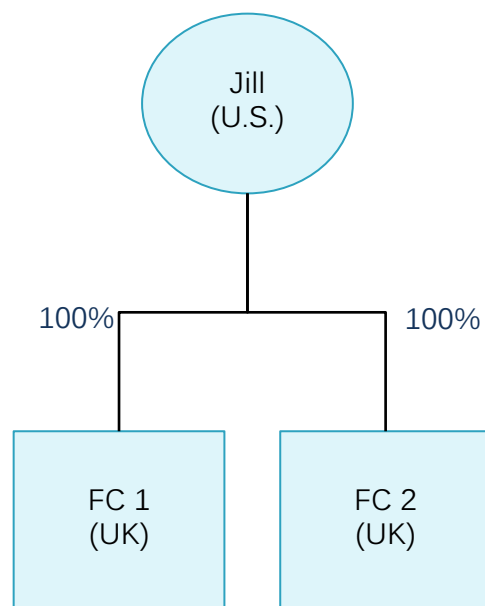
FC 1 and FC 2

- Each have \$1,000 of pre tax earnings and no fixed assets.
- Both FC and FC 2 pay 19% CIT in the UK
- All of the earnings are treated as 951A earnings

- Background facts: Same facts as example 1 except that Jill makes a §962 election

§962 tax liability	FC 1	FC 2	Total	
§951A / § 951(a) inclusion	810	810	1620	
§78 gross up	190	190	380	A
Tentative income	1000	1000	2000	
§250 deduction	-500	-500	-1000	
Net income after deduction	500	500	1000	
CIT 21%			210	B
Foreign tax credit (lesser of 80% of A or B)			210	C
§962 tax liability			0	

QUANTIFYING THE BENEFIT OR COST OF THE §962 ELECTION – EXAMPLE 2

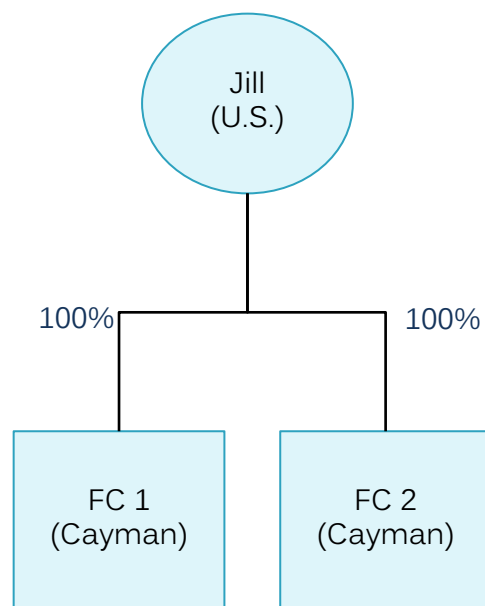


FC 1 and FC 2

- Each have \$1,000 of pre tax earnings and no fixed assets.
- Both FC 1 and FC 2 pay 19% CIT in the UK
- All of the earnings are treated as 951A earnings

- When the \$1,620 of earnings are distributed in a future year then the distributions will be subject to tax.
 - The UK is a country with a comprehensive income tax treaty with the U.S.. If we assume that FC 1 and FC 2 are qualified foreign corporations the distribution will be eligible for the preferential 20% rate.
 - Tax due will be **\$324** ($\$1620 \times 20\%$) before taking into account NIIT.
 - Savings of **\$275** ($\$599 - \324) plus the benefit of deferral.

