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INTERNATIONAL TAX REFORM: GILTI, FDII, BEAT AND MORE

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The Tax Cuts and Jobs Act, P.L. 115-97 (the “Act”) signed by President Trump on December 22, 2017, now fully in effect, is changing our international tax system foundationally and adding complexity in an already murky area. The Act professes to transform the United States international taxing system from a global one - which taxes worldwide income – to a territorial one – which taxes only U.S. source income. But something is lost in the translation, and the reality is that the new provisions tax on a quasi-territorial basis at best. Switching to this hybrid tax system is disruptive, taxing not globally but selectively, and as written is complex in application. Practically, different types of income and taxpayers are now taxed even more differently; the contrast is particularly pronounced comparing taxable “C” corporations versus individual and other non-corporate taxpayers.

One of the Act’s other primary goals is to discourage U.S. businesses from shielding taxable income through low taxed foreign operations or investments and instead encourage them to maintain business assets – especially intangible assets – in the U.S. while exporting their products and services. In an increasingly globalized economy, these shifts in policy have a material impact on businesses and individuals since key changes in the Act often create contradictory economic incentives for those who transact business internationally. Overall, the application and interaction of the numerous changes to the Internal Revenue Code’s international tax provisions remain unclear in many important respects, and guidance has been sporadic at best.

The Act attempts to accomplish its objectives by, among other things, imposing a one-time transition tax that taxes previously deferred foreign income, a current and on-going tax on certain foreign income, a tax break for select exports, and limits on deductions of payments between U.S. companies and their foreign affiliates.

U.S. INTERNATIONAL TAXATION HISTORICALLY

Historically, the U. S. taxed worldwide income, meaning U.S. residents and corporations were taxed on all income earned globally.¹ Whether an individual or business was subject to U.S. tax on its global earnings depended on whether such individual was a U.S. resident and whether the business entity was organized in the U.S. Key factors in determining U.S. income tax liability with respect to international activities of these U.S. taxpayers included the location, type and frequency of their business activity, location and type of business assets, and source and nature of their income. Escaping this residency-based regime was not a simple process, which led to complex tiered entity structures generally involving foreign entities.

Once ensnared in the U.S. tax regime, the related tax rules allowed U.S. corporations to defer payment of tax on income earned abroad by using foreign corporations which sheltered this income from current U.S. taxation.² Subject to limited anti-deferral rules (e.g., the Subpart F rules applicable to controlled foreign corporations – “CFCs” – which, though located abroad, had a certain requisite level of U.S. shareholder ownership), the U.S. taxed income earned in foreign corporations to their U.S. shareholders only when funds were actually paid out to these shareholders.^{3, 4} Thus active business income earned overseas in a foreign corporation could generally stay there untaxed until it was brought to the U.S. Additionally, U.S. corporate shareholders traditionally also received a credit for foreign taxes paid on this distributed income⁵ and thus did not have the income double taxed. The Subpart F anti-deferral rules caused certain categories of generally more passive investment-type income earned abroad by the CFC to be taxed currently to U.S. shareholders even when they did not receive a current distribution of such income.⁶ The Subpart F rules are among the most complex in the Internal Revenue Code and have now taken on renewed and different importance. While traditionally being deemed Subpart F

¹ U.S. Congress, Joint Explanatory Statement of the Committee of Conference (to Accompany H.R. 1, the Tax Cuts and Jobs Act), Report 115-409, 115th Congress, 2017, page 433.

² *Corporate Tax Reforms Will Lead to International Tax Battles*, by Gary Clyde Hufbauer, Peterson Institute for International Economics, December 14, 2017.

³ U.S. Congress, Joint Explanatory Statement of the Committee of Conference (to Accompany H.R. 1, the Tax Cuts and Jobs Act), Report 115-409, 115th Congress, 2017, page 454.

⁴ Subpart F income is an exceptions to the deferral rules for foreign derived income. Subpart F income only applies to CFCs , and relates mostly to passive type income. A CFC is, in very general terms, a foreign corporation in which U.S. persons own over 50 percent of the corporation's stock, measured by vote or value.

