School of Continuing and Professional Studies

OUTBOUND PLANNING AND CHOICE OF ENTITY CONSIDERATIONS FOR INDIVIDUALS

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Overview

- Review of Relevant Law
- Structuring a New Business
- Restructuring an Existing Business
- Special Cases: U.S. Citizens Abroad and Temporary U.S. Residents
- Attribution Rules: The Impact of Amended Section 958(b)(4)
- Repatriation Planning

Review of Relevant Law

Individuals and CFCs: Casually Forgotten Castoffs

- The 2017 Act expanded the definition of CFCs and the classes of income subject to Subpart F.
  - For U.S. corporations, it implemented a quasi-territorial (?) system with GILTI functioning as a minimum tax on low-taxed income.
  - But for U.S. individuals, the Act dramatically increased the tax associated with business income earned through CFCs.
    - This was not necessarily contemplated, but it results from pre-existing features of U.S. tax, including (a) the fact that Subpart F (and therefore GILTI) inclusions are not entitled to qualifying dividend treatment (see *Rodriguez v. Commissioner*, 5th Cir. 2013); (b) the fact that high taxed income is treated as GILTI but individuals are not entitled to indirect foreign tax credits; (c) individuals are not entitled to the dividends received deduction; section 956 remains in place for non-Subpart F income or GILTI.

Taxing Business Income

- For individuals, what was deferred business income has become GILTI taxed at 37% (plus 3.8% when the income is distributed) plus state tax and with no foreign tax credit.
  - Some states follow Federal rules and tax Subpart F income when earned; others (e.g., California) tax income when distributed.
- This presentation is concerned with how individuals can deal with this harsh system in a number of situations:
  - Establishing a new business
  - Restructuring choices for an existing business
  - Special situations
    - U.S. citizens residing abroad
    - Temporary U.S. residents
- We are concerned with closely held businesses and, with one exception, we assume that the business needs to operate abroad through some form of local business entity.

Individual U.S. Shareholder of a CFC

	Income (Deduction)	Tax
Gross Income – GILTI	$1,000,000	
Foreign Tax on CFC (assume 20%)		$200,000
Federal Tax (37%) on individual (no FTC)		$296,000
Distribution from CFC	$800,000	
PTI	($800,000)	
Foreign withholding tax (15%)	$120,000	$120,000
State Tax (assume 8%)		$64,000
Net Investment Income Tax (3.8%)		$30,400
Total Taxes		$710,100

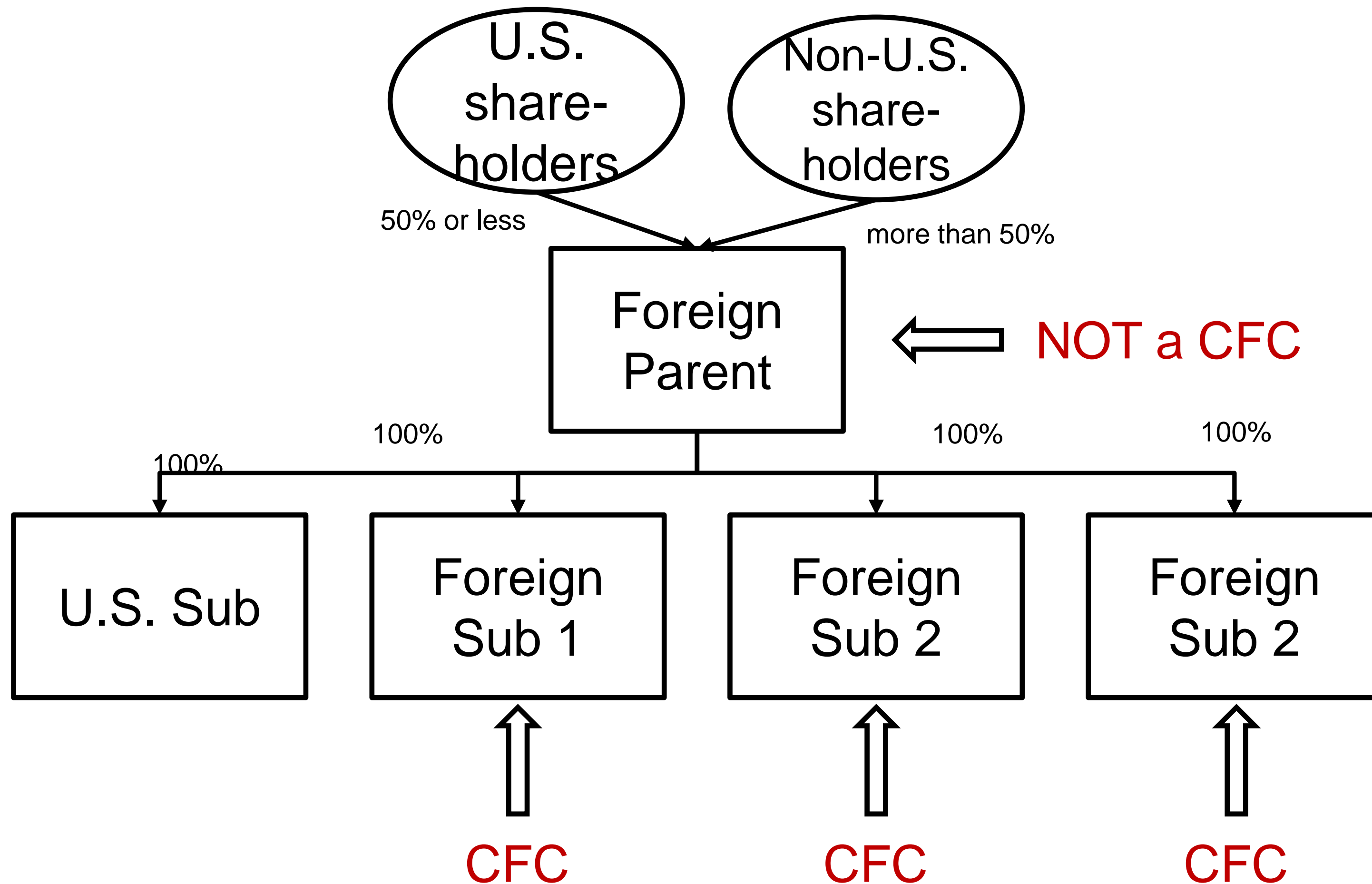
Effective Tax Rate: 71% (49.6% when income earned; 20.4% when distributed)
Note: Summary of GILTI rules set out in Appendix
Note: May be possible to get a refund of withholding tax under IRC sec. 960

Expanded Definition of CFC

- Subpart F (and now GILTI) apply to "U.S. shareholder" where U.S. shareholders hold in aggregate hold more than 50% of the CFC by votes or value
  - BEFORE: U.S. shareholder was U.S. person who held 10% or more of the voting power
  - AFTER: U.S. shareholder was U.S. person who held 10% or more of the voting power <u>or</u> value of the stock
- Congress eliminated the requirement that a foreign corporation be a CFC for at least 30 days during the year
- Section 958(b)(4): Downward attribution
  - BEFORE: No downward attribution of share ownership from foreign shareholders, partners, or beneficiaries
  - AFTER: Shares owned by foreign corporation are attributed to U.S. subsidiary for purposes of determining CFC status

Downward Attribution

- The 2017 Act expanded coverage of CFC rules by allowing for so-called “downward attribution”. E.g., foreign subsidiaries of foreign group with just one U.S. member may be CFCs.