QUANTIFYING THE BENEFIT OR COST OF THE §962 ELECTION – EXAMPLE 3



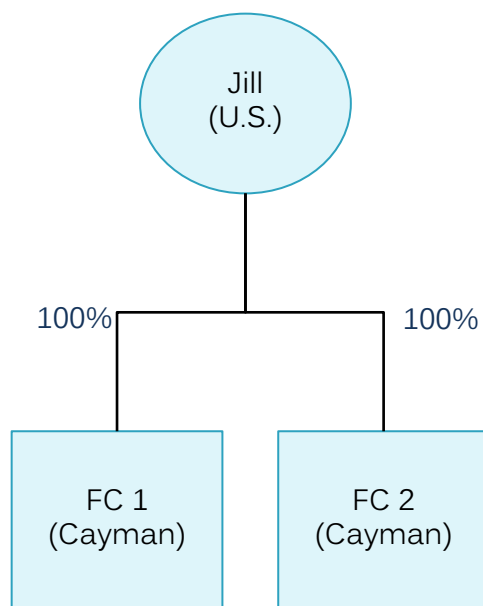
FC 1 and FC 2

- Each have \$1,000 of pre tax earnings and no fixed assets.
- FC 1 and FC 2 do not pay CIT
- All of the earnings are treated as 951A earnings

- Background facts: Same facts as example 2 except that FC 1 and FC 2 are Cayman corporations and pay no tax

§962 tax liability	FC 1	FC 2	Total	
§951A / § 951(a) inclusion	1000	1000	2000	
§78 gross up	0	0	0	A
Tentative income	1000	1000	2000	
§250 deduction	-500	-500	-1000	
Net income after deduction	500	500	1000	
CIT 21%			210	B
Foreign tax credit (lesser of 80% of A or B)			0	C
§962 tax liability			210	

QUANTIFYING THE BENEFIT OR COST OF THE §962 ELECTION – EXAMPLE 3

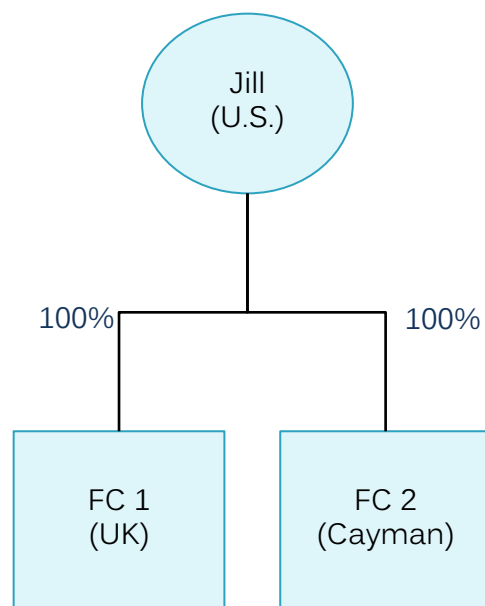


FC 1 and FC 2

- Each have \$1,000 of pre tax earnings and no fixed assets.
- FC 1 and FC 2 do not pay CIT
- All of the earnings are treated as 951A earnings

- When the \$2,000 of earnings are distributed in a future year then tax due at the time of distribution will be $\$662 = (\$2,000 - \$210) \times 37\%$ (before taking into account NIIT)
- Total tax with 962 election is **\$872** ($\$662 + \210)
- Liability without 962 is **\$740** = $\$2,000 \times 37\%$.
- By making a 962 election Jill has an increase in tax liability on a fully distributed basis but has the benefit of deferral.

QUANTIFYING THE BENEFIT OR COST OF THE §962 ELECTION– EXAMPLE 4



FC 1 and FC 2

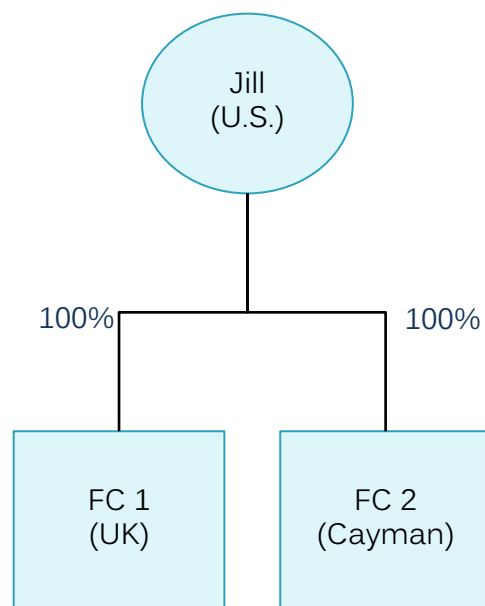
- Each have \$1,000 of pre tax earnings and no fixed assets.
- FC 1 is a UK corporation and pays 19% CIT.
- FC 2 does not pay CIT
- All of the earnings of FC 1 are treated as 951A earnings
- The earnings of FC 2 are FPHCI

