Cohen & Co

Inbound and Outbound International Tax Rules

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Welcome & Introductions

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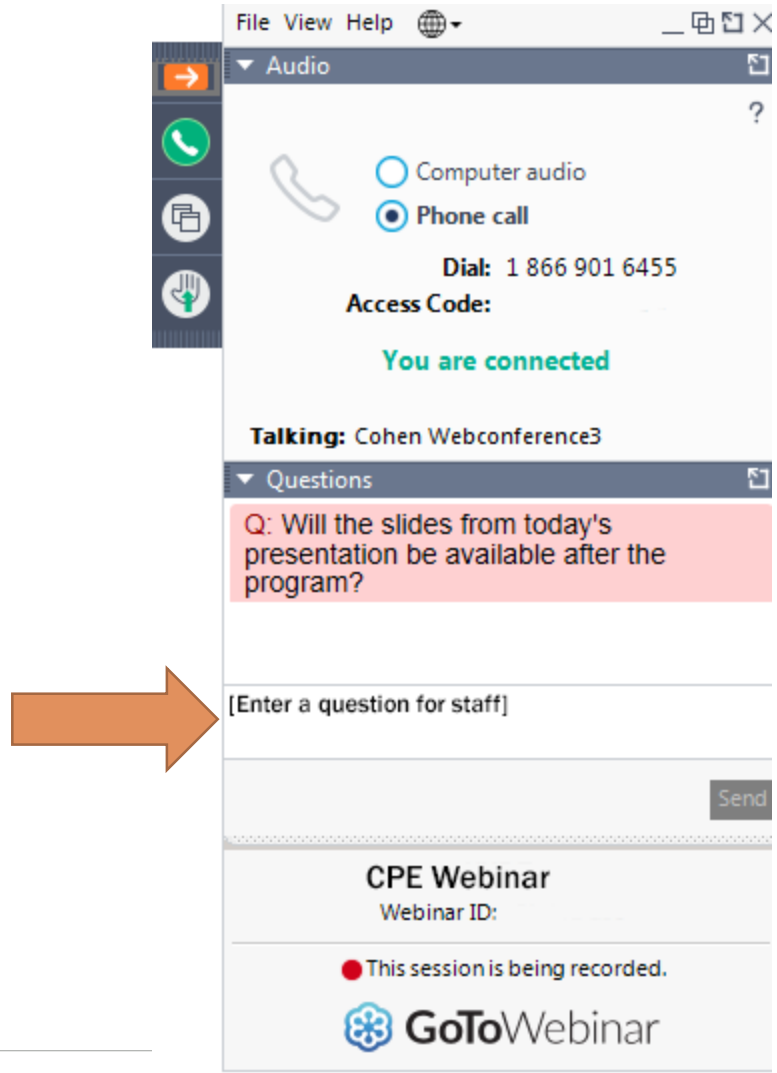

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U.S. Tax Reform – In General

- C Corporations
  - Permanent decrease of 35% corporate rate to flat 21% rate
  - Repeal of alternative minimum tax
- Pass-Through Entities
  - Decrease of individual tax rates
  - New 20% qualified business income deduction for income effectively connected with a U.S. trade or business

International Tax

- Before Tax Reform
  - Foreign corporate earnings were deferred from U.S. tax
  - Certain exceptions applied
- After Tax Reform
  - Certain foreign corporate earnings will permanently avoid U.S. tax
  - Base erosion provisions may deter shifting income outside of the U.S.

International Tax

- After Tax Reform
  - Prior untaxed foreign earnings
    - Deemed repatriation of foreign earnings
    - Transition tax at favorable rates
  - Future foreign earnings
    - New foreign dividends received deduction
    - Base erosion provisions currently tax certain income

International Provisions

› Summary

- 100% deduction for certain foreign subsidiary dividends
- Current inclusion of Global Intangible Low-Taxed Income (GILTI)
- Base Erosion and Anti-Abuse Tax (BEAT Tax)
- Partial deduction for Foreign Derived Intangible Income (FDII)
- Transition tax on deferred foreign income
- Expansion of Controlled Foreign Corporation (CFC) rules
- Disposition of U.S. partnership interests
- New interest expense limitations

Polling Question #1

Foreign Dividend Received Deduction

- 100% exemption for foreign-sourced portion of dividends paid by foreign corporation to domestic corporate shareholder owning 10% or more of foreign corporation stock
- No foreign tax credit or deduction is allowed for foreign taxes paid or accrued with respect to any exempt dividend

