

U.S. INTERNATIONAL TAX REFORM:

GILTI, BEAT & FDII

Mr. Rubén Flores, C.P.A. & Attorney

www.floresattorneys.com



FLORES GROUP
ATTORNEYS & ADVISORS

Member of



International Fiscal Association



International Bar Association

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 Taxed Income (GILTI) & Base Erosion and Anti-Abuse Tax (BEAT)

IRC SEC. 951A: GILTI – Global Intangible Low Taxed 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 Taxed 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 Taxed 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 Taxed 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 line 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. CFC has \$180,000 of Qualified Business Assets. (QBA)

GILTI EXAMPLE – INDIVIDUAL VS CORPORATION

Step	Item	CFC	Individual	Corporation
Step 1: Tested Income	Tested Income	50,000	50,000	50,000
	Tested Loss			
	Net CFC tested Income		50,000	50,000
	Tested Foreign Income Taxes	8,000	8,000	8,000
	Foreign ETR on Tested Income	13.79%	13.79%	13.79%
Step 2: QBAI	Qualified Business Asset Investments (QBAI)	180,000	180,000	180,000
	10% of QBAI		18,000	18,000
	Interest expense reduced tested income and corresponding income not included in tested income	2,000	2,000	2,000
	Net deemed tangible income		16,000	16,000
Step 3: Calculate GILTI	GILTI		34,000	34,000

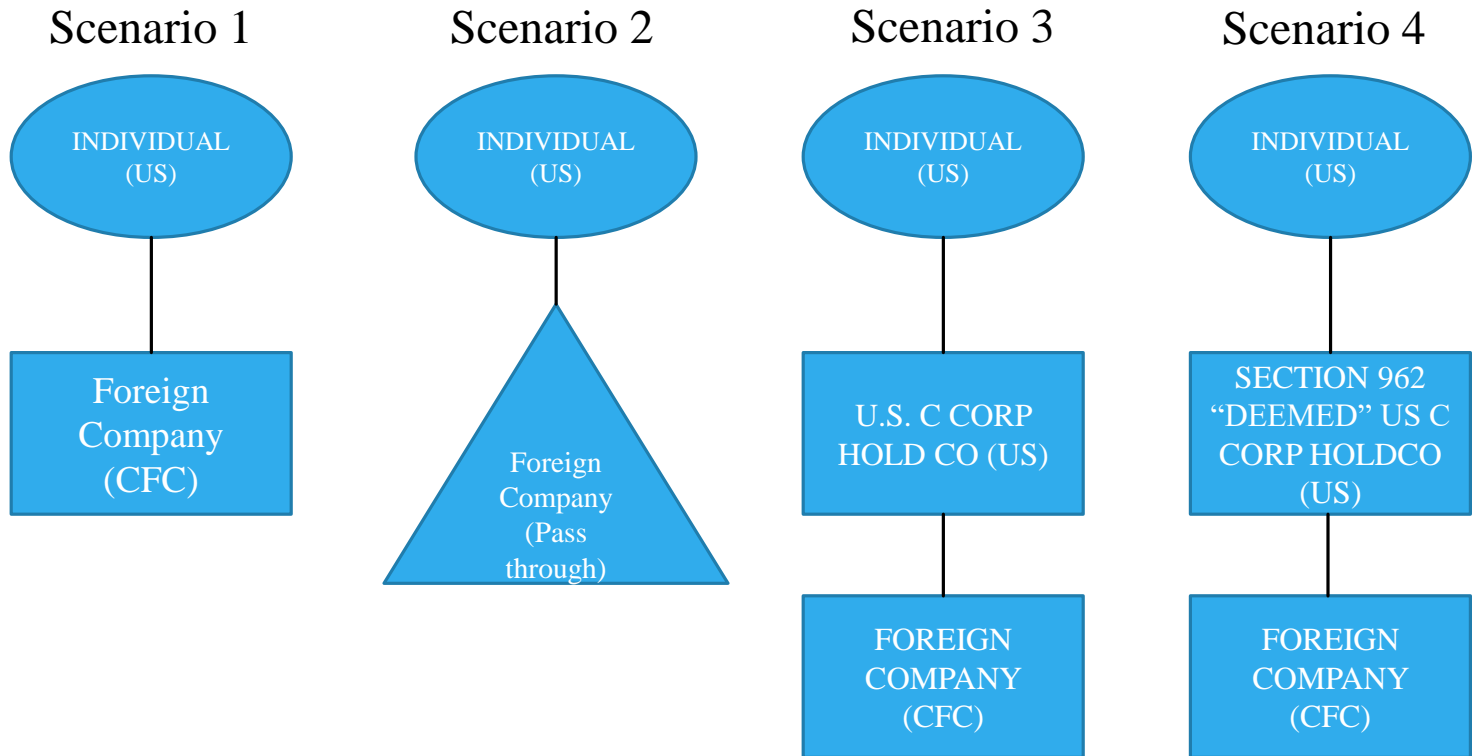
GILTI EXAMPLE – INDIVIDUAL VS CORPORATION

