

TAX CUTS AND JOBS ACT
INTERNATIONAL
DECEMBER 22, 2017

BY JEANNE GOULET

BYRAM RIVER CONSULTING LLC

June 28, 2018

COMPLEXITY!!!

Too Complicated?

The international provisions of the new U.S. tax code reach “**new heights of complexity**,” a former Treasury official said—and may not even achieve the desired effect.

Dana Trier, counsel at Davis Polk & Wardwell LLP's tax department in New York and former deputy assistant secretary for tax policy at Treasury “**There was no point at which people said, ‘we have to pay attention to how complex this is getting.’”**

“A number of people say the same thing: that **no intelligent tax lawyer**, unlike in the old days, **can actually look at a planning context and intuit what the results are**, because as you play through it, the ramifications of any single planning step are not clear until you understand how it plays through all these different parts,”

DEFINITIONS

DEFINITION OF “US PERSON”

- a citizen or resident of the United States,
- a domestic partnership,
- a domestic corporation,
- any estate (other than a foreign estate)
- any trust if a court within the United States is able to exercise primary supervision over the administration of the trust, and one or more United States persons have the authority to control all substantial decisions of the trust under § 7701(a)(30)

EXPANSION OF DEFINITION OF “US SHAREHOLDERS”

- A US person who owns, or is considered as owning, **10%** or more of the total combined **voting power** of all classes of stock entitled to vote of a foreign corporation *or* **10%** or more of the **total value** of shares of all classes of stock of a foreign corporation under § 951(b)
- A US person who owns less than 10% vote or value is NOT a “US Shareholder”, as defined