Foreign Dividends Received Deduction - Example

	U.S. C Corp	U.S. Individual
Pre-Foreign Tax Income	$100,000	$100,000
Foreign Income Tax (20%)	$ 20,000	$ 20,000
After-Tax Foreign Income / Foreign Dividend	$ 80,000	$ 80,000
Less: Foreign Dividends Received Deduction	($80,000)	-
Taxable Dividend	-	$ 80,000
Total U.S. Tax*	-	$ 19,040
Total Tax (U.S. + Foreign)	$ 20,000	$ 39,040
U.S. Effective Tax Rate	0%	19.04%
Global Effective Tax Rate	20%	39.04%

*Assuming combined dividend rate of 23.8% (20% + 3.8% net investment interest tax)

Global Intangible Low-Taxed Income (GILTI)

- Income inclusion of controlled foreign corporation (CFC) earnings over a deemed reasonable rate of return on tangible assets
- Applies to all U.S. shareholders, including non-corporate ones
- Exception to both foreign dividend received deduction regime and the deferral regime

Global Intangible Low-Taxed Income (GILTI)

- GILTI equals:
  - U.S. shareholder's pro-rata share of CFCs' aggregate net income, *minus*
  - Deemed 10% return on CFCs' aggregate basis in depreciable tangible property

GILTI = Net CFC Tested Income − [(10% x Adjusted Basis of Fixed Assets) - Interest Expense]

Global Intangible Low-Taxed Income (GILTI)

- C Corporations can claim a deduction equal to 50% of the GILTI inclusion plus the foreign tax gross-up amount
  - Deduction decreases to 37.5% for tax years beginning after 12/31/25
- C Corporations can also claim a deemed paid foreign tax credit equal to 80% of foreign taxes attributable to the GILTI inclusion

Global Intangible Low-Taxed Income (GILTI) - Example

	U.S. C Corp	U.S. Individual
GILTI Inclusion	$80,000	$80,000
Sec. 78 Gross-up	$20,000	N/A
Less: 50% GILTI Deduction*	($50,000)	N/A
Taxable Income	$50,000	$80,000
U.S. Tax (21% for C Corp, 37% for pass-through individual owner)	$10,500	$29,600
Less: Foreign Tax Credit (subject to 80% limitation)	($16,000)	N/A
U.S. Tax Liability	$0	$29,600
Global Effective Tax Rate	20%	49.6%

*Assumptions: $100,000 of pre-tax income, 20% foreign tax rate, no foreign tax credit limitations, no distributions out of C Corporation

Polling Question #2

Base Erosion and Anti-Abuse Tax (BEAT Tax)

- New minimum tax that applies to certain payments made to related foreign entities
- Only applies to corporations that:
  - Have average annual gross receipts of $500M or more, and
  - Have made certain related party deductible payments - 3% of corporation's total deductions for the year
- Does not apply to RICs, REITs, S Corporations

Base Erosion and Anti-Abuse Tax (BEAT Tax)

- BEAT tax is excess of:
  - A certain percent of modified taxable income, over
  - Regular tax liability
- Rate of tax
  - 2018: 5%
  - 2019-2024: 10%
  - 2025 & beyond: 12.5%
- Modified taxable income is taxable income, adding back certain base eroding payments

Foreign Derived Intangible Income (FDII)

- Corporate taxpayers are permitted a deduction of 37.5% of foreign derived intangible income
- Results in an effective tax rate of 13.125%
- Deduction reduced to 21.875% for tax years beginning after 12/31/25

Foreign Derived Intangible Income (FDII)

- Foreign derived deduction eligible income is income derived in connection with:
  - Property sold or leased/licensed to a foreign person and the property satisfies the “foreign use” requirements, or
  - Services provided to any person or with respect to the property not located within the U.S.

Foreign Derived Intangible Income (FDII)

- FDII income is foreign portion of deemed intangible income
  - Deemed intangible income is deduction-eligible income, less 10% of qualified business asset investment

$$\text{FDII} = \text{Deemed Intangible Income} \times \frac{\text{Foreign-Derived Eligible Income}}{\text{Total Income}}$$

$$\text{Deemed Intangible Income} = \text{Deduction Eligible Income} - \text{10\% QBAI}$$

Foreign Derived Intangible Income (FDII)

- Foreign related party sales qualify only if:
  - Property is ultimately sold by a related party, or
  - Used by a related party in connection with property sold or services provided to an unrelated foreign person
- Foreign related party services qualify only if service is not substantially similar to services the foreign related party provides to persons within the U.S.