Step 4: U.S. Inclusion	Inclusion %		68%	68%
	Deemed FTC before 20% reduction			5,440
	Deemed FTC after 20% reduction			4,352
	Grossed-up GILTI	34,000		39,440
	50% Deduction			19,720
	TI before credit and expense	34,000		19,720
	Expense allocated to GILTI basket			
	GILTI for FTC limitation	34,000		19,720
	Tax Rate		37%	21%
	FTC limitation			4,141
	TI before FTC	34,000		19,720
	Tax Rate		37%	21%
	U.S. tax liability before credit		12,580	4,141
	FTC			4,141
	U.S. tax on GILTI		12,580	

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 (To be treated as a C-Corp for GILTI purposes)

LEGAL STRUCTURE COMPARISION





BEAT – Base Erosión & 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%

IRC SEC. 59A - BASE EROSION & ANTI-ABUSE TAX (BEAT)

- 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

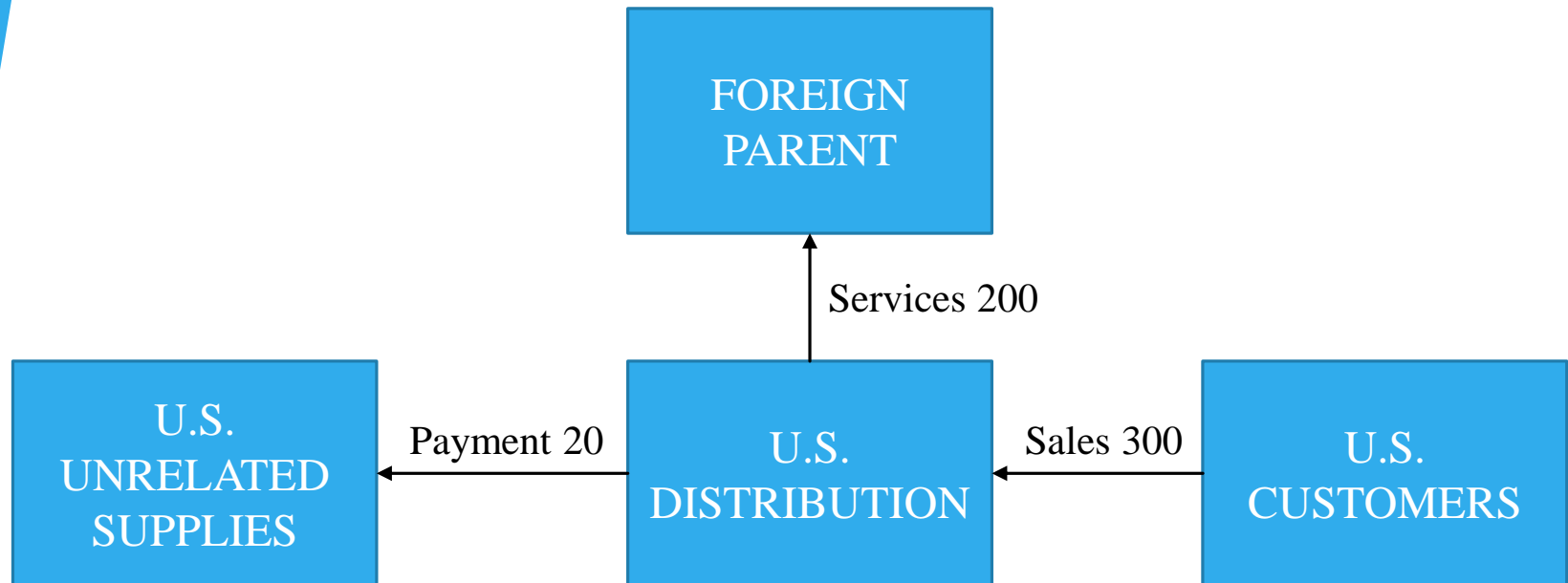
IRC SEC. 59A - BASE EROSION & ANTI-ABUSE TAX (BEAT)

- The BEAT rate is applied against modified taxable income (MTI)
- The BEAT rate is:
 - 5% in 2018
 - 10% in 2019 – 2024
 - 12.5% in 2025 - Beyond
- MTI is the regular taxable income + base erosion payments
- No credit for foreign taxes paid or accrued

IRC SEC. 59A - BASE EROSION & ANTI-ABUSE TAX (BEAT)