Structuring a New Business

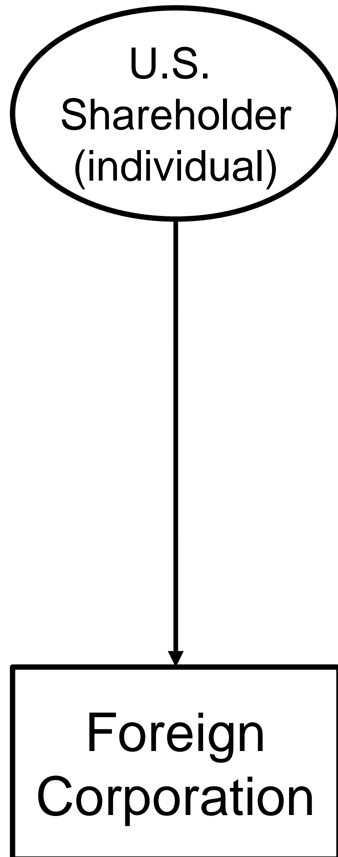
Choice of Entity (U.S.–Controlled)

- The choices, illustrated in the following slides, are:
  - Direct ownership of a foreign corporation that will be a CFC
  - U.S. corporation which will operate through:
    - A foreign corporation that will be a CFC
    - A foreign entity that is classified as a partnership or disregarded entity (whether by default or based on a check-the-box election)
  - Direct ownership of a foreign entity that is classified as a partnership or disregarded entity
- Or, consider staying home and take advantage of:
  - Section 199A
  - FDII
  - Interest charge DISC

Considerations

- U.S. considerations
  - Entity classification
  - Foreign tax credit
  - High tax kickout rules
  - Whether to plan for Section 962 election
  - Availability of qualifying dividend treatment
- Foreign considerations
  - Foreign rules on classifying entities – in many foreign countries, most entities are taxed as companies
  - Corporate tax rates
  - Withholding tax
  - Other taxes – e.g., social contributions, surtaxes, etc., digital
- Multilateral considerations
  - Overall effective rate (U.S. and foreign)
  - Availability of tax treaty
  - Anti-hybrid rules

Individual U.S. Shareholder



- As noted earlier, this structure may result in very high effective rates of tax (see Slide 6)
- Consider whether to make a section 962 election – see sample computation on next page

Section 962 Election – Basic Rules

- 2017 (pre-Tax Act): Assume $1,000,000 Subpart F income and $200,000 foreign tax
- When income earned: Corporate-type tax
  - U.S. individual pays tax on the Subpart F income at corporate rates, taking into account indirect FTC
  - "Corporate" (type) tax paid by U.S. individual after FTC is $150,000 ($350,000 - $200,000 = $150,000)
- When income distributed: Shareholder-level tax
  - Subpart F tax on "corporation" ($150,000) is tax-free PTI
  - Under section 962(d), remaining $650,000 is taxable to U.S. individual when distributed (if any foreign withholding tax, FTC given)
  - So, U.S. Individual pays tax twice!
- If distribution is a qualified dividend, tax will be $130,000 plus 3.8% x 800,000 = 30,400
- Second tax is deferred, possibly for a long time
- Tax on fully distributed income:
  - $200,000 + $150,000 (when earned) + $160,400 = $510,400

Section 962 Election – Tax on the Distribution

- Under section 962(d), the E&P in excess of the U.S. corporate-type tax previously "shall, when such earnings and profits are distributed, notwithstanding the provisions of section 959(a)(1), be included in gross income …"
- Is the distribution a dividend?
- If so, is the dividend qualified?
- See *Smith v. Commissioner*, 151 T.C. No. 5 (2018)
  - No "deemed U.S. corporation" except for purposes of computing Subpart F tax
  - Therefore, actual distribution should be treated as made by the corporation for purposes of section 1(h)(11)
  - Issue not fully resolved in *Smith*, but clearly implied:
    - One CFC was Hong Kong corporation – clearly not qualified
    - One CFC was Cyprus and court remanded to determine if treaty applied

Section 962 Election – GILTI Example

- Assume in 2018 $1,000,000 GILTI and $200,000 foreign tax
- GILTI – No 962 Election
  - $800,000 x 37% = $296,000
  - Total taxes $200,000 foreign + $296,000 GILTI = $496,000 (plus 3.8% on dividend from CFC plus state tax)
- GILTI – With 962 Election

  Corporate-type tax = $105,000 – (80% x $200,000) = 0, i.e., no residual U.S. tax

  Shareholder-level tax on dividend = $800,000 x (37% + 3.8%) = $326,400 or $800,000 x (20% + 3.8%)** = $190,400

  Total U.S. tax = $326,400 or $190,400 (deferred until distribution)

  Total of foreign and U.S. taxes = $526,400 or $390,400

** Assumes CFC is a qualified foreign corporation and dividend is a qualified dividend

Section 962 Election – GILTI Example

- Assume in 2018 $1,000,000 GILTI and no foreign tax paid (Cayman company, for example)
- GILTI – No 962 Election
  - $1,000,000 x 37% = $370,000
  - Total taxes $370,000 GILTI (plus 3.8% on dividend from CFC plus state tax)
- GILTI – With 962 Election

  Shareholder-level tax from GILTI = $105,000 ($210,000 x .50) (becomes PTI)
  Shareholder-level tax on dividend** = $895,000 x (37% + 3.8%) = $365,160
  Total U.S. tax = $470,160 ($365,160 deferred until distribution)

** Assumes CFC is NOT a qualified foreign corporation and dividend is NOT a qualified dividend

- Above illustrates 962 election not always the best choice
  - Generally, not advisable if FC is in low-tax jurisdiction and dividends don't qualify for preferred dividend rates

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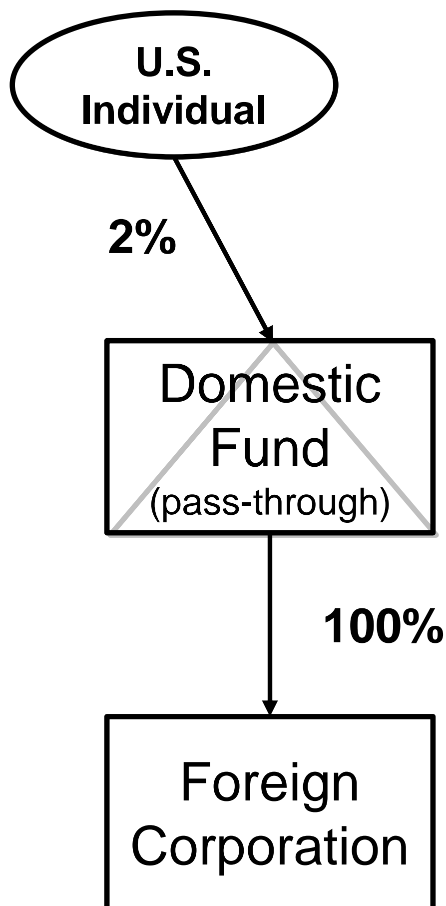
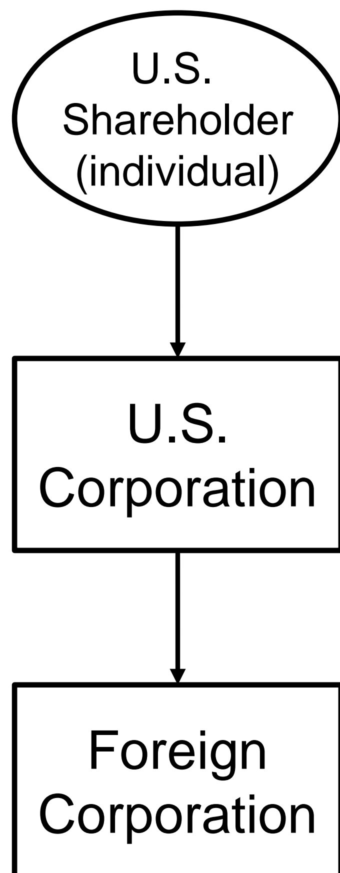
Section 962 Election – Who Can Elect?



- 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.