Foreign Derived Intangible Income (FDII) - Example

	U.S. C Corp	U.S. Pass-Through
FDII Income	$1,000,000	$1,000,000
Less: 37.5% FDII Deduction*	($ 375,000)	N/A
Less: Pass-through Deduction (20%)	N/A	($ 200,000)
Taxable Income	$625,000	$800,000
U.S. Tax Liability (21% for C Corp, 37% for Pass-through individual owners)	$131,250	$296,000
Global Effective Tax Rate	13.125%	29.6%

*Assumptions: All income is eligible for the FDII deduction, all income is qualified business income eligible for the pass-through deduction, no foreign tax imposed, no distributions out of C Corp.

*Deduction for FDII is reduced from 21.875% for taxable years beginning after Dec. 31, 2025

Polling Question #3

Transition Tax on Deferred Foreign Earnings

- Deemed repatriation of non-previously taxed accumulated foreign earnings and profits (E&P)
  - Greater of accumulated post-1986 deferred foreign income on 11/2/17 or 12/31/17
  - Netting of E&P deficits allowed
- Intended to transition from the prior deferral regime to the new territorial regime
- Applies to any U.S. shareholder

Transition Tax on Deferred Foreign Earnings

- Reduced effective tax rates
  - 15.5% for cash and cash equivalent earnings
  - 8% for other earnings
- Reduced foreign tax credits
- Installment payment option
  - Eight annual installments
  - No interest charge

Transition Tax on Deferred Foreign Earnings

- S Corporation shareholder payment deferral election
  - Can elect to defer payment indefinitely until triggering event
  - Triggering events
    - S Corporation election terminated or revoked
    - Liquidation or dissolution of S Corporation or cessation of business
    - Sale of S Corporation shares

Transition Tax on Deferred Foreign Earnings - Example

Example	Amount
Accumulated earnings & profits	$1,000,000
Cash and cash equivalents	$ 400,000
E&P subject to 15.5% tax	$ 400,000
Tax at 15.5%	$ 62,000
E&P subject to 8% tax	$ 600,000
Tax at 8%	$ 48,000
Total Tax Liability	$ 110,000

Expansion of Controlled Foreign Corporation Rules

- Expanded definition of U.S. shareholder
  - Controlled foreign corporations are foreign corporations (CFCs) owned if U.S. shareholders own (directly or indirectly) more than 50%
  - Definition of U.S. shareholder is now based on 10% or more of control <u>or</u> value (not just control)
- Expanded stock attribution rules
  - Constructive stock attribution rules now include downward attribution from a foreign entity to a related U.S. entity

Expansion of Controlled Foreign Corporation Rules

- Elimination of 30-day ownership requirement for CFC Subpart F income inclusion
  - A deemed Subpart F income inclusion can now occur if a foreign corporation is a CFC at <u>any time</u> during the tax year
  - Prior rules required that a foreign corporation be considered a CFC for an uninterrupted period of 30 days or more

Polling Question #4

Disposition of U.S. Partnership Interests

- Foreign person gain from sale of U.S. partnership interest is subject to U.S. tax
  - Gain (or loss) from the sale of an interest in a partnership engaged in a U.S. trade or business as effectively connected income
  - Codifies Rev. Rul. 91-32
  - Contrary to holding in *Grecian Magnesite Mining* Tax Court case

Disposition of U.S. Partnership Interests

- New withholding requirement
  - Requires transferee of partnership interest to withhold 10% of the amount realized
  - Recent IRS notice provided relief and guidance
    - Suspended withholding requirement for sales of publically traded partnerships
    - Until further guidance issued, withholding rules based on the Foreign Investors in Real Property (FIRPTA) rules

New Interest Expense Limitations

- Deduction for business interest now limited to 30% of adjusted taxable income plus business interest income
- Definition of adjusted taxable income
  - Earnings before interest, taxes, depreciation and amortization (EBITDA)
  - For 2022 and after, defined as earnings before interest and taxes (EBIT)
- Excess interest carried forward
- Special rules for pass-through entity owners
- Notable exceptions
  - Small taxpayers
  - Real estate business

Takeaways and Planning Opportunities

- Evaluate tax efficiency of current structure
  - Domestic parent company
  - Foreign subsidiaries
- Minimize potential tax effects of transition tax and GILTI inclusion
- Maximize export incentives

Questions for our Presenters?

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Upcoming CPE Event

Save the Date for our Annual **CPE Day** on **November 13, 2018** in Cleveland

Stay tuned for details!

Thank you.

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July 31, 2018