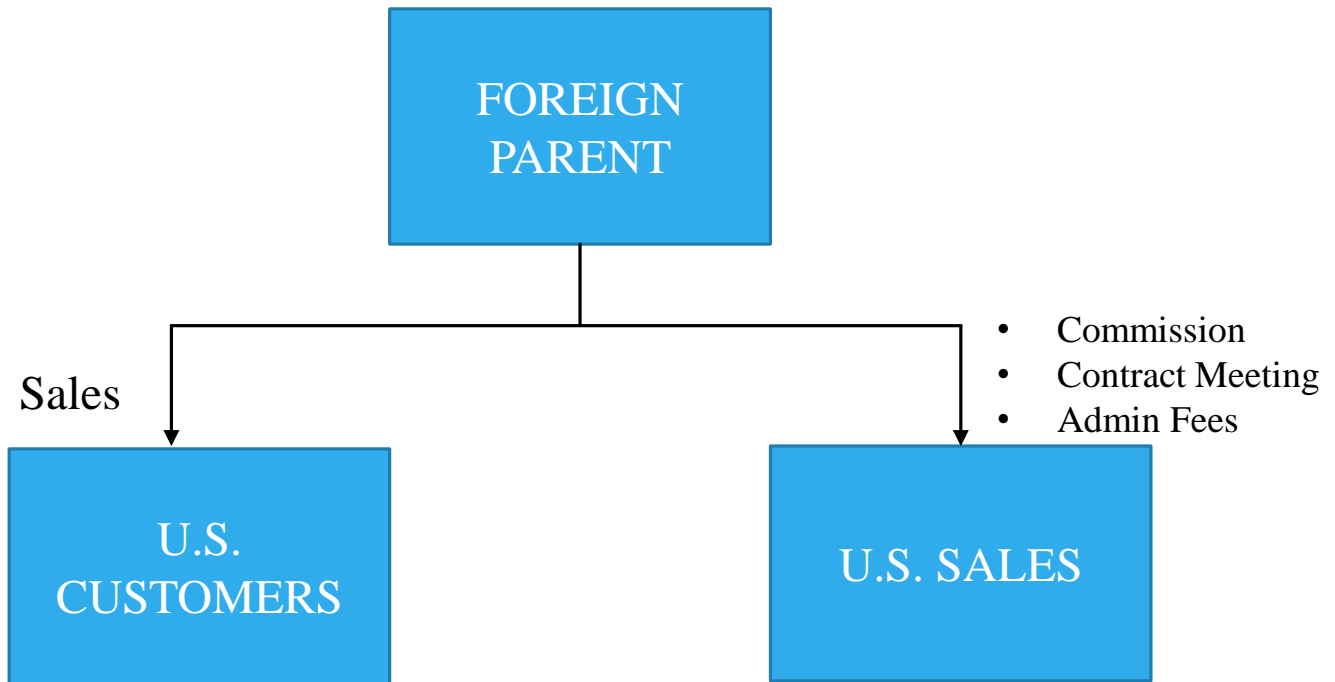
- A related party for BEAT purposes includes:
 - Any 25% foreign owner of the corporation
 - Any person that is related to the taxpayer or any 25% owner of the corporation
 - Any other foreign person who is related to the corporation under IRC SEC. 482

BEAT – EXAMPLE #1



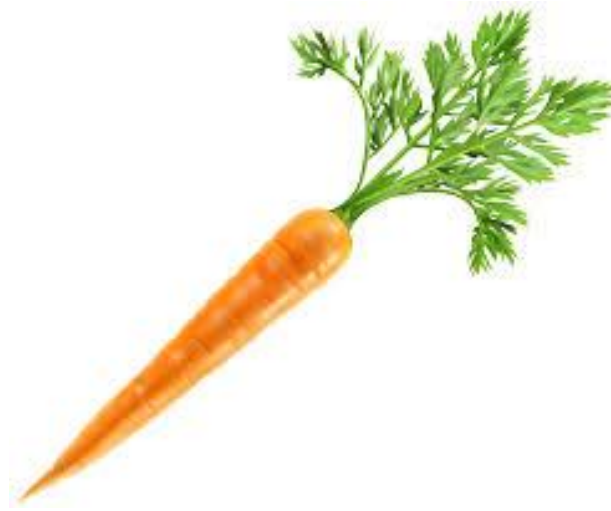
1. Base Erosion Percentage: $200/220=90\%$
2. Modified Taxable Income: $300 - 20=280$
3. Regular Tax: $300 - 220= 80 \times 21\% = 16.8$
4. BEAT Tax: $280 \times 10\% = 28 - 16.8 = 11.2$
5. Total Tax: $16.8 + 11.2 = \underline{28}$

BEAT – EXAMPLE #2



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

Deduction Eligible Income (DEI)	100,000
Less: Deemed Tangible Income Return (QBAI * 10%)	-
Deemed Intangible Income (DII)	100,000
Foreign Derived Deduction Eligible Income (FDDEI)	100,000
Percentage of Foreign Derived Deduction Eligible Income (FDDEI) to Deduction Eligible Income (DEI)	100% (100% / 100,000)
Foreign Derived Intangible Income (FDII)	100,000 (100% * 100,000)
Less: 37.5% Deduction for FDII	(37,500)
Taxable Income	62,500
U.S. Tax at 21%	13,125
Effective Tax Rate	13.125%

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

CONCLUSION

- New Tax Reform brings many benefits to international Business companies
- A through review of current structures to determine tax effects and to identify tax planning opportunities
- Planning is the key word for the near future.