- Background facts: Same facts as example 2 except FC 2 is a Cayman corporation and the income from FC 2 is Subpart F (FPHCI) income

§962 tax liability	FC 1	FC 2	Total	
§951A / § 951(a) inclusion	810	1000	1810	
§78 gross up	190	0	190	A
Tentative income	1000	1000	2000	
§250 deduction	-500	0	-500	
Net income after deduction	500	1000	1500	
CIT 21%	105	210	315	B
Foreign tax credit (*)	105	0	105	C
§962 tax liability	0	210	210	

*Foreign tax credit limitations of 904 apply. Foreign taxes attributable to the GILTI basket cannot offset the tax liability on income in other baskets.

QUANTIFYING THE BENEFIT OR COST OF THE §962 ELECTION– EXAMPLE 4



FC 1 and FC 2

- Each have \$1,000 of pre tax earnings and no fixed assets.
- FC 1 is a UK corporation and pays 19% CIT.
- FC 2 does not pay CIT
- All of the earnings of FC 1 are treated as 951A earnings
- The earnings of FC 2 are FPHCI

- Background facts: Same facts as example 2 except FC 2 is a Cayman corporation and the income from FC 2 is Subpart F (FPHCI) income. FC 1 is a qualified foreign corporation.

Liability on Distribution	FC 1	FC 2	Total
Tentative Distribution	810	1000	1810
962 income tax paid*		210	210
Amounts distributed	810	790	1600
Tax Rate	20%	37%	
Tax liability on distribution	162	292	454

- Total liability **\$664** = \$210+454 (before considering NIIT)
- If no 962 election was made for example 4 then liability would be \$670 = (\$810+\$1,000)*37%
- By making the 962 election there is a small savings on a fully distributed basis plus the benefit of deferral.

DETERMINING WHEN TO MAKE THE §962 ELECTION

- The §962 election has two potential benefits
 - Permanent reduction in tax liability and/or
 - Deferral
- In order to determine when to make the election taxpayers will need to project the tax liability with and without the election both on a current and fully distributed basis.
 - If there is a reduced tax liability on a fully distributed basis the election should be made.
 - If there is an increased tax liability on a fully distributed basis then taxpayers must weigh the benefit of deferral vs the increased tax cost.
- Factors that can affect tax liability: type of §951(a) income and availability of the §250 deduction, whether CFCs are qualified foreign corporations, effective tax rate that foreign corporations pay, withholding tax on actual distributions.
 - Effective rate is not just the stated rate – corporations with NOL carryforwards, countries with tax regimes that incentivize investment or businesses in certain areas.

MAKING THE §962 ELECTION

- The election is made by attaching a statement to a taxpayer's income tax return. The statement must include the following:
 - I. Name, address, and taxable year of each CFC to which the taxpayer is a U.S. shareholder and any foreign entity through which they are indirect owner of a CFC.
 - II. The §951(a) income included in the §962 election on a CFC by CFC basis.
 - III. Taxpayer's pro-rata share of E&P and taxes paid for each applicable CFC.
 - IV. Distributions actually received by the taxpayer during the year on a CFC by CFC basis with details on the amounts that relate to (1) excludible §962 E&P (2) taxable §962 E&P (3) E&P other than §962.
- There is also a requirement under the regulations that the statement must be accompanied by any other information or forms which are required by the IRS – but there has been no guidance issued on any other requirements specific to making the election (8993 discussed during the next section).

