U.S. INTERNATIONAL TAX REFORM:

GILTI, BEAT & FDII

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INTRODUCTION – INTERNATIONAL TAX REFORM: THE CARROT AND STICK STRATEGY

The 2017 tax reform made fundamental changes to the U.S. tax system, specially significant changes were made to the international provisions. The changes provide important benefits to some and detriments to others, “the carrot and stick strategy”

- The Stick: GILTI & BEAT
- The Carrot: FDII & Others
The Stick: Global Intangible Low Tax Income (GILTI) & Base Erosion and Anti-Abuse Tax (BEAT)
IRC SEC. 951A: GILTI – Global Intangible Low Tax Income

• Purpose: To provide a detriment (income inclusion and tax) to U.S. C-Corporations and individuals that keep their intangibles outside the U.S.

• GILTI is a new category of subpart F income that applies to all controlled foreign corporations (CFCs) which requires inclusion of GILTI income, subject to special rules for deductions and credits

• GILTI assumes a fixed rate of return (10%) on a CFC’s tangible assets (QBAI) any excess income is deemed to come from intangible used outside of the U.S.
IRC SEC. 951A: GILTI – Global Intangible Low Tax Income

• The detriment is the inclusion of GILTI income in the U.S. shareholder’s income in the applicable tax years similar to subpart F income

• In order to reduce the impact of the GILTI inclusion new IRC SEC. 250 allows a deduction of 50% of the GILTI, but only U.S. C-Corporations are eligible. The deduction is reduced to 37.5% after 2025

• The result is an effective tax rate of 10.5% for U.S. C-Corporations

• Individuals and pass through entities are not eligible for the GILTI deduction
IRC SEC. 951A: GILTI – Global Intangible Low Tax Income

• U.S. C-Corporations are eligible for a foreign tax credit for foreign taxes attributable to GILTI, but limited to 80% of the foreign taxes paid. No carry forwards or carrybacks for used foreign tax credits.

• Individuals and pass through entities are not eligible for the GILTI foreign tax credit.
IRC SEC. 951A: GILTI – Global Intangible Low Tax Income

• The calculation of the GILTI tax requires an understanding of several new concepts

1. Net Tested Income (Loss): The aggregate net income (or loss) of a shareholder’s CFC other than:
   • Effective connected income of a U.S. T.B.
   • Subpart F Income
   • Income excluded because its from high tax jurisdiction
   • Dividends received from a foreign person
   • Foreign oil and gas extraction income

2. Net Deemed Tangible Income Return: The deemed return (10%) on the tangible assets of the CFC known as QBAI, qualified Business asset investment

3. QBAI – The quarterly average of the adjusted tax basis in depreciable tangible property used in its trade or business. Only straight time depreciation is allowed for this calculation (ADR)
GILTI EXAMPLE – INDIVIDUAL VS CORPORATION

• FACTS

1. U.S. Corporation/Individual directly owns a CFC
2. After applying the income testing rules, we have determined that CFC earned $50,000 of tested income and has $8,000 of associated foreign income taxes
3. CFC recognized $2,000 of interest expense
4. After calculating QBAI, we have determined that CFC has $18,000 of qualified business assets
### GILTI EXAMPLE – INDIVIDUAL VS CORPORATION

<table>
<thead>
<tr>
<th>Step</th>
<th>Item</th>
<th>CFC</th>
<th>Individual</th>
<th>Corporation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Step 1: Tested Income</strong></td>
<td>Tested Income</td>
<td>50,000</td>
<td>50,000</td>
<td>50,000</td>
</tr>
<tr>
<td></td>
<td>Tested Loss</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Net CFC tested Income</td>
<td>50,000</td>
<td>50,000</td>
<td>50,000</td>
</tr>
<tr>
<td></td>
<td>Tested Foreign Income Taxes</td>
<td>8,000</td>
<td>8,000</td>
<td>8,000</td>
</tr>
<tr>
<td></td>
<td>Foreign ETR on Tested Income</td>
<td>13.79%</td>
<td>13.79%</td>
<td>13.79%</td>
</tr>
<tr>
<td><strong>Step 2: QBAI</strong></td>
<td>Qualified Business Asset Investments (QBAI)</td>
<td>180,000</td>
<td>180,000</td>
<td>180,000</td>
</tr>
<tr>
<td></td>
<td>10% of QBAI</td>
<td>18,000</td>
<td>18,000</td>
<td>18,000</td>
</tr>
<tr>
<td></td>
<td>Interest expense reduced tested income and corresponding income not included in tested income</td>
<td>2,000</td>
<td>2,000</td>
<td>2,000</td>
</tr>
<tr>
<td></td>
<td>Net deemed tangible income</td>
<td>16,000</td>
<td>16,000</td>
<td></td>
</tr>
<tr>
<td><strong>Step 3: Calculate GILTI</strong></td>
<td>GILTI</td>
<td>34,000</td>
<td>34,000</td>
<td></td>
</tr>
</tbody>
</table>
### GILTI EXAMPLE – INDIVIDUAL VS CORPORATION

