ACIC Annual Meeting and Education Conference
Effect of US Tax Law Changes

October 18-19, 2018
Grand Hyatt, New York

Moderator

Mary F. Voce, Greenberg Traurig, LLP

Panelists

Pamela S. Petree, Nuveen

Olga Bogush, Schiff Hardin LLP

Joy E. Tegtmeyer, PricewaterhouseCoopers LLP

1. Transition tax (deemed dividend of offshore earnings) - IRC § 965

General Rule

- Section 965 provides for a mandatory deemed repatriation, or a transition toll charge, in the form of a subpart F inclusion of a US shareholder's share of net accumulated post-1986 untaxed earnings and profits ("E&P") of their foreign subsidiaries.
- This is part of a migration to a participation exemption regime.
- Who is subject to toll charge: A Deferred Foreign Income Corporation ("DFIC") on post-1986 E&P which have accumulated in such corporation.
  - A DFIC includes any Controlled Foreign Corporation ("CFC") and any other foreign corporation (other than a PFIC) with respect to which one or more domestic corporations is a U.S. 10% Shareholder (a Specified Foreign Corporation or "SFC"). The portion of the post-1986 E&P subject to the transition toll tax does not include E&P accumulated by a foreign corporation prior to attaining its status as a DFIC.
  - A CFC is a foreign corporation more than 50% owned by U.S. persons each of whom owns at least 10% of vote or value (a "U.S. 10% Shareholder").

1. Transition tax (deemed dividend of offshore earnings) - IRC § 965 (con't)

<u>Section 965 Details</u>

- Year of toll charge inclusion: Toll charge increases subpart F income with respect to its last taxable year which begins before January 1, 2018 ("toll charge year").
- Amount of toll charge inclusion: the "accumulated post-1986 deferred foreign income" determined as of November 2, 2017, or December 31, 2017, whichever is greater.
- Effective tax rate on inclusion amount: The amount included in income is offset by a deduction which has the effect of reducing rates for corporate taxpayers to 15.5% for cash and equivalent assets, and 8% for non-cash assets.
- A U.S. shareholder may elect to pay the tax over a period of 8 years.

Polling Question

In your company impacted by the Transition Tax?

a. Yes

b. No

c. Don’t know

d. N/A

2. Base Erosion and Anti-Abuse rules (BEAT) – IRC § 59A

General Rule

- Under Section 59A, an applicable taxpayer is liable for tax equal to the "base erosion minimum tax amount" ("BEMTA"), which is the excess of (a) 10% (5% for 2018, 12.5% for taxable years beginning after December 31, 2025) of the "modified taxable income" of the taxpayer for the taxable year over (b) an amount equal to the regular tax liability reduced by certain credits.

- "Modified taxable income" generally means taxable income determined without regard to any "base erosion tax benefit" with respect to any "base erosion payment," or the base erosion percentage of NOLs.

- Formula - BEMTA = (10% * Modified Taxable Income) – (Regular Tax Liability for the Taxable Year).

2. Base Erosion and Anti-Abuse rules (BEAT) – IRC § 59A (con't)

Who is an applicable taxpayer

- Generally, an applicable taxpayer is a U.S. corporate taxpayer (that is not a RIC or a REIT) with average annual gross receipts in excess of $500 million over a 3-taxable-year period ending with the preceding tax year, and a "base erosion percentage" of 3% or higher in the current taxable year (2% for banks or registered securities dealers).

- A "base erosion payment" means any amount paid or accrued by the taxpayer to a foreign related party for which a deduction is allowable. A related person is generally related by 25% ownership with certain applicable attribution rules.
- There are a number of exceptions to the defined term "base erosion payments."