MAKING THE §962 ELECTION

Election by U.S. Shareholder of a Controlled Foreign Corporation to Be Taxed at Corporate Rates IRC Section 962(a)

Section 962(a) Election

_____ hereby elects pursuant to Section 962(a) of the Internal Revenue Code to be subject to tax at corporate rates on amounts includible in gross income pursuant to Section 951(a) for the year ending _____. THE TAXPAYER elects to utilize a foreign tax credit for taxes paid with regard to the earnings and profits attributable to such amounts. The following information is submitted in compliance with Regulation §1962-2(b):

- 1) THE TAXPAYER was a U.S. shareholder for the year _____ in the following controlled foreign corporations:

<u>Name</u>	<u>EIN</u>	<u>Address</u>	<u>Tax Year End</u>
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____

- 2) THE TAXPAYER has included the following amounts in income under §951(a):

<u>Name</u>	<u>§951(a) Inclusion</u>
_____	160,847
_____	_____
_____	_____

MAKING THE §962 ELECTION

- 3) THE TAXPAYER pro rata share of the earnings and profits of each corporation determined under Reg. §1.964-1 foreign income taxes paid with respect to such earnings and profits:

<u>Name</u>	<u>Pro-rata share of Earnings and Profits</u>	<u>Foreign Taxes Paid</u>
<u>[REDACTED]</u>	<u>306,424.</u>	<u>260,932.</u>
<u> </u>	<u> </u>	<u> </u>
<u> </u>	<u> </u>	<u> </u>
<u> </u>	<u> </u>	<u> </u>

- 4) THE TAXPAYER received the following distributions from the above corporations:

<u>Name</u>	<u>From Excludable §962 Earnings and Profits</u>	<u>From Taxable §962 Earnings and Profits</u>	<u>From Other Earnings and Profits</u>
<u>[REDACTED]</u>	<u>NONE</u>	<u>NONE</u>	<u>NONE</u>
<u> </u>	<u> </u>	<u> </u>	<u> </u>
<u> </u>	<u> </u>	<u> </u>	<u> </u>
<u> </u>	<u> </u>	<u> </u>	<u> </u>

- 5) THE TAXPAYER was not a U.S. shareholder in any other controlled foreign corporations during the year ending [REDACTED].

MAKING THE §962 ELECTION

- The election needs to be made with the taxpayers return.
 - There is no additional guidance on timing ('original', 'timely filed', etc).
 - Taxpayer was allowed to make the election on amended return after they determined they may have a 951(a) liability – *Dougherty v. Commissioner*; GCM 36325

REPORTING THE §962 TAX

- The §962 tax is reported directly on the taxpayer's income tax return and added to any other income taxes due.
- 2018 1040 11a instructions: "Tax due to making a section 962 election (the election made by a domestic shareholder of a controlled foreign corporation to be taxed at corporate rates). See section 962 for details. Check box 3 and enter the amount and "962" in the space next to that box. Attach a statement showing how you figured the tax."
- No direct guidance on what needs to be included on the statement outside of requirement that it must show the tax was determined. It is generally a good idea to 'show your work' for tax computations so that the return can be followed.
- The Form 8993 must be attached where a §962 election is made and a §250 deduction is taken (50% deduction on GILTI).
- See Prop Reg §1.250(a)-1(d)

REPORTING THE §962 TAX

- No specific guidance, outside of the §965 FAQs, on additional forms that need to be attached to a Taxpayer's return when making a §962 election.
 - Actually attaching the forms as statements: 1120, 1118
 - Form instructions are specific to actual corporations – not individuals, trusts, and estates making an election.
 - Ex. “Any corporation that elects the benefits of the foreign tax credit under section 901 must complete and attach Form 1118 to its income tax return.

REPORTING THE §962 TAX

- If you are an individual and have a §965 inclusion (for example for a fiscal year CFC) then the 965 FAQs instruct you to file Form 1118:
 - “If an IRC 962 election is made, report the relevant section 965(a) amount, the relevant section 965(c) deduction, the deemed paid foreign taxes with respect to the relevant section 965(a) amount, and the disallowed foreign taxes under section 965(g) on **Form 1118**.”
- If you do not have a § 965 inclusion then weigh complexity of calculations; carryovers; guidance under 965 FAQs on filing the Form 1118;



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