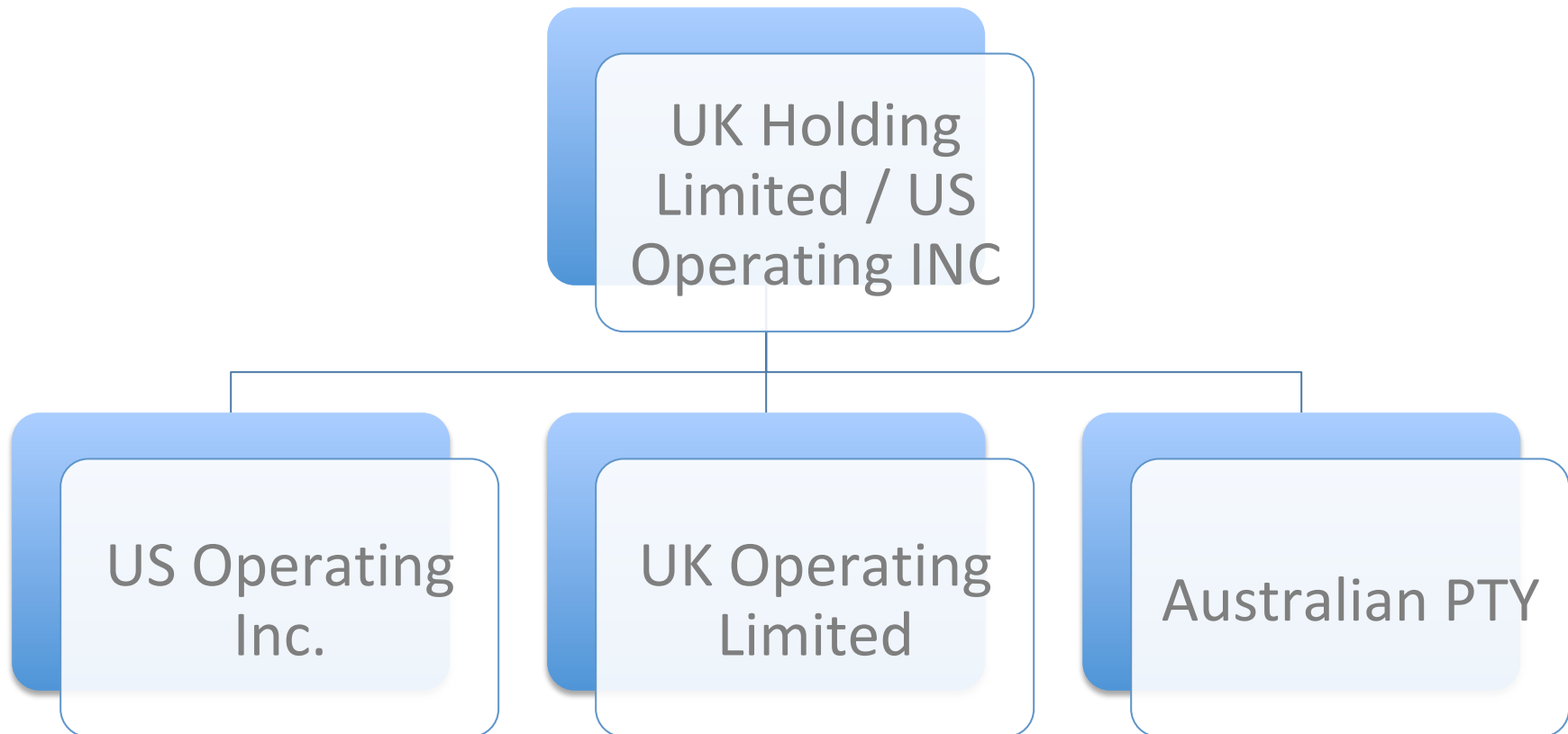
DEFINITION OF “CFC” CONTROLLED FOREIGN CORPORATION

- CFC means any foreign corporation if more than 50% of the total combined voting power of all classes of stock *OR* the total value of the stock is considered as owned **directly, indirectly or constructively** by “US Shareholders” on **any day** of the taxable year under § 957.
- US persons who are NOT “US Shareholders”, as defined, are not included in the greater than 50% count.

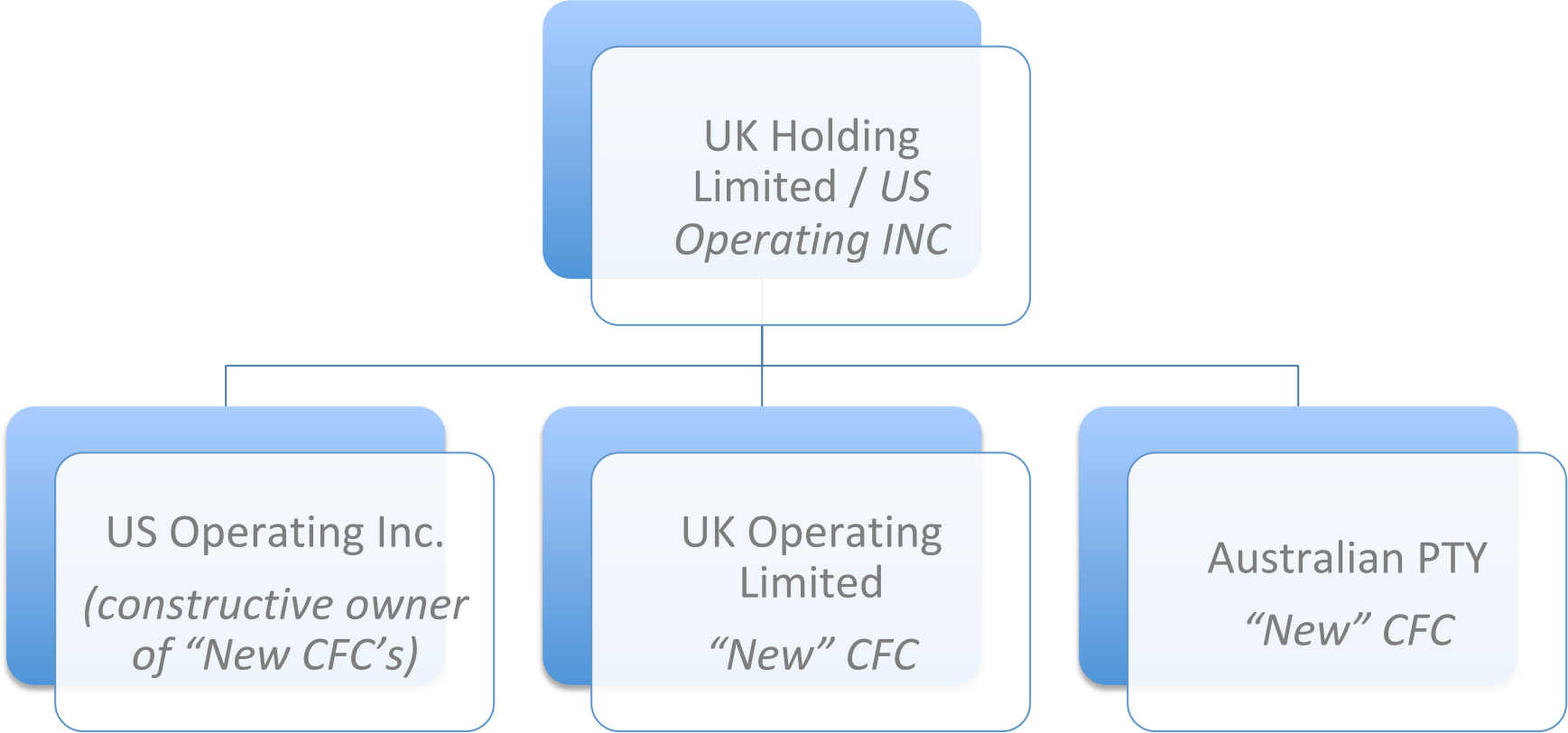
EXPANSION OF DEFINITION OF “US SHAREHOLDERS”