U.S. Holding Corporation with CFC



	Rate on original pre-tax profit
■ As the computation on the next slide shows, tax is paid when Foreign Corporation earns income and again when it makes a distribution and a third time when U.S. Corporation pays dividend	
◆ When Subpart F income or GILTI earned: Foreign tax + Federal tax at 21% – foreign tax credit (80% FTC)	20.0%
◆ When Foreign Corporation pays dividend – foreign withholding tax plus state tax	9.6%
◆ When U.S. Corporation pays dividend 20% + 3.8% plus state tax	22.4%

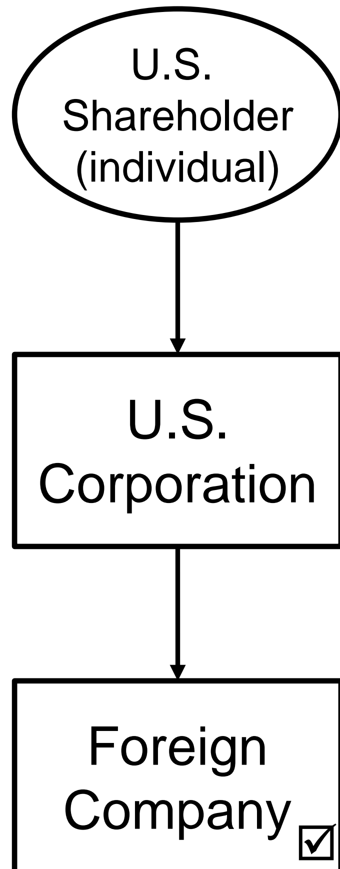
- Timing is key; consider accumulated earnings tax (AET)

U.S. Holding Corporation with CFC

	Income (Deduction)	Tax	
Gross Income (GILTI)	$1,000,000		
Foreign Tax (20%)			$200,000
Federal Tax (21%)		$105,000	
Foreign Tax Credit		($105,000)	
Net Federal tax			$0
Distribution to U.S. Corporation	$800,000		
Foreign withholding tax (5%)			$40,000
Additional Foreign Tax Credit (245A)			(0)
Distribution from U.S. Corporation	$760,000		
Federal Tax (20%)			$152,000
State Tax (assume 8%)			$60,800
Net Investment Income Tax (3.8%)			$28,880
Total Taxes			$481,680

Effective Tax Rate: 48.2% (20% when income earned; 0% when distributed to U.S. corporation; 28.2% when distributed to U.S. shareholder)

U.S. Holding Corporation – CTB, Branch or Partnership



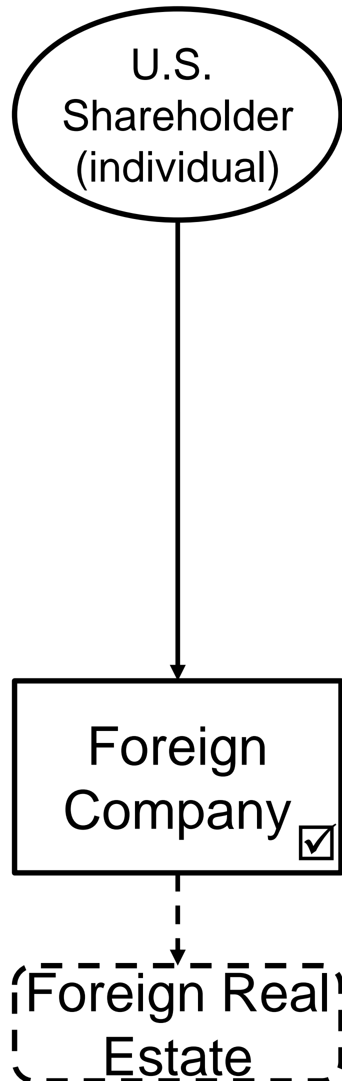
- No CFC or GILTI issues
- No deferral of U.S. corporate tax (even of non-Subpart F/non-GILTI income)
- 100% foreign tax credit available to U.S. Corporation (both indirect and withholding)
- Foreign tax likely not affected by check-the-box election but would be affected if foreign company is transparent for foreign purposes
  - When income earned: Foreign tax + Federal tax at 21% – foreign tax credit (100% FTC) + state tax (should be deductible)
  - When U.S. Corporation pays dividend 20% + 3.8% plus state tax
- Timing still important; deferral within U.S. corporation but consider AET

U.S. Holding Corporation – CTB, Branch or Partnership

	Income (Deduction)	Tax	
Gross Income	$1,000,000		
Foreign Tax (20%)			$200,000
Federal Tax (21%)		$210,000	
Foreign Tax Credit		($200,000)	
Net Federal tax			$10,000
Distribution to U.S. Corporation	$800,000		
Foreign withholding tax (5%)			$40,000
Additional Foreign Tax Credit (timing)			($10,000)
Distribution from U.S. Corporation	$790,000		
Federal Tax (20%)			$158,000
State Tax (assume 8%)			$63,200
Net Investment Income Tax (3.8%)			$30,020
Total Taxes			$501,220

Effective Tax Rate: 50.1% (21% when income earned; 3% when distributed to U.S. corporation; 25.1% when distributed to U.S. shareholder)

Foreign Company – CTB, Branch or Partnership



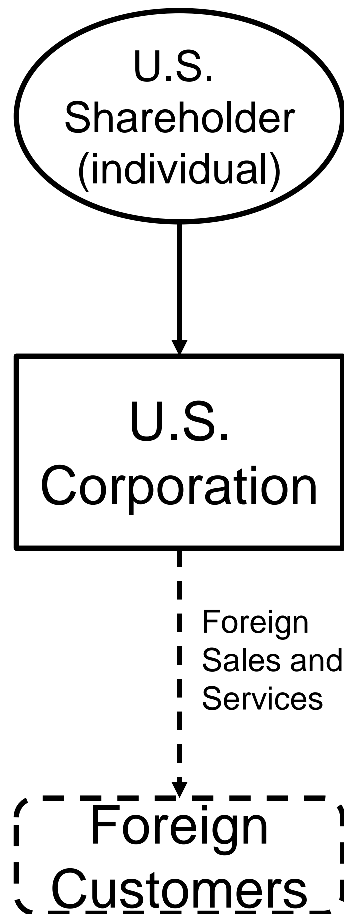
- No CFC or GILTI issues
- No deferral
- 100% foreign tax credit available
- Foreign tax likely not affected by check-the-box election but would be affected if foreign company is transparent for foreign purposes
- Tax results:
  - When income earned: Foreign tax + Federal tax at 37% or 20% – foreign tax credit (100% FTC) + state tax (probably not deductible)
  - When foreign company pays dividend, no U.S. tax but there may be foreign withholding tax (note section section 960)
- This structure may make particular sense for foreign real estate investments

Foreign Company – CTB, Branch or Partnership

	Income (Deduction)	Taxes (Credit)	
Gross Income	$1,000,000		
Foreign Tax (20%)			$200,000
Federal Tax (37%)		$370,000	
Foreign Tax Credit		($200,000)	
Net Federal tax			$170,000
Distribution to U.S. Individual	$800,000		
Foreign withholding tax (15%)			$120,000
Additional Foreign Tax Credit (timing)			($120,000)
State Tax (assume 8%)			$80,000
Net Investment Income Tax (3.8% but could be 0% if taxpayer materially participates)			$38,000
Total Taxes			$488,000

Effective Tax Rate: 48.8% all payable when income earned
But note possible 0% NII

U.S. Company – FDII Planning



- US C corporations taxed at 13.125% rate on income (above fixed routine return on tangibles) derived from foreign sales or services
  - This is accomplished through a deduction of 37.5% of the qualifying income. After 2025, this deduction is reduced to 21.875%, which increases the effective tax rate to 16.406%.
    - Formula for calculating FDII set forth in Appendix
- Note, foreign branch income is excluded from the calculation and will not result in FDII; thus, use of prior structure may not be possible. However, a corporate subsidiary acting as an intermediary to the foreign market is permissible