⁵ U.S. Congress, Joint Explanatory Statement of the Committee of Conference (to Accompany H.R. 1, the Tax Cuts and Jobs Act), Report 115-409, 115th Congress, 2017, page 454. *See* IRC §902, pre-act repeal.

⁶ U.S. Congress, Joint Explanatory Statement of the Committee of Conference (to Accompany H.R. 1, the Tax Cuts and Jobs Act), Report 115-409, 115th Congress, 2017, page 454. *See* IRC §§951, *et seq.*

meant a higher tax rate applied, even on income not distributed, now Subpart F income is sometimes ultimately taxed at a lower rate than that which applies under the new post-reform provisions to other types of foreign income.

The Act materially modifies how the U.S. now taxes U.S. residents and corporations, nominally aiming to tax them on a territorial basis, meaning that only U.S.-sourced income is taxed. The Act provides incentives to encourage U.S. business to keep assets and investments in the U.S., not abroad. However, this concept is not consistent throughout the Act, and overseas income is often taxed currently. At the same time, credits for foreign tax paid partially or completely disappear, at times increasing the overall tax due. Thus, while tax reform's underlying concepts are straightforward, as applied in the Act, they are not. Perhaps the most troubling changes involve the continued taxation of low-taxed foreign income, which in extreme situations may lead to double taxation. This unpleasant reality occurs because certain credits are lost while new taxes are added to income earned abroad or otherwise connected to a U.S. shareholder.

DIVIDEND RECEIVED DEDUCTION

One of the principal means for creating a territorial international tax system is an increased dividend received deduction (“DRD”). The DRD provides for no tax on a qualifying dividend payment received. U.S. corporate shareholders have traditionally received a foreign tax credit for foreign income taxes that the foreign corporation paid on distributed profits; that “indirect” foreign tax credit is now gone.⁷ While this deduction provision was meant to eliminate U.S. taxes on overseas earnings, as written it has a very narrow impact and some of its benefit is overridden by other provisions of the Act. A 10 percent U.S. *corporate* shareholder now gets a dividend-received deduction for the full foreign-source portion of a dividend it receives; thus, it pays no U.S. tax on the actual dividend distribution.⁸ This change essentially means that a 10 percent U.S. corporate shareholder's dividend income earned outside the U.S. is not taxed in the U.S. A tax credit basically ensures that no double tax is paid in different countries on the same income. With the indirect foreign-tax credit eliminated, the excluded dividends cannot be taken into account when computing a U.S. shareholder's foreign tax credit limitation.⁹ Further, no deductions for foreign

⁷ IRC §902, repealed by the Act, §14301(a); cf. IRC §960 [Subpart F indirect foreign tax credit remains] .

⁸ IRC §§245A(a), 951(b) [definition of “United States Shareholder”]

⁹ IRC §904(b)(5).

withholding taxes on the distribution can be taken.¹⁰ Only narrow types of earnings fall within this deduction provision, and a minimum 366-day holding period applies.¹¹ Thus, many prior advantageous tax provisions no longer apply for a large number of shareholders.

Additionally, the scope of this new “territorial” tax system is very limited. The DRD deduction does not apply if the foreign company is a CFC, restricting who benefits from this deduction. The territorial tax system is entirely a C corporation concept; S corporations, individuals and other non-corporate taxpayers are not eligible to receive the DRD deduction and, thus, still pay their normal tax rate on any distributions. The effective date relates to distributions after December 31, 2017.

TRANSITION TAX

The Act imposes new taxes on foreign income that are inconsistent with a pure territorial system. One of the most immediate impacts of the Act is a one-time “transition tax” on foreign earnings retained abroad and not yet subject to U.S. tax.¹² The transition tax is a tax payment on earnings held overseas and not yet subject to U.S. tax; thus, it is levied on shareholders of a deferred foreign income corporation. The financial impact of this transition tax is material. Roughly \$2.6 trillion of deferred earnings, depending on estimates, has been kept overseas to avoid U.S. taxation.¹³ The intent behind the legislation seems to be that these earnings, once taxed, can then enter the United States to be used for investment and growth here.

These foreign earnings which are earned indirectly through “specified foreign corporations”¹⁴ retained offshore and not distributed by January 1, 2018, and not yet taxed by the U.S., now get collectively taxed.¹⁵ This income will be taxed to corporations at a 15.5 percent rate on cash and cash equivalents, and at 8 percent on less liquid assets (for individuals and other non-

¹⁰ IRC §245A(d).