- The United States shareholder's ownership in a CFC is determined based on direct and indirect ownership under § 958(a) and
- Constructive ownership under § 957(b)
 - Under prior law, there was no attribution under § 318(a)(3) to consider a US person as owning stock which is owned by a person who is not a US person § 958(b)(4)

TYPICAL FOREIGN CORPORATE STRUCTURE



CONSTRUCTIVE ATTRIBUTION



CONSEQUENCES OF REPEAL

CASE 1

- UKHL has no US Shareholders, therefore there is no income inclusions to itself or the 2 “new” CFC’s.
- Form 5471 Information Returns of US Persons with respect to Certain Foreign Corporations is not required under Notice 2018-13 as there is no US Shareholders in the “new CFC’s)

CONSEQUENCES OF REPEAL

CASE 2

- If UKHL has one US Shareholders, then, as an indirect owner of the 2 “new” CFC’s, the US Shareholder may have an income inclusion.
- Form 5471 Information Returns of US Persons with Respect to Certain Foreign Corporations is required under § 6038(a)(4) with respect to the 2 new CFC’s

FAILURE TO FILE PENALTIES

FORM 5471

- A **\$10,000** penalty is imposed for **each annual accounting period of each foreign corporation** for failure to furnish the required information within the time prescribed.
- If the information is not filed within 90 days after the IRS has mailed a notice of the failure to the U.S. person, an additional \$10,000 penalty (per foreign corporation) is charged for each 30-day period, or fraction thereof, during which the failure continues after the 90-day period has expired.
- The additional penalty is limited to a maximum of **\$50,000 for each failure**

FORM 5471

CATEGORIES OF FILERS

1. Repealed
2. US citizen or resident who is an officer or director of a foreign corporation that has a US Shareholder, as defined
3. A US Shareholder, as defined
4. A US Person who had control of a CFC for 1.6038-2(d)
5. A US Shareholder in a foreign corporation that is a CFC who owns that stock on the last day of that year

TRANSITION TO A PARTICIPATION EXEMPTION SYSTEM

DEFERRED FOREIGN INCOME CORPORATION TRANSITION TAX

- A US Shareholder of a DFIC must include in gross income its pro rata share of the increase in Subpart F income for the DFIC's last taxable year beginning before January 1, 2018, § 965(a)
- The DFIC must increase its Subpart F income by its accumulate post-1986 deferred foreign income taxed at 15.5% of cash and 8% for the balance (transition tax)
- This one time increase in Subpart F income is a means by which the US can transition to a participation exemption system.
- Unexpectedly, a 10% direct or indirect US Shareholder would have an income inclusion even if the DFIC is NOT a CFC (50% or less ownership) if there is a US domestic corporation that is a US Shareholder constructively!