U.S. Company – FDII Planning

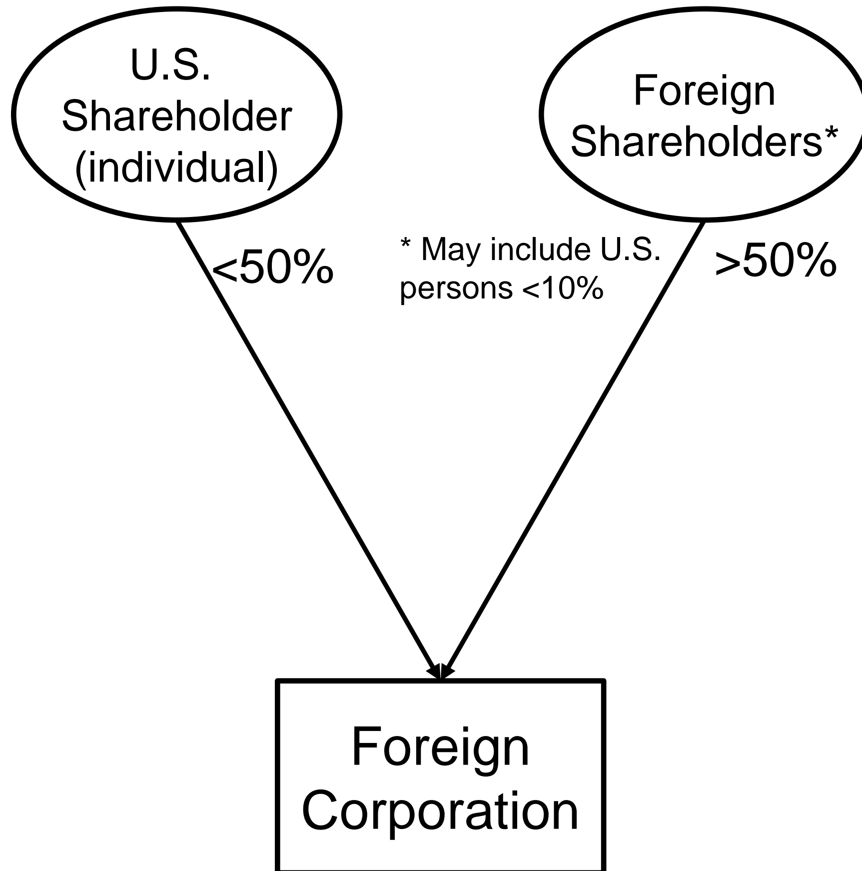
	Income	Deduction	Tax
Gross Deduction Eligible Income	$1,000,000		
Deductions Allocable to Gross DEI		-	
Deduction Eligible Income	$1,000,000		
Deemed Tangible Return		-	
Deemed Intangible Income (QBAI)	$1,000,000		
Foreign-Derived Ratio	1.00		
Foreign Derived Intangible Income	$1,000,000		
FDII Deduction		$ 375,000.00	
Net Income	$ 625,000		
Federal Tax (21%)			$ 131,250.00
Distribution from U.S. Corporation	$ 868,750		
Federal Tax (20%)			$ 173,750.00
State Tax (assume 8%)			$ 69,500.00
Net Investment Income Tax (3.8%)			$ 33,012.50
Total Taxes			$ 407,512.50

Effective Tax Rate: 40.75%; 13.125% when income is earned; balance when distributed

Choice of Entity (Minority)

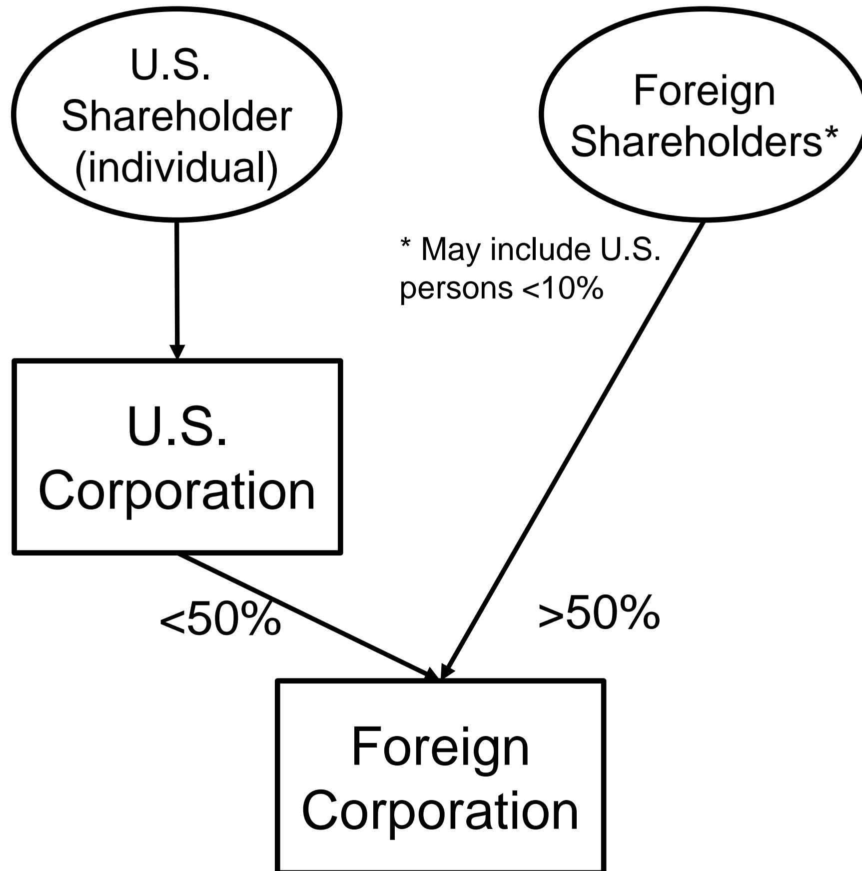
- The choices, illustrated in the following slides, are:
  - Direct ownership of a foreign corporation that is not a CFC
  - U.S. corporation which will operate through:
    - A foreign corporation that will not be a CFC (i.e., other non-attributed foreign owners own 50% or more of the value and voting power) (Note: No change to rule that foreign-held shares not attributed to U.S. person)
    - A foreign entity that is classified as a partnership or disregarded entity (whether by default or based on a check-the-box election)
  - Direct minority ownership of a foreign entity that is classified as a partnership or disregarded entity

Individual Shareholder Holds Foreign Corporation Directly



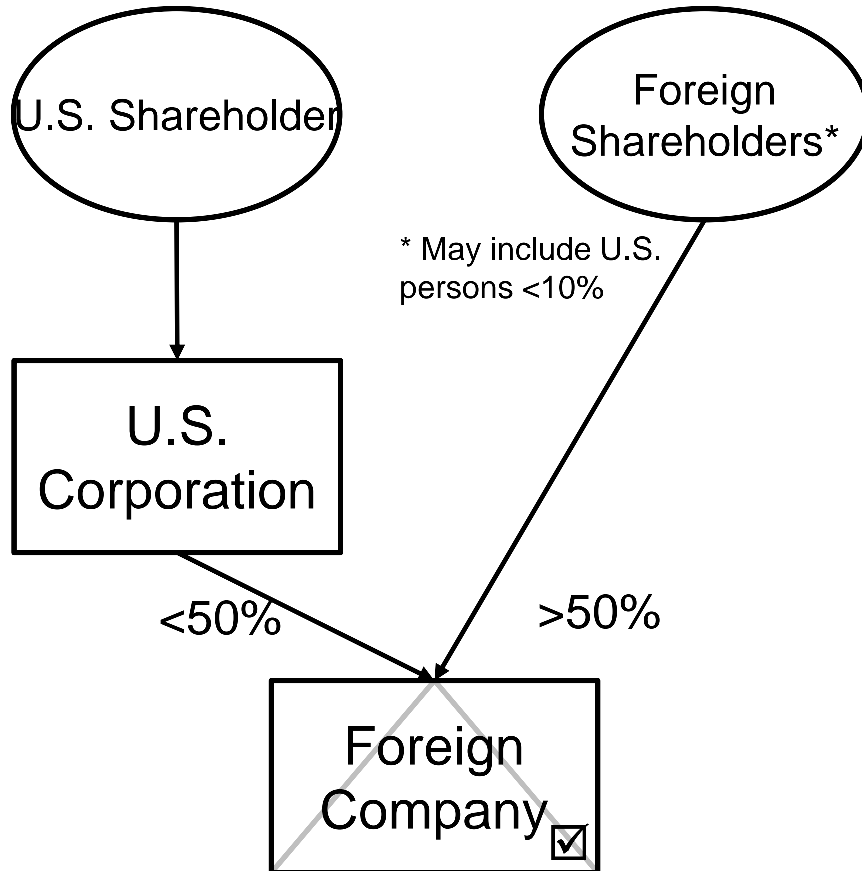
- Foreign corporation is not a CFC – but track CFC status in case of redemptions, sales, etc. and change of status of foreign shareholder
- No U.S. tax before dividend
- No FTC, except for withholding tax
- 20% (qualifying dividend) or 37%, + 3.8% in either case
- PFICs (section 1291 funds): Dividends don't qualify, excess distributions attract interest charge; gains on sale are ordinary; consider QEF election if available