Polling Question

Is your company subject to BEAT?

a. Yes

b. No

C. Don’t know

D. N/A

3. Dividends received deduction - IRC § 245A

- New 100% deduction for the foreign-source portion of dividends received by a domestic corporation from a “specified 10-percent owned foreign corporation.”
- “Specified 10-percent owned foreign corporation”:
  - Must be 10% (vote or value) owned by the domestic corporation.
  - Must not be a passive foreign investment company.
- “Foreign-source portion” of a dividend received from a foreign subsidiary is everything other than the portion attributable to:
  - Income effectively connected with the conduct of a trade or business in the United States, and
  - Dividends from an 80%-owned (by vote and value) domestic corporation.
- Applies to dividend distributions made after December 31, 2017.

3. Dividends received deduction - IRC § 245A (con’t)

<u>Impact on CFC Pledges and Guarantees in Lending Transactions</u>

- ***Section 956 Deemed Dividend***
  - The following pledges and guarantees may result in annual *deemed* dividend distributions by a controlled foreign corporation (“CFC”) to its US shareholders:
    - Guarantee by the CFC of the obligation of any US person,
    - Pledge of the assets of the CFC as support for the obligation of any US person, or
    - Pledge of 66⅔% or more of the *voting* shares of the CFC as support for the obligation of any US person.
- ***Section 245A Dividends Received Deduction***
  - Applies only to *actual* dividend distributions, not Section 956 deemed distributions.

3. Dividends received deduction - IRC § 245A (con't)

<u>Impact on CFC Pledges and Guarantees in Lending Transactions</u>

- ***Section 956 Deemed Dividend***
  - A function of:
    - Previously taxed income under the anti-deferral regime
    - Current and accumulated E&P
    - Dividend distributions
- ***What is the effect of Section 245A and other TCJA provisions on Section 956?***

3. Dividends received deduction - IRC § 245A (con't)

<u>Impact on CFC Pledges and Guarantees in Lending Transactions</u>

- ***Credit Agreement Language:***
  - ***Prior to TCJA:*** It was standard in loans involving a US borrower to carve out from the general pledge and guarantee provisions:
    - Direct pledges by CFCs,
    - Direct guarantees by CFCs, and
    - Pledges by the US borrower of more than 65% of the voting stock of CFCs.
  - ***After TCJA?***

Polling Question

In negotiating loan documentation this year, do you see any changes in the customary collateral package carve-outs for controlled foreign corporations (“CFCs”)?

a. Yes, more borrowers with CFCs agree to the carve-outs kicking in only when there are material adverse tax consequences

b. Yes, more borrowers with CFCs agree to forgo CFC carve-outs altogether

d. No

e. I don’t know

f. N/A

4. Deduction for pass-through entities - § 199A

- New deduction of up to 20 percent of “qualified business income” (“QBI”).
- Applies to non-corporate owners of sole proprietorships, partnerships, LLCs that are taxed as partnerships, and S corporations.
- Does not apply to income from ***“specified service businesses” :*** health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, or brokerage services.
    - Exception for taxpayers with taxable income below certain thresholds (joint filers under $415,000 and single filers under $207,500).

4. Deduction for pass-through entities - § 199A (con't)

- The 20% deduction of QBI is generally limited* to the greater of:
  - 50% of the W-2 wages of the business, or
  - The sum of 25% of the W-2 wages paid by the business and 2.5% of the asset basis (acquisition cost not reduced by depreciation).

**Above certain income thresholds*

Polling Question

Do any of your loan agreements entered into this year with pass-through entities (i.e., partnerships, LLCs treated as partnerships and S corporations) take into account the new 20% deduction under IRC Section 199A in computing permitted tax distributions?

a. Yes

b. No

c. I don’t know

d. N/A

5. Controlled foreign corporations

U.S. shareholder and attribution rule change

- The definition of U.S. shareholder now includes a U.S. person who owns 10 percent of the total vote *or value* of all classes of stock of a foreign corporation.
  - Previously it was a test based only on vote.
  - Change effective for foreign corporation tax years beginning after 12/31/17.
- The TCJA also eliminates the requirement that a foreign corporation be a CFC for 30 days in order for its U.S. shareholders to have subpart F inclusions.