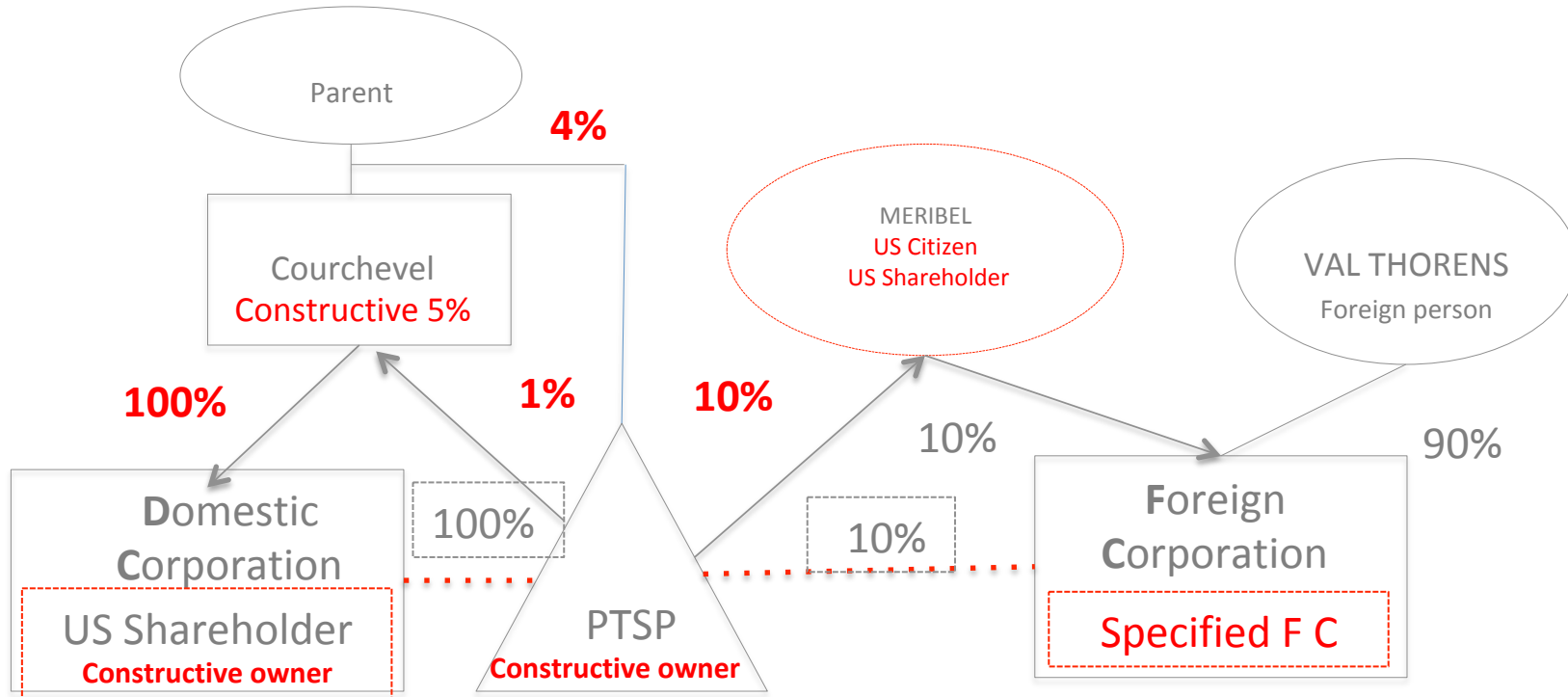
DEFERRED FOREIGN INCOME CORPORATION DEFINITION (DFIC)

- A DFIC is any Specified Foreign Corporation (SFC) of a US Shareholder § 965(d)(1)
 - An SFC is
 - Any CFC § 957(b) or
 - Any foreign corporation that has a domestic corporation as a US Shareholder § 965(e)(1)
- Passive Foreign Investment Company (PFIC) § 1297 that is not also a CFC is excluded § 965(e)(3)
- Has accumulate post-1986 deferred foreign income greater than zero at the measurement dates (November 2, 2017 or December 31, 2017) § 965(d)(1)

APPLICATION OF NEW DEFINITIONS OF US SHAREHOLDER & CONSTRUCTIVE OWNERSHIP

- The PRE 2018 expansion of the definition of US Shareholders to include only vote and **not value** applies to the transition tax
- In CONTRAST, the REPEAL of the constructive attribution rule under § 958(b)(4) applies to the transaction tax! See Pub. L. No. 115-97, § 14213
- Many surprised US Shareholders unexpectedly received an income inclusion without an accompanying cash distribution under the constructive ownership rules
- Treasury and IRS acknowledged that It may be difficult to determine if a foreign corporation is an SFC under certain circumstances IRS Notice 2018-26

CONSTRUCTIVE ATTRIBUTION UNDER NOTICE 2018-26



The Treasury Department and the IRS have determined that it would pose compliance difficulties for taxpayers and administrative difficulties for the IRS to require a United States person to determine whether a foreign corporation with respect to which it is a United States shareholder is a specified foreign corporation. Therefore a 5% de minimus rule was developed.