¹¹ IRC §246(c)(5)(A).

¹² IRC §965.

¹³ *Corporate Tax Reforms Will Lead to International Tax Battles*, by Gary Clyde Hufbauer, Peterson Institute for International Economics, December 14, 2017.

¹⁴ IRC §965(e)(1) provides the term “specified foreign corporation,” which means any CFC, and any foreign corporation, in which one or more domestic corporations is a United States shareholder (10 percent corporation). “For purposes of IRC §§ 951 and 961, a 10-percent corporation is treated as a CFC solely for purposes of taking into account the subpart F income of such corporation under §965(a). IRC §965(e)(2). However, if a passive foreign investment company (as defined in IRC §1297) with respect to the shareholder is not a CFC, then such corporation is not a specified foreign corporation. IRC §965(e)(3).” Internal Revenue Notice 2018-07.

¹⁵ IRC §965.

corporate U.S. taxpayers, at 17.5 and 9.05 percent, respectively,¹⁶ with S corporations being curiously alone in their ability to elect to defer this income acceleration).¹⁷

Shareholders are able to elect to pay the tax over eight years.¹⁸ The deferred foreign income is the greater amount of such income as determined as of November 2, 2017, or, alternatively, as of December 31, 2017 (curiously without referring to the end of the fiscal year date of foreign corporations with non-calendar fiscal years). Payment of the elected transition tax installments is accelerated if a taxpayer pays late, or sells or substantially liquidates the corporation. This concept is similar to acceleration on sale clauses in shareholder or employment contracts.

Specified foreign corporations whose shareholders are subject to the transition tax include CFCs and any other foreign corporation that has one or more U.S. corporations which is a defined U.S. shareholder (i.e., owning directly, indirectly, or by attribution 10 percent by vote *or value* of the foreign corporation).¹⁹ But once there is a specified foreign corporation, all such U.S. shareholders, whether corporate or non-corporate domestic shareholders, are taxable on their pro rata shares of the specified corporation's deferred, accumulated foreign income at the above-mentioned rates. Once taxed, the foreign corporation's distribution of these accumulated earnings avoids taxation a second time upon its distribution as previously taxed income.²⁰ Previously taxed income is an amount earned which has already been deemed to have been taxed by the U.S. (regardless of whether it was actually distributed) and, thus, will not again be subject to U.S. tax.

A domestic corporation receives an indirect foreign tax credit for the foreign corporation's foreign income taxes associated with the taxable percentage of the accumulated earnings,²¹ but a non-corporate taxpayer does not. As a result, non-corporate taxpayers could now have much larger transition tax bills since they cannot offset U.S. tax due with any credits for tax paid overseas. Non-corporate U.S. shareholders, therefore, may want to consider whether they want to elect to be treated as corporate shareholders in order to access the indirect foreign tax credit.²² By so electing, those individuals will forego having future distributions from the foreign corporation treated as

¹⁶ IRC §965(c).

¹⁷ IRC § 965(i).

¹⁸ IRC §965(h).

¹⁹ See IRC §951(b), as amended by the Act, §14214(a).

²⁰ See IRC §959.

²¹ The indirect foreign tax credit under §902 was repealed but only with respect to tax years beginning after December 31, 2017. Act §14301(a). See IRC §965(g) which limits the foreign tax credit to the percentage of the accumulated earnings taken into income under the transition tax computation.

²² IRC §§962, 960.

excluded previously taxed income. Still unclear is whether this election, letting individuals be taxed as corporations to lower their overall tax rate, is possible.

Practically speaking, it will be difficult for corporations to minimize this transition tax, especially given the effective date makes it applicable to tax years ending on or after December 31, 2017. Corporations must decide how to account for this potentially large tax liability in an effort to minimize the impact on current earnings for financial reporting purposes. The Internal Revenue Service has released guidance covering certain aspects of Internal Revenue Code Section 965,²³ but material aspects are still unclear. Increasingly, delayed guidance is a complication when the taxpayer is attempting to comply, but gets caught up trying to interpret new provisions of the Act.