<table>
<thead>
<tr>
<th>Step 4: U.S. Inclusion</th>
<th>Inclusion %</th>
<th>68%</th>
<th>68%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deemed FTC before 20% reduction</td>
<td></td>
<td>5,440</td>
<td></td>
</tr>
<tr>
<td>Deemed FTC after 20% reduction</td>
<td></td>
<td>4,352</td>
<td></td>
</tr>
<tr>
<td>Grossed-up GILTI</td>
<td></td>
<td>34,000</td>
<td></td>
</tr>
<tr>
<td>50% Deduction</td>
<td></td>
<td>19,720</td>
<td></td>
</tr>
<tr>
<td>TI before credit and expense</td>
<td></td>
<td>34,000</td>
<td></td>
</tr>
<tr>
<td>Expense allocated to GILTI basket</td>
<td></td>
<td>19,720</td>
<td></td>
</tr>
<tr>
<td>GILTI for FTC limitation</td>
<td></td>
<td>34,000</td>
<td></td>
</tr>
<tr>
<td>Tax Rate</td>
<td></td>
<td>37%</td>
<td></td>
</tr>
<tr>
<td>FTC limitation</td>
<td></td>
<td>4,141</td>
<td></td>
</tr>
<tr>
<td>TI before FTC</td>
<td></td>
<td>34,000</td>
<td></td>
</tr>
<tr>
<td>Tax Rate</td>
<td></td>
<td>37%</td>
<td></td>
</tr>
<tr>
<td>U.S. tax liability before credit</td>
<td></td>
<td>12,580</td>
<td></td>
</tr>
<tr>
<td>FTC</td>
<td></td>
<td>4,141</td>
<td></td>
</tr>
<tr>
<td>U.S. tax on GILTI</td>
<td></td>
<td>12,580</td>
<td></td>
</tr>
</tbody>
</table>
GILTI – PLANNING OPPORTUNITIES

1. Status Quo – Do nothing and pay the tax
2. Check the box – Convert the CFC’s to Flow through entities
3. Transfer CFC stock to a U.S. C-Corporation
4. IRC SEC. 962 Election by Individual Shareholders
LEGAL STRUCTURE COMPARISION

Scenario 1
- INDIVIDUAL (US)
- Foreign Company (CFC)

Scenario 2
- INDIVIDUAL (US)
- Foreign Company (Pass through)

Scenario 3
- INDIVIDUAL (US)
- U.S. C CORP HOLD CO (US)
- FOREIGN COMPANY (CFC)

Scenario 4
- INDIVIDUAL (US)
- SECTION 962 “DEEMED” US C CORP HOLDCO (US)
- FOREIGN COMPANY (CFC)
BEAT – Base Erosion & Anti-Abuse Provision
IRC SEC. 59A - BASE EROSION & ANTI-ABUSE TAX (BEAT)

- **Purpose:** To provide a detriment (minimum tax) to U.S. C-Corporations that reduce their U.S. taxable income through payments and deductions to foreign related parties.
- **BEAT** is a minimum tax on U.S. and non-U.S. Corporations with:
  1. Average annual gross receipts of at least $500 million over the prior 3 year period, and
  2. A base erosion percentage of at least 3%
- **Base erosion payments** include payments made by the taxpayer to a foreign related party when the payment results deductions or reductions of taxable income
- **Base erosion payments** excludes payments for cost of goods sold
- **A related party** includes a person who owns directly or indirectly at least 25% of the voting power or value of the corporation
- **A corporation base erosion percentage** is determined by dividing the amount of deductions related to base erosion payments by the amount of total deductions
IRC SEC. 59A - BASE EROSION & ANTI-ABUSE TAX (BEAT)