SPECIFIED FOREIGN CORPORATION (SFC) - Definition

- Under § 958(b) and § 318(a)(3)(A), PTSPS would be treated as owning 100% of the stock of DC and 10% of the stock of FC.
- As a result, under § 958(b), § 318(a)(5)(A), and § 318(a)(3)(C), DC would be treated as owning the stock of FC treated as owned by PTSP, and
- Thus DC would be a US Shareholder with respect to FC, causing FC to be a **SFC** under § 965(e)(1)(B).
- Meribel is a US Citizen & US Shareholder with respect to FC and thus, absent an exception, would be required to include amounts in gross income under § 951(a)(1) by reason of the transition tax under § 965 with respect to FC.
- The results are the same whether Courchevel or PTSP or both are domestic or foreign persons.

CURRENT INCOME INCLUSIONS, EXCEPTIONS TO THE PARTICIPATION EXEMPTION SYSTEM

SUBPART F

- Foreign base company income
 - Foreign base company sales purchase of personal property from a related person for sale to an unrelated person
 - Foreign base company services income means income derived from performing services for, or on behalf of, a related person, and the services are performed outside the CFC's country of organization.
 - Foreign personal holding company income

GILTI

- GILTI is defined as the excess of a US Shareholder's aggregate net CFC tested income over its net deemed intangible income return.
- Net deemed intangible income return is 10% of the aggregate qualified business asset investment (QBAI) of the CFCs
 - QBAI is tangible property used in a CFC's trade or business that is depreciable under US concepts. § 167

INVESTMENT IN US PROPERTY

- An investment in US property is considered to be a means by which a US Shareholder could effectively bring money back to the US and thus it is considered to be a dividend paid by the CFC to the US Shareholder
- The increase in the CFC's investment of earnings in U.S. property is taxed to a US Shareholder.
 - (1) Tangible property located in the United States,
 - (2) Stock of a domestic corporation,
 - (3) An obligation of a U.S. person, or
 - (4) Any other right to use in the United States a copyright, patent, invention, model, design, formula, process, or similar property right the CFC acquired or developed for use in the United States.

CALCULATION OF TAX IMPACT TO US SHAREHOLDERS

RESPONSIBILITY OF FOREIGN CORPORATION

- Non-US companies who want to come to the US to raise capital from venture capital funds will be dependent on the foreign corporation to provide detailed information about the foreign group so that they can meet their US tax requirements.

INCREMENTAL TAX COSTS

- Incremental US tax costs to US Shareholders may discourage US investments in marginal businesses
- For an current income inclusion under GILTI followed by a dividend distribution in year 2, at a 18% foreign tax rate, the difference in tax costs to a US Shareholder of an investment in a non-CFC vs. a CFC is an increase in tax of 37% (see table)

	USS holds shares	USS holds shares
	CFC NO 962 ELECTION	NOT CFC
Non-US INCOME	100.00	100
Non- US TAX	18	18
Foreign Corporation Net Income	82.00	82.00
GILTI		
INCOME	82.00	
GROSS-UP	0	
DEDUCTION 50%	0	
TAX RATE	0.37	
US GILTI TAX	30.34	
WORLDWIDE TAX YEAR 1	48.34	18.00
DIVIDEND TO SHAREHOLDER PREVIOUSLY TAXED INCOME sec 959	82.00	82.00
	-82.00	0.00
NET DIVIDEND	0.00	82.00
Dividend Tax To individual *	3.12	19.52
WORLDWIDE TAX YEAR 1 & 2	51.46	37.52
WW ETR	51.5%	37.5%
NEAT INDIVIDUAL Year 1 & 2	48.54	62.48
* The Net investment tax applies to the Dividend		

TAX PLANNING OPPORTUNITIES FOR US SHAREHOLDERS - § 962

- Individuals can make a technical election under § 962 to be taxed as a corporation with regard to income taxed with respect to any GILTI, Investment in US property or Subpart F
- Sec. 962 was enacted in 1962 along with the Subpart F regime and it was designed to allow individuals who invested in foreign corporations to have the same treatment they would have had, if they had invested through a US corporation
- Three major issues/uncertainties regarding the calculation for the § 962 election
 1. PTI limited to taxes previously paid and not to the entire income inclusion
 2. Subsequent dividend may not qualify as a qualified dividend taxed at 20% but rather at 37%
 3. The 50% dividend received deduction is available to domestic corporations