Individual Shareholder Holds Foreign Corporation Through U.S. Corporation



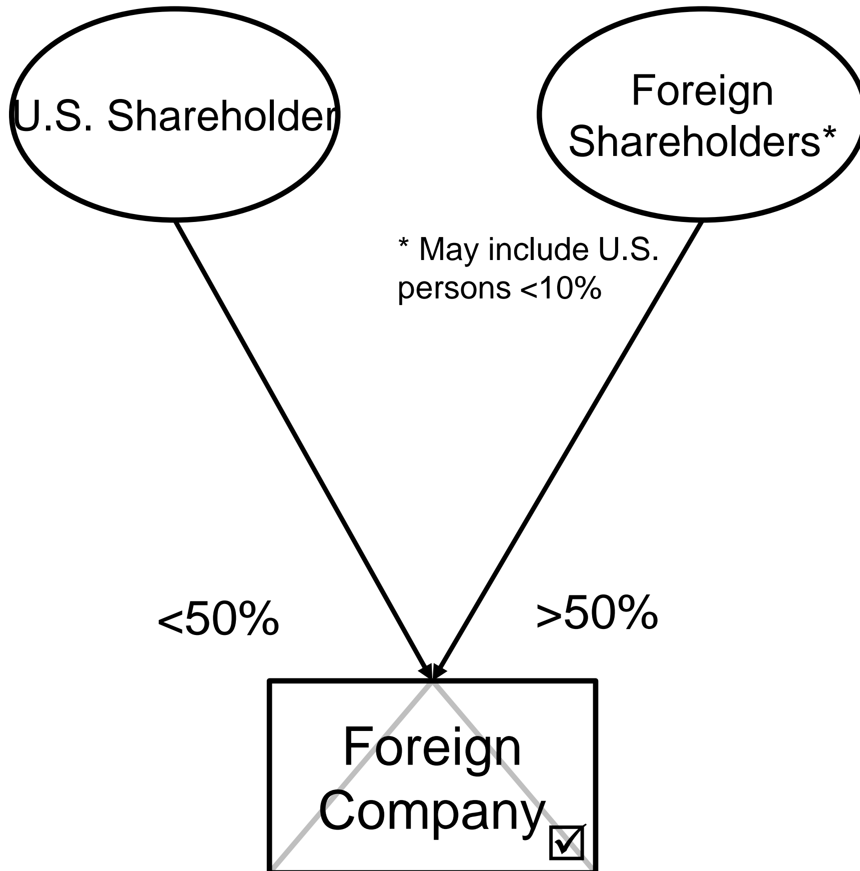
- Foreign corporation not a CFC – but track CFC/PFIC status
- U.S. corporation no longer entitled to indirect FTC
  - Many treaties provide for indirect FTCs for 10% or greater shareholders
  - Unclear if 2017 Act overrides treaties - it has been stated that legislation passed through Budget reconciliation cannot override a treaty
- Structure results in double taxation but not until U.S. Corporation pays dividend
- AET can apply

Individual Shareholder Holds Foreign Partnership Through U.S. Corporation



- Same as Slides 20-21
- May be difficult to persuade Foreign Company to make the CTB election

Individual U.S. Shareholder



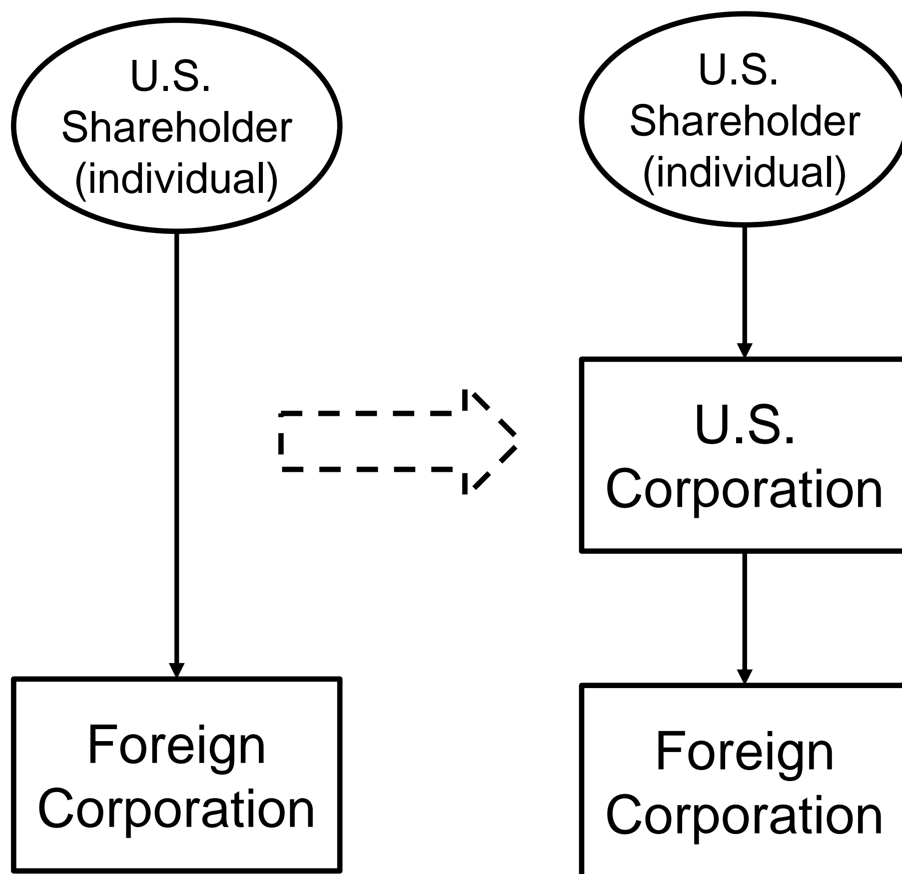
- Same as Slides 22-23
- But again, may be difficult to persuade Foreign Company to make the CTB election

Restructuring an Existing Business

Choice of Entity Considerations

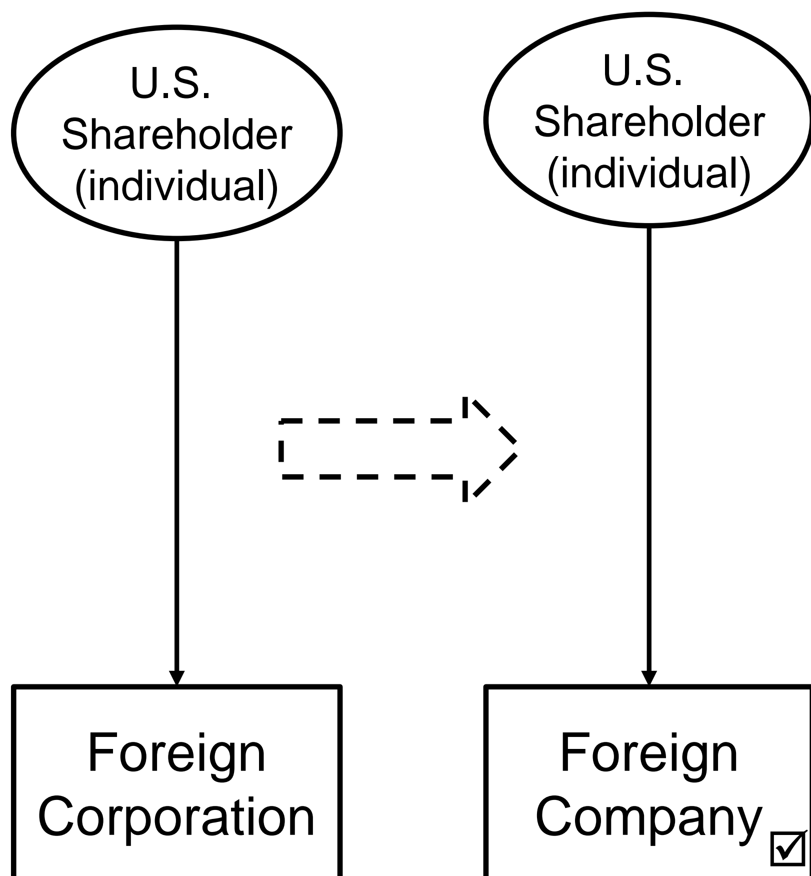
- Assumption that individual shareholder is a U.S. Shareholder of a CFC
- The choices of entity are the same as in the context of setting-up a new business
- The impact of converting an existing business to the desired structure, however, largely drives the decision
- Choices are:
  - Interposing a U.S. holding company
  - Converting an existing CFC to a pass-through entity
  - Liquidating an existing CFC and establishing a U.S. entity
  - “De-Control” transaction