5. Controlled foreign corporations (Cont.)

Constructive Attribution – Change to Downward Attribution

- The downward attribution rules under Section 318(a)(3) are designed to attribute to corporations, partnerships, and trusts the stock held by their owners/beneficiaries. Where they apply, the entity will be attributed *all of the stock of its owner (shareholder, partners, or beneficiary).*

  - *All of the stock* of a tested corporation held by a partner will be attributed to the partnership, in theory no matter how small an interest in the partnership is held by the partner.

  - If a shareholder holds 50% or more by value in a corporation, then the corporation will be attributed ownership of all of the stock of a tested corporation that the shareholder holds.

5. Controlled foreign corporations (Cont.)

- Historically, Section 958(b)(4) prevented the downward attribution of stock held by a foreign entity to a US entity.
- However Section 958(b)(4) was repealed, which can lead to CFC status in a number of contexts where it might not have been expected.
- This change is effective for the last tax year of foreign corporations ending before January 1, 2018 and all later years.

Polling Question

Is your company impacted by the changes in the attribution rules or the definition of US shareholder?

a. Yes, and we are making changes to our structure
b. Yes, and we are not making changes
c. No
d. We are still considering / awaiting future guidance
e. N/A

5. Controlled foreign corporations (Cont.)

GILTI – Global Intangible Low-Taxed Income

- Similar to subpart F income, any GILTI realized by a foreign corporation that is a **CFC** is included on a current basis in the income of each of its U.S. shareholders that owns 10 percent or more of the stock of the CFC by vote or value regardless of whether that income is actually distributed to them.
- For corporate U.S. corporate shareholders:
  - A deduction of 50% of the GILTI amount is permitted, limited by taxable income
  - An indirect foreign tax credit of 80% of the foreign taxes properly attributable to the GILTI inclusion is allowed
- The name "Global Intangible Low-Taxed Income" is a misnomer. It does not apply only to "intangible" or "low taxed" income.
- There are several technical points that are still being evaluated.

5. Controlled foreign corporations (Cont.)

GILTI – Global Intangible Low-Taxed Income (con't)

General Overview

- GILTI: the excess (if any) of the shareholder's **net CFC tested income** over the shareholder's **net deemed tangible income return**.
- Net CFC tested income: excess of the aggregate of the U.S. shareholder's pro rata share of the **tested income** of each CFC over the aggregate of its pro rata share of the **tested loss** of each CFC.
- Tested income: excess of (i) the CFC's gross income:
  - **excluding** US source ECI, subpart F income, income excluded from foreign base company income or insurance income by reason of the high-tax exception under section 954(b)(4), dividends received from a related person, and foreign oil and gas extraction income;
  - over (ii) deductions (including taxes) properly allocable to such gross income.

5. Controlled foreign corporations (Cont.)

GILTI – Global Intangible Low-Taxed Income (con't)

General Overview (con't)

- Tested loss: excess (if any) of deductions (including taxes) properly allocable over the amount of gross income determined with regard to the exclusions.
- Shareholder's net deemed tangible income return: amount
  - equal to **10 percent** of the aggregate of the shareholder's pro rata share of the **qualified business asset investment** ("QBAI") of each CFC with respect to which it is a U.S. shareholder,
  - **reduced by** the amount of **interest expense** taken into account in determining its net CFC tested income to the extent the interest expense exceeds the interest income properly allocable to such expense that is taken into account in determining its net CFC tested income.

5. Controlled foreign corporations (Cont.)

GILTI – Global Intangible Low-Taxed Income (con't)

General Overview (con't)

- QBAI: the average of a CFC's aggregate adjusted bases (calculated using the alternative depreciation system) in tangible property used in the production of its tested income.
- Interest Expense Reduction: Net deemed tangible income return = 10% of the aggregate of the U.S. shareholder's pro rata share of the QBAI of its CFCs reduced by interest expense taken into account in determining net CFC tested income to the extent the income attributable to the expense is not taken into account in determining such shareholder's net CFC tested income.
  - Contrast interest paid to a US shareholder or to wholly unrelated persons vs interest paid between two wholly owned CFCs of the same US shareholder.