	962 ELECTION WORST CASE	962 ELECTION MID CASE	962 ELECTION BEST CASE
Non-US INCOME	100	100	100
Non-US TAX	18	18	18
Foreign Corporation Net Income	82.00	82.00	82.00
GILTI			
INCOME	82.00	82.00	82.00
GROSS-UP	18.00	18.00	18.00
DEDUCTION 50% *		50.00	50.00
TAX RATE	0.21	0.21	0.21
US GILTI TAX	21.00	10.50	10.50
FOREIGN TAX CREDIT (GILTI 80%)	-14.40	-14.40	-14.40
FTC CARRYOVER	0.00	0.00	0.00
US INCREMENTAL TAX SEC 962(d)	6.60	0.00	0.00
WORLDWIDE TAX YEAR 1	24.60	18.00	18.00
DIVIDEND TO SHAREHOLDER	82.00	82.00	82.00
PREVIOUSLY TAXED INCOME sec 962(d)	-6.60	-10.50	-10.50
NET DIVIDEND	75.40	71.50	71.50
Dividend Tax To individual **	30.76	29.17	17.02
WORLDWIDE TAX YEAR 1 & 2	55.36	47.17	35.02
WW ETR	55.4%	47.2%	35.0%
NEAT INDIVIDUAL Year 1 & 2	44.64	52.83	64.98

TAX PLANNING OPPORTUNITIES FOR US SHAREHOLDERS - US DOMESTIC HOLDING COMPANY

- Another planning opportunity exists if an individual US Shareholder were to hold investments in foreign corporations in a US domestic corporation
- Two levels of tax can be mitigated due to the deduction for previously taxed income
- The results are similar to the tax paid if the foreign corporation were not a CFC
- Note that for all these calculations, different local tax rates and withholding taxes would modify the results.

	D C holds shares of	USS holds shares
	CFC	NOT CFC
Non-US INCOME	100	100
Non-US TAX	18	18
Foreign Corporation Net Income	82.00	82.00
GILTI		
INCOME	82.00	
GROSS-UP	18.00	
DEDUCTION 50% *	50.00	
TAX RATE	0.21	
US GILTI TAX	10.50	
FOREIGN TAX CREDIT (GILTI 80%)	-14.40	
FTC CARRYOVER	0.00	
US INCREMENTAL TAX SEC 962(d)	0.00	
WORLDWIDE TAX YEAR 1	18.00	18.00
CORPORATE DIVIDEND from FC	82.00	
PREVIOUSLY TAXED INCOME sec 959	-82.00	
CORPORATE 2ND LEVEL OF TAX	0.00	
DIVIDEND TO SHAREHOLDER	82.00	82.00
PREVIOUSLY TAXED INCOME sec 962(d)	0.00	0.00
NET DIVIDEND	82.00	82.00
Dividend Tax To individual **	19.52	19.52
WORLDWIDE TAX YEAR 1 & 2	37.52	37.52
WW ETR	37.5%	37.5%
NEAT INDIVIDUAL Year 1 & 2	62.48	62.48

US TAX PLANNING OPPORTUNITIES AVAILABLE TO FOREIGN CORPORATIONS

- There may exist other opportunities at the level of the foreign corporation or its subsidiaries to mitigate the impact of the Tax Act
- Due to the peculiar application of the downward attribution rules where the foreign parent may not be a CFC although it's subsidiaries may be, the possibility may exist to convert the parent company to the “trading company” where Subpart F and GILTI, may not apply
- The possibility may exist to convert corporate subsidiaries of a foreign holding company into pass-through entities

CONCLUSION

- A non-US headquartered company is still a viable solution where the non-US tax rate is below the US 21% rate.
- In the future, the US 21% rate may not be politically sustainable
- Transferring IP to the US is still a one-way street
- Tax benefits like Foreign Derived Intangible Income, which provides a 13.125% tax rate on a portion of income derived from servicing foreign markets with products or services, has been challenged in the World Trade Organization as an illegal export subsidy.

DISCLAIMER

- *This presentation does not constitute tax, legal, or other advice from Byram River Consulting LLC, which assumes no responsibility with respect to assessing or advising the reader as to tax, legal, or other consequences arising from the reader's particular situation.*