Interposing U.S. Holding Company



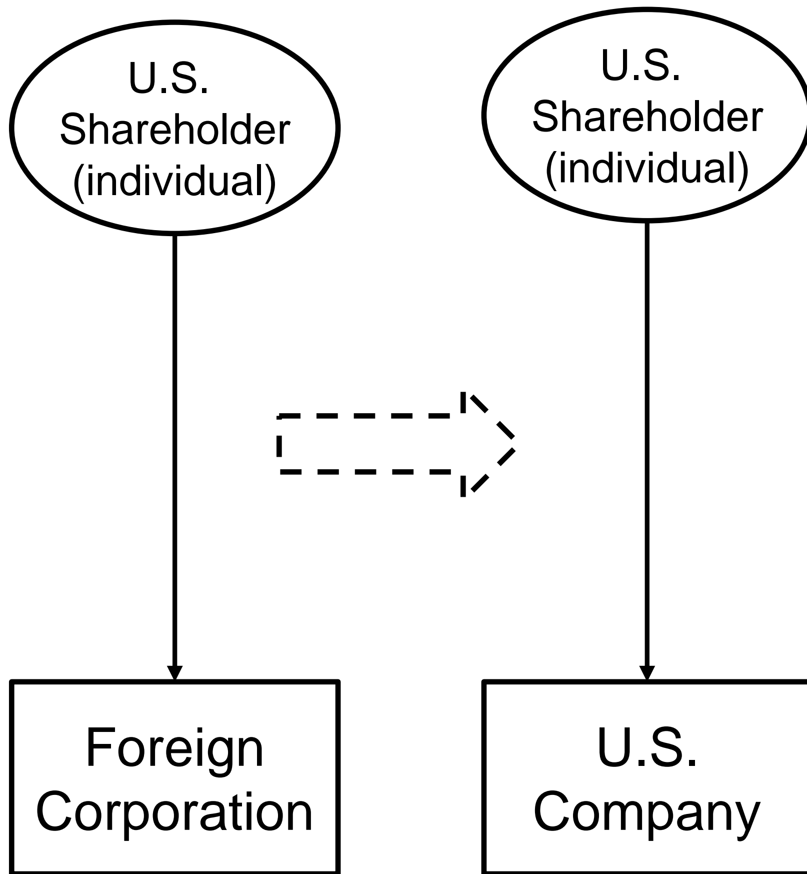
- Tax-free section 351 exchange for U.S. purposes
- Does the transfer trigger foreign tax?
- Is sale of foreign corporation the anticipated exit?
- Is U.S. individual shareholder a tax resident of another country (see Slide 40)?
- Any 965 acceleration concerns (see Slides 37-38)?

Converting Existing CFC to Pass-Through



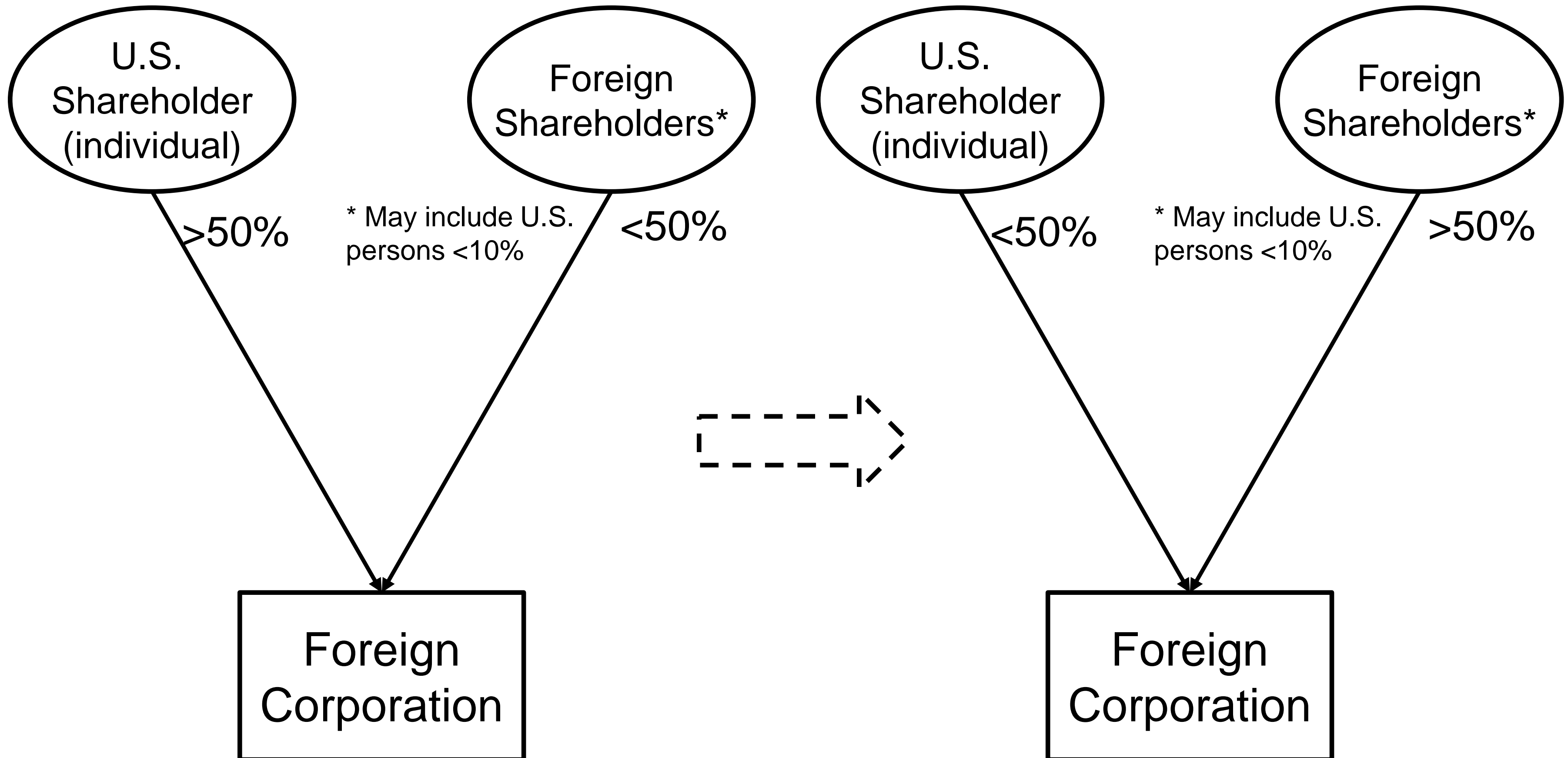
- Check-the-box election causes a taxable liquidation
  - Model outcome; given proximity to 965 repatriation, may still be a viable solution
  - Deemed disposal of assets incl. goodwill may trigger large amounts of GILTI or Subpart F income
- Any 965 acceleration concerns (see Slides 37-38)?
- FDII limitations on foreign branch income
- CTB election not possible for some privately held foreign entities, e.g., Canada company or corporation, French or Swiss S.A., Mexican S.A. de C.V.