GILTI

The Act adds a new tax, under the global intangible low taxed-income (“GILTI”) provisions,²⁴ that provides a minimum tax on certain types of foreign income earned by a CFC after allowing for a 10 percent return on specified assets. Thus, income does not escape immediate U.S. tax, even though it is taxed favorably. This provision of the Act’s new international tax rules is intended to bring low-taxed offshore income, GILTI, into the U.S. tax base, rather than having it be excluded as a result of the DRD deduction. The effect of the GILTI provisions is to make the new international tax regime at best a quasi-territorial tax system.²⁵ Practically speaking, income that is earned overseas is still being subject to partial U.S. tax.

GILTI, is a new category of currently taxed Subpart F income created under the Act.²⁶ Essentially, GILTI is income of a CFC that exceeds a nominal return of 10 percent on tangible assets.²⁷ The 10 percent return which is calculated on the aggregate adjusted tax base of the CFC’s tangible assets, but not its intangible assets, is first allowed; then, any excess return over this 10

²³ See *IRS Notice 2018-26*, I.R.B. 2018-16. *Questions and Answers about Reporting related to Section 965 in 2017 Tax Returns* in March 2018 – updated in April 2018, I.R.B. 2018-06, *IRS Notice 2018-13*, and *IRS Notice 2018-07*, I.R.B. 2018-04. On August 9, 2018, the IRS issued proposed regulations under Section 965. REG-104226-18, 83 FR 39514.

²⁴ IRC §951A.

²⁵ Rather than referring to the Act’s new international tax regime as a quasi-territorial system, it might be better to refer to it as an immediate worldwide income, anti-deferral tax system with preferred tax rates for export income.

²⁶ IRC §951A(b)(2)(A).

²⁷ IRC §951A(b)(2)(A), 951A(d).

percent level of return becomes an additional Subpart F inclusion.²⁸ A U.S. corporation, including GILTI in income, receives a deemed foreign tax credit based on foreign taxes paid by the CFC on this income.²⁹ This deemed foreign tax credit is subject to an 80 percent limitation³⁰ and is only partially creditable; thus, even high-taxed foreign income is subject to U.S. taxation if it exceeds the threshold of 10 percent of tangible assets.

Basically, GILTI imposes a minimum tax on a U.S. shareholder's share of the CFC's active earnings which qualified for deferral under previous law but were subject to full taxation (after the indirect foreign tax credit, which avoided double taxation) upon repatriation (or deemed repatriation under the transition tax, discussed above). Related amounts are calculated on a global, not territorial, basis. A U.S. shareholder of a CFC includes in income its GILTI as part of its Subpart F income. Timing differences between U.S. and foreign laws can result in recognizing GILTI for U.S. tax purposes, before foreign tax credits for foreign taxes paid on the income are available, potentially now resulting in a double tax, even without regard to the 80 percent limit on the foreign tax credit. Further, an individual or other non-corporate CFC shareholder is taxed on his or her share of GILTI at ordinary tax rates without the benefit of the FDII 50 percent deduction discussed below. This again results in a preferential rate for corporate shareholders, with individuals and pass-through entities not getting an equivalent break.

FDII

Foreign-derived intangible income ("FDII") provisions provide a tax break for services and intangible derived income earned from overseas sales by U.S. corporations. This tax break is quite puzzling as, again in the Act, some types of income get favorable treatment with little explanation as to why. The Act provides, in effect, significant tax breaks to domestic corporations' earnings from offshore exports of tangible and intangible assets, foreign services, and other specified foreign income. FDII, despite its name, is not directly traced to intangible assets. Rather, in broad terms, a U.S. corporation, with foreign sales and/or providing services to persons outside the U.S., computes a deemed tangible income return by multiplying the adjusted basis of its depreciable business property by 10 percent. This net deemed tangible return is the same 10 percent as computed under GILTI. The resulting amount is deducted from the corporation's defined total

²⁸ IRC §951A(a) .

²⁹ See IRC §960.