• BEAT anti-abuse provision disallows deductions for payments made by “hybrid entities” or in a “hybrid transaction”, specifically to interest or royalty payments paid to a related party of either:

1. The payment is not included in the receipts income under the local tax jurisdiction, or

2. The recipient is allowed a deduction with respect to the payment under the local tax jurisdiction
THE CARROT: FOREIGN DERIVED INTANGIBLE INCOME DEDUCTION
IRC SEC. 250(a): FDII – FOREIGN DERIVED INTANGIBLE INCOME

• Purpose – To provide a Benefit (deduction) to U.S. C-Corporation that keep their intangibles in the U.S. and export to foreign markets.

• FDII is a new category of income and it does not have to come from intangible assets.

• FDII provision assumes a fixed rate of return (10%) on a corporations tangible assets, any excess income is deemed to come from intangible assets.
IRC SEC. 250(a): FDII – FOREIGN DERIVED INTANGIBLE INCOME

• The Benefit is a 37.5% FDII deduction against taxable income, the income may be generated through:
  1. Sales of property to a non-U.S. person for foreign use, including leases, licenses, exchanges, and other dispositions
  2. Services provided to any person or with respect to any property outside of the U.S.

• Sales and services provided to related parties may be eligible subject to special rules and limitations

• The FDII deduction results in an effective tax rate of 13.125% of FDII

• Beginning in years after 2025, the FDII deduction is reduced to 21.875% resulting in an effective tax rate of 16.406%
IRC SEC. 250(a): FDII – FOREIGN DERIVED INTANGIBLE INCOME

- Determining the FDII deduction requires understanding several concepts:
  1. Deduction Eligible Income (DEI): The gross income less deductions, excluding subpart F and GILTI income
  2. Foreign Derived Deduction Eligible Income (FDDEI): which is eligible income attributable to either the sale or services from “foreign use” foreign use means any use, consumption or disposition not within the U.S.
  3. Deemed Intangible Income (DII): which is the deduction eligible income less deemed tangible income return
  4. Deemed Tangible Income Return (DTIR): which is 10% of QBAI
  5. QBAI: same as GILTI provisions
**FDII EXAMPLE – SERVICE COMPANY WITH NO TANGIBLE ASSETS**

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deduction Eligible Income (DEI)</td>
<td>100,000</td>
</tr>
<tr>
<td>Less: Deemed Tangible Income Return (QBAI * 10%)</td>
<td>-</td>
</tr>
<tr>
<td>Deemed Intangible Income (DII)</td>
<td>100,000</td>
</tr>
<tr>
<td>Foreign Derived Deduction Eligible Income (FDDEI)</td>
<td>100,000</td>
</tr>
<tr>
<td>Percentage of Foreign Derived Deduction Eligible Income (FDDEI) to Deduction Eligible Income (DEI)</td>
<td>100% / 100,000</td>
</tr>
<tr>
<td>Foreign Derived Intangible Income (FDII)</td>
<td>100,000</td>
</tr>
<tr>
<td>Less: 37.5% Deduction for FDII</td>
<td>(37,500)</td>
</tr>
<tr>
<td>Taxable Income</td>
<td>62,500</td>
</tr>
<tr>
<td>U.S. Tax at 21%</td>
<td>13,125</td>
</tr>
<tr>
<td>Effective Tax Rate</td>
<td>13.125%</td>
</tr>
</tbody>
</table>
OUTLOOK FOR FDII

- A Group of European Union Finance Ministers stated that the foreign-derived intangible income regime could qualify as an illegal export subsidy under the WTO. The U.S. law has not yet been brought before the WTO.
- U.S. government officials have said FDII is intended to act as a counterpart to the global intangible low-taxed income, or GILTI, provision, and that together, the two provisions work to neutralize corporations’ decision on whether to locate assets at home or abroad.
- The WTO has not yet considered FDII’s legality because no one has brought the case before the organization yet. Before the EU moves to bring any challenge before the WTO, it is waiting to see more Treasury guidance on the new laws.