Liquidating CFC and Establish U.S. Company



- Taxable liquidation for U.S. and foreign purposes.
  - Possible to interpose U.S. parent followed by section 332 liquidation of CFC, but may still be taxable in U.S.
  - Timing foreign tax credit.
- Any 965 acceleration concerns (see Slides 37-38)?
- Foreign tax on liquidation or transfer of assets to U.S. company

“De-Control” Transaction



Beware anti-avoidance rules – Regulation 1.957-1(b)(2) is still in effect to counteract shifts in formal voting power

Not Quite Past History – IRC Sections 965(h) and (i)

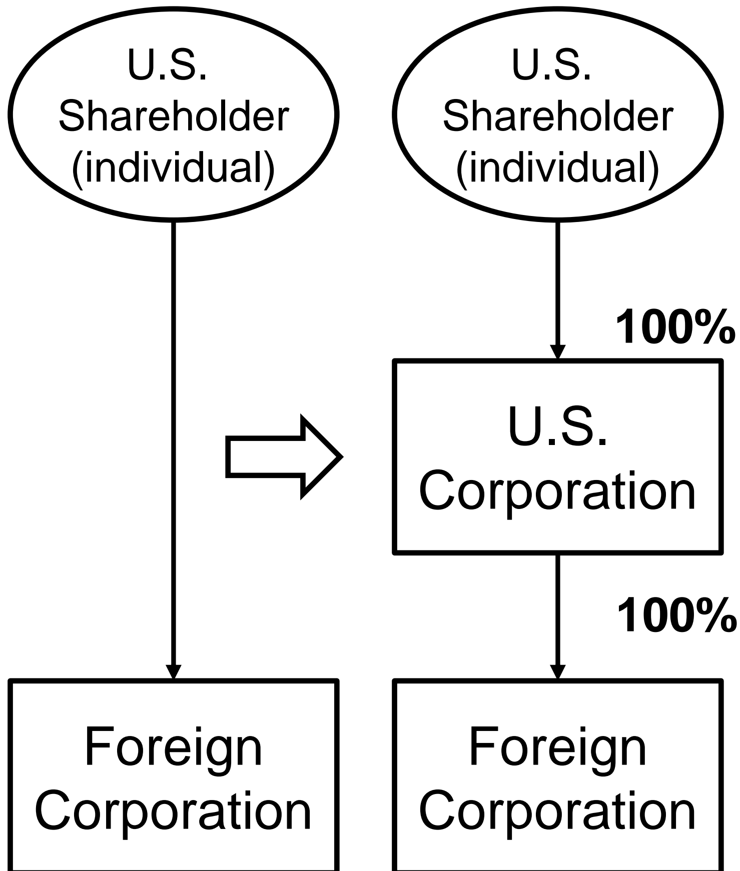
- Section 965(h)(3) provides for acceleration of the transition tax if:
  - An addition to tax for failure to timely pay any installment
  - A liquidation, sale, exchange, or other disposition of substantially all of the assets of the person (including in a title 11 or similar case, or, in the case of an individual, by reason of death)
  - In the case of a person that is not an individual, a cessation of business by the person
  - Any event that results in the person no longer being a United States person, including a resident alien
  - In the case of a person that was not a member of any consolidated group, the person becoming a member of a consolidated group
  - Determination by the Commissioner that there was a material misrepresentation with respect to a transfer agreement
- Eligible 965 Transferee Exception
  - For our purposes, a liquidation, sale, exchange or other disposition of substantially all of the assets of the person (<u>other than by reason of death</u> (no exception there)) and enters into a transfer agreement.

Not Quite Past History – IRC Sections 965(h) and (i)

- Section 965(i), applicable to S corporations, provides for unlimited deferral of the transition tax until a triggering event:
  - Such corporation ceases to be an S corporation (determined as of the first day of the first taxable year that such corporation is not an S corporation)
  - A liquidation or sale of substantially all the assets of such S corporation (including in a title 11 or similar case), a cessation of business by such S corporation, such S corporation ceases to exist, or any similar circumstance
  - A transfer of any share of stock in such S corporation by the taxpayer (including by reason of death, or otherwise)
- Eligible section 965(i) transferee exception:
  - A transfer of any share of stock in such S corporation by the taxpayer (including by reason of death, or otherwise), AND
  - Enter into a transfer agreement

Expatriates and Temporary U.S. Residents

Expatriates



- U.S. expats income tax resident in a foreign country may not be able to utilize a U.S. corporation holding company vehicle
  - Interposing a domestic corporation may create a sandwich (foreign-U.S.-foreign)
  - There may be other adverse foreign tax consequences (e.g., gain realization)

Temporary U.S. Persons

- Temporary U.S. persons exiting in the short-to-medium term also may find it overly costly to utilize a U.S. corporation holding company vehicle, which is not attractive once that individual ceases to be a U.S. person
  - Move to foreign country may create sandwich
  - Exit event may be cumbersome
- Therefore Section 962 election may be preferable for U.S. resident alien who expects to become an NRA in future
  - Non-covered expatriate: *Smith* holds that any distribution is made by the foreign corporation, if no distribution is made until the resident alien is an NRA, theoretically should be no tax on post-residence distribution
  - Covered expatriate
    - Under section 877A, taxpayer deemed to sell stock of CFC while still a resident
    - Gain will be taxed
      - Section 1248 may cause part of gain to be treated as dividend, which may be qualified dividend if CFC is a qualified foreign corporation
      - But are earnings and profits previously taxed at corporate rates under section 962 nevertheless taxable under section 1248? See Treas. Reg. § 1.1248-2(e)(3)(iii)

Takeaways

- There is no single approach
- The taxpayer's situation will depend on numerous factors
- If there is one constant, every structure, actual and proposed, should be subject to a projection of the overall tax on fully distributed income and the timing for payment of the components of that tax – foreign taxes, U.S. corporate taxes, U.S. individual taxes at Federal and state levels
- Most often, this will require realistic income projections from the taxpayer, an understanding of taxes in the foreign jurisdiction, and the expected timing of distributions and of any potential exit
- A reliable crystal ball into political developments would also be helpful

Repatriation Planning

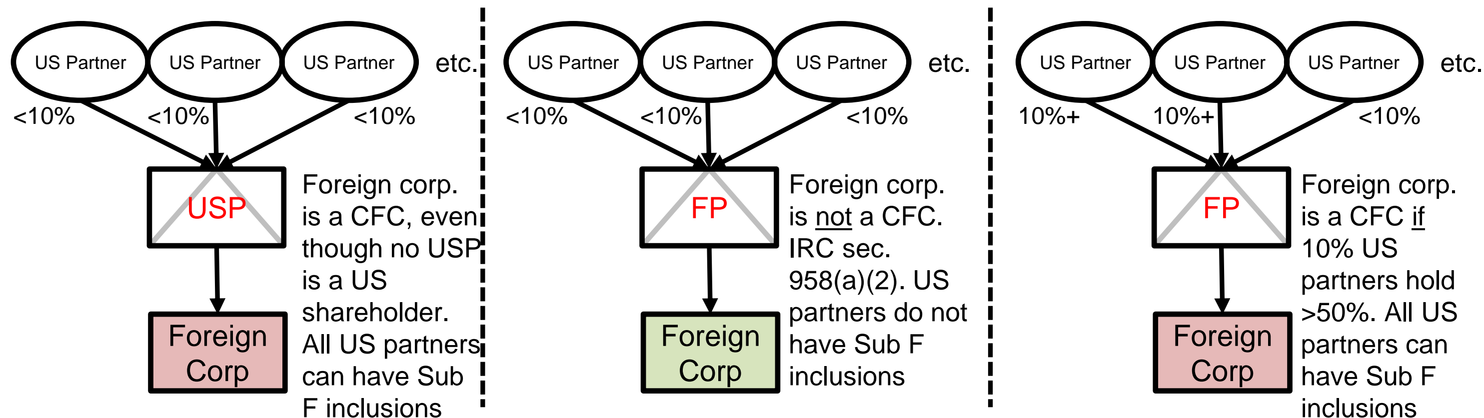
Section 960(c) – Dealing with Timing Mismatches