³⁰ IRC §960(d)(1).

income to arrive at the deemed intangible income. The deemed intangible income is then allocated to arrive at foreign derived intangible income, which is based on the ratio of net income from foreign sales and services to total net income (in both cases excluding Subpart F income, dividends and certain other items). Thus, FDII is based on income from the sale of property (including leases and licenses) to foreign individuals for their use, disposition or consumption outside of the United States and services performed by a person or for property outside the United States.³¹ A U.S. corporation includes FDII in gross income, and then takes a related deduction.³²

Specifically, a U.S. corporation (*but not a non-corporate taxpayer*), gets a deduction related to these types of income after December 31, 2017, and on or before December 31, 2025, which equals the sum of 50 percent of its GILTI (including the Internal Revenue Code Section 78 gross up for its deemed-paid foreign taxes under the Subpart F rules indirect-foreign tax credit)³³ and 37.5 percent of the FDII.³⁴ For tax years after 2025, the deduction percentages are reduced to 37.5 percent for GILTI and to 21.875 percent for FDII.³⁵ The effective corporate tax rate on GILTI is thus 10.5 percent (based on the 50 percent deduction) until 2025 and then 13.125 percent after that (based on a 37.5 percent deduction), while the effective tax rate on FDII is 13.125 percent through 2025 and 16.406 percent thereafter.³⁶ The FDII and GILTI related deductions, as calculated, cannot exceed the corporation's taxable income.³⁷ The related calculations are incredibly complex. Overall, these provisions ensure that certain shareholders are getting preferential treatment on certain types of foreign-related income. Given that many multinational businesses are no longer heavy on tangible assets, how these provisions impact any given taxpayer will vary greatly.

Thus, combined, these two categories -- GILTI and FDII -- not only complicate tax calculations, they also ensure that a U.S. tax is paid, but not without some controversy. As noted above, domestic corporations can deduct 37.5 percent of their earned offshore FDII.³⁸ This income includes services provided to those outside the U.S. and sales of property abroad for use outside

³¹ IRC §250(b)(4).

³² IRC §250(b)(4) and §250(b)(5). This deduction also appears to be allowed to a U.S. corporation owned by non-U.S. persons.

³³ IRC §250(a).

³⁴ IRC §250(a)(1).

³⁵ IRC §250(a)(3).

³⁶ IRC §250(a)(3).

³⁷ IRC §250(a)(2).

³⁸ IRC §250(a)(1)(A) (new).

the U.S.³⁹ As a result of this deduction, a corporate tax rate of 13.125 percent (i.e., 62.5 percent of 21 percent) is assessed against a domestic corporation's exports, which provides a substantial indirect export subsidy for U.S. services and product exports. This effect has not gone unnoticed by major U.S. trading partners, the Organization for Economic Cooperation and Development (OECD) and the World Trade Organization (WTO); retaliatory responses from our foreign trading partners are brewing.

BEAT AND HYBRID TRANSACTIONS

The Act has additional provisions to ensure that income relating to foreign operations does not inappropriately reduce U.S. taxation, again a worldwide income taxation concept, not a territorial one. These provisions are aimed at ensuring that larger corporations can no longer use excessive deductions for expenses paid to related foreign entities to reduce U.S. tax.

The Base Erosion Anti-Abuse Tax ("BEAT") addresses and potentially limits outbound payments and is meant to prevent earnings-stripping through foreign affiliates.⁴⁰ Earnings-stripping entails a U.S. company using deductible expenses, such as interest, with impunity to effectively lower their U.S. tax payments. With BEAT, large multinationals are more limited in their ability to make intercompany payments to reduce U.S. tax.

BEAT can generate additional tax liability by limiting the deductibility of certain payments between a U.S. subsidiary and a related foreign entity.⁴¹ The types of payments between the related parties which are limited by BEAT include interest, royalties, rents, service fees, the acquisition of property from a related party subject to depreciation or amortization, a premium paid among related parties for reinsurance payments, and the cost of goods sold for a company that inverted to become foreign after November 9, 2017.⁴² An inversion occurs when a U.S. and foreign corporation merge, with the place of incorporation for the combined company becoming that of the foreign entity, which typically has a lower tax rate. Under the Act, the cost of doing business between related entities is now higher. However, to the extent that full, generally 30

³⁹ IRC §250(a)(1).

⁴⁰ U.S. Congress, Joint Explanatory Statement of the Committee of Conference (to Accompany H.R. 1, the Tax Cuts and Jobs Act), Report 115-409, 115th Congress, 2017, page 524.