5. Controlled foreign corporations (Cont.)

GILTI – Global Intangible Low-Taxed Income (con't)

General Overview (con't)

- Deemed paid FTCs are available under section 960 with respect to 80% of: (i) the US shareholder's **inclusion percentage**, multiplied by (ii) the aggregate tested foreign income taxes of its CFCs.
- Tested foreign income taxes: the foreign income taxes paid or accrued by a CFC that are "properly attributable" to the CFC's tested gross income.
- Foreign taxes paid by loss CFCs: Tested foreign income taxes are defined in section 960(d)(3) to mean foreign income taxes paid or accrued which are attributable to the "tested income" of such foreign corporation.

5. Controlled foreign corporations (Cont.)

GILTI – Global Intangible Low-Taxed Income (con't)

Additional Considerations

- Zero GILTI? The magic 13.125% threshold.
- US shareholder level expenses, such as interest, stewardship, and R&D, could be allocated to the GILTI basket to reduce the GILTI FTC limitation - resulting in residual US tax on GILTI even if the income is subject to a foreign effective rate of 13.125% or higher.
- For purposes of determining the foreign tax credit limitation, a US shareholder's GILTI is separately basketed and excess credits are not available for carryover.
- **GILTI inclusion as subpart F income:** A GILTI inclusion is not a subpart F inclusion but is included in gross income in a similar manner and treated as one for certain purposes.
    - GILTI inclusion is allocated proportionately back to each CFC based on that CFC's tested income as compared to the aggregate amount of tested income.

5. Controlled foreign corporations (Cont.)

GILTI – – Global Intangible Low-Taxed Income (con't)

Section 250 Deduction:

- **Section 250 deduction for GILTI**: Section 250 allows for a 50% deduction against both the gross GILTI inclusion and the section 78 gross-up for corporate taxpayers.
  - The amount of the GILTI deduction is limited to the taxable income of the domestic corporation determined without regard to the section 250 deduction.
  - Note, the limitation is applied solely for purposes of determining the amount of deduction allowed under section 250 but does not otherwise affect the amount of GILTI to be included in the domestic corporation's income.
- **NOLs effect on taxable income limitation**: NOL carryforwards which reduce taxable income to an amount less than the sum of GILTI and FDII will have the effect of reducing the total deduction available to each.

5. Controlled foreign corporations (Cont.)

<u>GILTI – – Global Intangible Low-Taxed Income (con't)</u>

<u>Uncertainties</u>

- Does Section 163(j) apply at the CFC level?
- Does Section 904(d)(3) look-thru to GILTI for interest, rents and royalty income paid to a US affiliate?
- How to determine what taxes are properly attributable to sub F or GILTI under a "properly attributable" standard?
- How do you order PTI distributions?
- How does anti-abuse rule in proposed regulations apply?

Polling Question

Does your company expect an incremental U.S. tax liability related to GILTI?

a. Yes

b. No

c. Still analyzing

d. Have not considered

e. Not applicable

6. Changes to Foreign Tax Credit Rules

- Section 902 is repealed - therefore no deemed paid credit with respect to dividends.
- Section 960 indirect credit remains for subpart F, section 956, and GILTI inclusions.
- Standard is "properly attributable to" rather than pooling.
- Instead of two baskets (general and passive), now four baskets – general limitation, GILTI, branch and passive.
  - Difficulty with cross crediting, expiring credits.
  - GILTI – no carryforward or carryback; 20% haircut.

6. Changes to Foreign Tax Credit Rules (Cont.)

Foreign Tax Credit Uncertainties

- Transition rules for basketing of taxes carried back or forward.
- Applicable expense allocation and apportionment rules, particularly for GILTI basket.
- Applicability of properly attributable standard where local tax year and U.S. tax year do not align.
- FTCs on distribution of GILTI basket previously taxed income.