- Section 965 and 951A may create large amounts of PTEP
  - Distribution of PTEP does not result in additional U.S. tax (other than possible state and ACA taxes), but may incur a foreign withholding tax
    - What to do about this given income was included in prior year for U.S. purposes?
- Section 960(c) allows the taxpayer in these circumstances to increase his or her applicable limitation under section 904(a)
  - Effect is to allow a foreign tax credit to offset U.S. source income
- Insufficient taxable income. -- If an increase in the limitation under 960(c) exceeds the tax imposed for such year, the amount of such excess shall be deemed an overpayment of tax for such year

Regulations on Treatment of Partnerships

Treatment of Partnerships – 1

- June 21, 2019 final regulations addressed 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

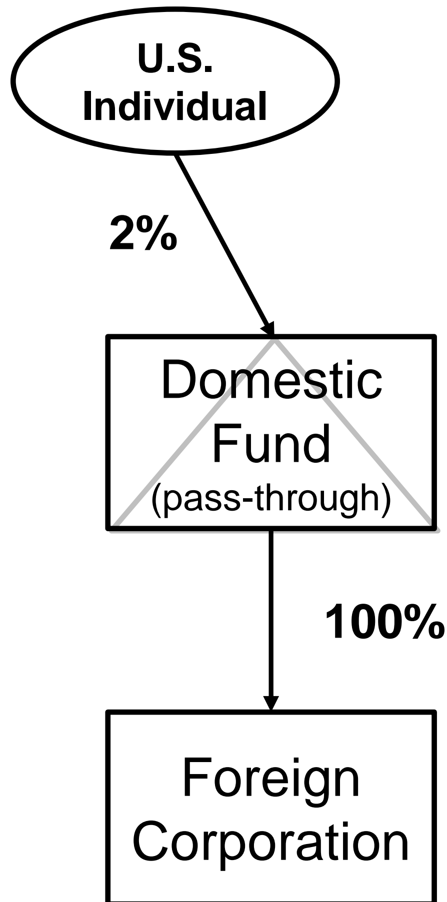


- October 2018 GILTI proposed regs: Hybrid approach – where foreign corporation is a CFC but partner in domestic partnership is not a U.S. shareholder, partner has a distributive share of partnership GILTI; if partner is a U.S. shareholder, GILTI calculated as if partnership were foreign

Treatment of Partnerships – 2

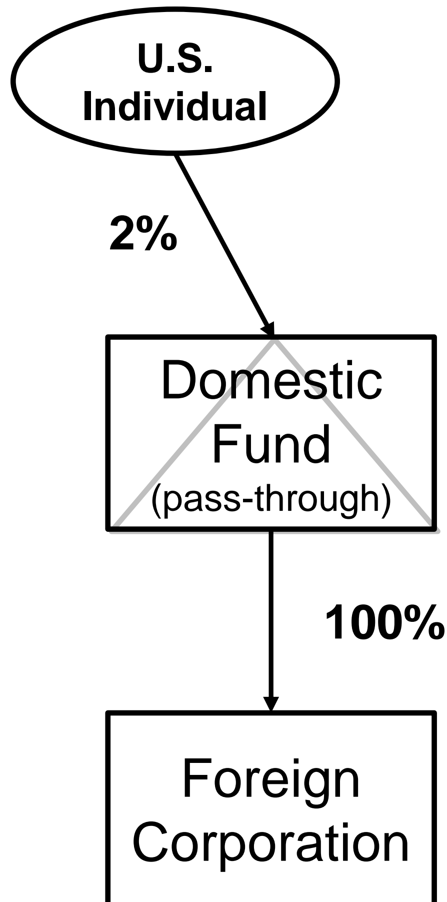
- June 2019 GILTI final regs: Pure aggregate approach – stock owned by domestic partnership is treated as owned by partners for purposes of determining GILTI. Result: Entity approach for Subpart F continues, but aggregate approach adopted for GILTI
- June 2019 GILTI proposed regs: Aggregate approach 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

Appendix – GILTI Basics and FDII Calculation

Subpart F, GILTI and QBAI – Overview

U.S. Shareholder

CFC		
Subpart F income	GILTI – section 951A (most business income)	Qualified business assets income (QBAI) and high taxed FPHC income
■ No change but note high tax kickout income increased due to cut in U.S. 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%)) – *but see June 2019 proposed regulations*	■ 10% C corporation shareholders: ◆ Immediate taxation at 50% (10.5%) ◆ 80% foreign tax credit available ■ Individuals ◆ Full individual rates ◆ Must consider section 962 election	■ QBAI = 10% return on tangible depreciable assets (adjusted basis) ■ High foreign tax FPHC (threshold now 18.9%) *or perhaps all high tax income* ■ 100% dividends received deduction for 10% C corporation shareholders; no section 956 ■ Other shareholders ◆ Deferral ◆ Sections 956 and 1248 not repealed

Typical Business Profile (Especially Individually–Owned)

U.S. Individual

CFC

Subpart F income	GILTI	QBAI

Or Will It Be . . . ?

U.S. Individual

CFC

Subpart F income	GILTI	QBAI and Income Subject to High Foreign Tax (see Slides 38 and 39)

GILTI Basics – 1

- GILTI =
  - CFC net tested Income (computed on a consolidated or aggregate basis for each U.S. shareholder)
  - Less "net deemed tangible income return"
- "Tested income" = CFC gross income, except:
  - Income effectively connected with conduct of U.S. trade or business
  - Subpart F income
  - High foreign tax FPHC income (effective rate of 90% of U.S. corporate rate) – but see possible broadened high tax exception – Slides 38 and 39
  - 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") (basis not FMV) x 10%
  - Less interest expense
- GILTI clearly includes income that does not derive from intangibles.

GILTI 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 U.S. 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

Dividends Received Deduction

- 100% dividend received deduction ("DRD") for foreign source dividends and section 1248/964(e) amounts received from specified foreign corporations, but only if received by a U.S. C corporation shareholder
  - Limited to income that is neither Subpart F income nor-GILTI
  - Subpart F income and GILTI income don’t need DRD because treated as previously taxed income
- Minimum 366-day holding period
- No DRD for hybrid dividends from a CFC
  - Think PECs or instruments treated as debt in foreign country but equity in United States
- No FTC on income for which DRD allowed

FDII Computation

- FDII = deemed intangible income (“DII”) x foreign-derived ratio
  - DII = deduction eligible income (“DEI”) – deemed tangible income return (“DTIR”)
  - DEI = gross DEI – deductions properly allocable to gross DEI
    - Gross DEI = gross income of the corporation without regard to the following items of gross income:
      - Subpart F income
      - GILTI
      - Financial services income
      - Dividends received from a CFC
      - Domestic oil and gas extraction income; and
      - Foreign branch income
  - DTIR = QBAI x 10%
  - Foreign-Derived Ratio = the ratio (not to exceed 1) of the foreign-derived deduction eligible income (FDDEI) for the year to the DEI
    - FDDEI = gross FDDEI – deductions properly allocable to gross FDDEI
      - Gross FDDEI = the portion of gross DEI derived from all of its FDDEI transactions.
        - FDDEI transactions = FDDEI sale or FDDEI service.

The above presentation is based on the completeness and accuracy of facts and assumptions stated above and of any other information provided to us. If any of the foregoing is not entirely complete or accurate, it is imperative that we be informed immediately, as the inaccuracy or incompleteness could have a material effect on our conclusions. We are relying upon the relevant provisions of the Internal Revenue Code of 1986 as amended, the regulations thereunder, any applicable treaty, and the judicial and administrative interpretations thereof, which are subject to change or modification by subsequent legislative, regulatory, administrative, or judicial decisions. Any such changes also could have an effect on the validity of our conclusions. Unless you specifically request otherwise, we will not update our advice for subsequent changes or modifications to the law and regulations or to the judicial and administrative interpretations thereof.

In addition, it should be understood that presentations of this nature are for purposes of discussion and necessarily involve simplification and compression. Descriptions of tax law in this presentation should be the subject of additional more detailed analysis before compliance or planning is implemented in reliance thereon.