⁴¹ IRC §59A.

⁴² IRC §59A(d).

percent, foreign tax withholding is imposed on a base erosion tax payment, the BEAT limitations do not apply.⁴³

As with many of the new international provisions, a complicated formula is required to figure out the tax due. Here, the related party payments are added back to income, which is then subjected to BEAT to impose a minimum tax liability upon the offending domestic corporation. BEAT is imposed at a 10 percent rate (five percent for the first taxable year beginning in 2018) upon the taxpayer's so-modified taxable income, reduced by its adjusted regular tax liability.⁴⁴ Thus, there is no BEAT liability if the domestic corporation's regular tax liability exceeds its 10 percent BEAT tax.

Essentially, BEAT is a minimum tax which is triggered by certain related-party deductible payments. This tax creates the possibility of a double tax: taxation in full in the recipient's jurisdiction without allowing for a full deduction in the United States. Still, it only applies to taxpayers with annual gross receipts of \$500 million or more⁴⁵ and related party deductible payments equaling over three percent of overall deductions.⁴⁶ No grandfathering provisions appear available to protect current related party payments under pre-Act transactions or structures.

Further, in addition to the BEAT limitations, the Internal Revenue Code now provides that no deduction is allowed for any "disqualified" related party amount paid or accrued as part of a hybrid transaction or for any such payment by or to a hybrid entity.⁴⁷ Related party amounts, thus disqualified, include those interest or royalty payments for which there is no income inclusion to the related party under local, foreign law or when the related party is allowed an offsetting deduction under local, foreign law.⁴⁸ A hybrid transaction is one treated differently for U.S. versus foreign tax purposes; specifically it is a transaction or other arrangement generating interest or royalties under U.S. tax law, but not interest or royalties to the payment's recipient under the laws of the country in which they are subject to tax.⁴⁹ A hybrid entity is one treated as either transparent for U.S. tax purposes or as transparent under the laws of its country of residence for tax purposes,

⁴³ IRC §59A(e)(2)(B). But *see* IRC §59A(e)(2)(B)(ii) (BEAT disallowance applies to the extent the withholding rate is reduced by tax treaty).

⁴⁴ IRC §59A(b)(1).

⁴⁵ IRC §59A(e)(1)(B).

⁴⁶ IRC §59A(e)(1)(C).

⁴⁷ IRC §267A.

⁴⁸ IRC §267A(b).

⁴⁹ IRC §267A(c).

but not under both sets of laws.⁵⁰ So, when companies are operating in multiple jurisdictions they might now end up paying a tax price, previously avoided under creative foreign, hybrid structures.

ATTRIBUTION RULE, OTHER CFC CHANGES

Another international tax change under the Act affects the attribution rules that control who is considered a U.S. shareholder of a CFC. Now, more taxpayers will be subject to U.S. tax on a CFC's Subpart F income even when they do not receive any actual payments. The Act repealed Internal Revenue Code Section 958(b)(4), which prohibited so-called "downward entity attribution."⁵¹ This change essentially alters the ownership attribution rules used to determine if stock of a foreign corporation owned by a foreign person is attributed to a related U.S. person for purposes of deciding if the foreign corporation is a CFC for U.S. tax purposes.⁵² Coupled with the change of the definition of a U.S. shareholder,⁵³ this attribution rule change now requires downward attribution of shares in a foreign corporation to partnerships, estates and certain trusts and corporations from their foreign interest-holders. As a result of the foreign corporation becoming a CFC, or a U.S. interest-holder becoming a U.S. shareholder of the CFC, as a result of this new attribution rule, U.S. taxpayers, might need to pay U.S. tax on the foreign corporation's Subpart F income, including GILTI. However, this attribution only applies for purposes of determining if a foreign corporation is a CFC. The CFC's Subpart F income which a U.S. shareholder must include in gross income is still determined based on direct or indirect ownership of the CFC, without the new downward attribution rules being applied. Before, U.S. shareholders only indirectly tied to other owners or entities could more easily avoid CFC status and being ensnared in U.S. Subpart F taxation regime regime.

Not only will these changes trap extra U.S. shareholders, since companies not previously considered to be CFCs will now be so considered, but the changes are retroactive.⁵⁴ The amendments to Section 958(b) apply starting with the last taxable year beginning *before* January 1, 2018, or, for a calendar year foreign corporation, its 2017 tax year. One perceived abuse that Section 958(b)(4)'s repeal was intended to address was the situation where a wholly-owned

⁵⁰ IRC §267A(d).

⁵¹ Tax Cuts and Jobs Act, H.R. 1, Section 14213.

⁵² IRC §958. U.S. Congress, Joint Explanatory Statement of the Committee of Conference (to Accompany H.R. 1, the Tax Cuts and Jobs Act), Report 115-409, 115th Congress, 2017, page 507.

⁵³ Which now includes by vote or value. IRC §951(b), post-Act amendment.

⁵⁴ IRC §958.

domestic subsidiary and its foreign parent corporation each own 50 percent of another foreign corporation. Prior to the repeal, the other foreign corporation was not a CFC as to the domestic subsidiary. After the repeal, there is downward attribution to the domestic corporation of the parent's stock in the other foreign corporation, so as to increase the domestic subsidiary's ownership of the other foreign corporation to 100 percent, thereby causing the other foreign corporation to become a CFC. This change does not necessarily subject the U.S. shareholder to U.S. tax on the CFC's foreign earnings. Rather, the U.S. shareholder must directly or indirectly own stock for it to include in gross income a share of the CFC's Subpart F income, an unnecessary inconsistency.⁵⁵ Thus, in the example above, the domestic subsidiary now must treat the other foreign corporation as a CFC, but it still will pick up only 50 percent of the other foreign corporation's CFC income, including its 50 percent share of the other foreign corporations GILTI income. Again, whether a U.S. taxpayer will need to pay tax on income from overseas, whether directly or indirectly tied to that taxpayer, has become a more fact-specific determination.

Additionally, the repeal of the prohibition on downward entity attribution could also ensnare U.S. taxpayers in the Act's transition tax. Now, as a result of the downward attribution of foreign-company shares a foreign company that was not previously a CFC can become one. Overall, potentially more complexity and more tax due will attach to taxpayers who formerly were outside the reach of the Subpart F rules.

Another change by the Act to the Subpart F rules repealed the requirement that a foreign corporation had to be a CFC for a minimum uninterrupted period of 30 days or more during the tax year, in order for the Subpart F rules to be applicable.⁵⁶ Thus, if the foreign corporation is a CFC at any time during the tax year, U.S. shareholders must include amounts in income under Subpart F. The most dramatic impact of this change may be with respect to shares of foreign corporations which pass to U.S. recipients upon the death of a nonresident alien, e.g., through a foreign non-grantor trust. In the past, the U.S. recipients had the ability to obtain a step-up to the basis of the assets held in the foreign corporation by making a check-the-box election effective less than 30 days after the foreign decedent's date of death, so that the gain upon the check-the-box liquidation of the foreign corporation did not get included in the U.S. recipients' incomes as a

⁵⁵ IRC §951(a)(2).

⁵⁶ IRC §951(a)(1), as amended by P.L. 115-97, §14215(a).

Subpart F inclusion; that planning possibility is no longer available.⁵⁷

CONCLUSION

These international tax provisions very obviously cross practice areas, impacting corporate, non-corporate and even largely domestic taxpayers. Due to the interrelationship among the changes to both international and domestic tax provisions, how major business enterprises and sophisticated individuals structure their holdings should now receive careful review in light of the dramatically changed advantages and disadvantages of different structuring options. Since the Act applies policy inconsistently, tax professionals can prospectively utilize the new provisions to their clients' benefit. However, given the new provisions' murky nature, potentially wide-ranging impact and uncertain application, those engaged in international transactions should be careful when making planning decisions. The amorphous nature of these new provisions cannot be over emphasized as regulations and more guidance is urgently needed to clarify their application. Until then, clients should be advised of the complexities and uncertainties related to the application of the Act's international provisions. Expert tax advice has become even more key when dealing with international tax issues, both on an individual and corporate level.

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⁵⁷ See "Controlled Foreign Corp. Restructuring for US Taxpayers," Carl Merino and Dina Kapur Sanna, August 13, 2018, Law360.