U.S. Tax Reform
Key International Aspects

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U.S. Tax Reform: Overview

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- "Jobs and Tax Cuts Act" signed on Dec 22, 2017
- Largest overhaul of the U.S. tax code since Tax Reform Act 1986
- Selected key aspects in a nutshell:
  - Reduced tax rates for individuals (6 brackets between 10% and 37%) and limits on itemized deductions (e.g. state and local taxes)
  - New deduction for individuals on „qualified business income" earned through pass-throughs and sole proprietorships
  - Reduction of (top marginal) corporate tax rate from 35% to (flat) 21%
  - Expensing of capital investment
  - Business interest deduction barrier (30% of „adjusted taxable income")
  - Substantial changes with respect to international tax rules

Relevant Perspective

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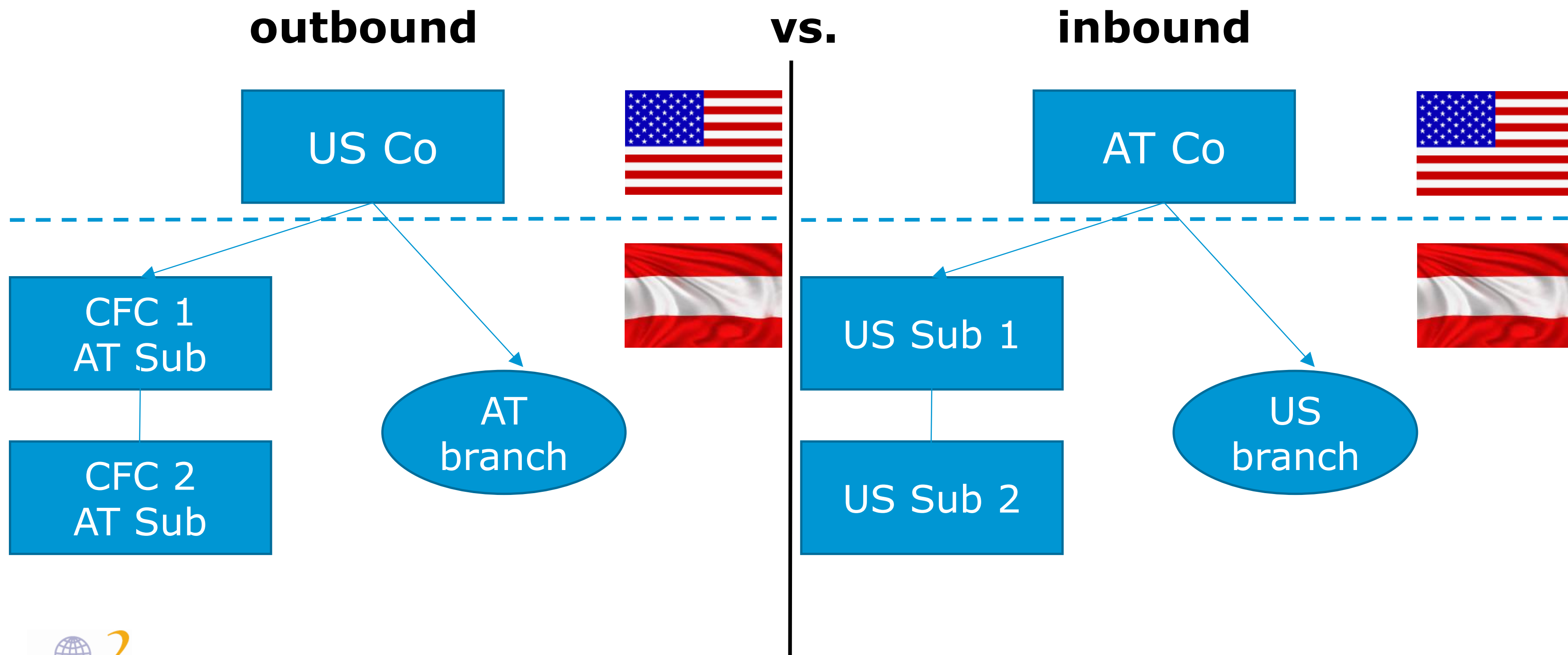
- Key to understanding the new rules' implications: **perspective**



Key Changes to International Tax Rules I

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100% Dividend Received Deduction (Sec 245a IRC)

- Scope: Foreign source portion of dividends paid by "specified 10% owned foreign corporation" to US corporate shareholder
- Not included: U.S. ECI, dividends from 80% owned domestic corporation and hybrid dividends from CFCs
- Minimum holding requirement: more than 365 days within 731-day period
- No current income inclusion but essentially exemption reached through 100% deductibility at the level of US shareholder
- Allegedly shift to territoriality
- **BUT**: Subpart F, i.e. U.S. CFC regime, remains (to the largest extent) untouched
  - „Territoriality" only with respect to a default class of income, i.e. all income that is not currently picked up on the basis of the CFC regime
  - CFC income: FPHCI (dividends, interest, royalties), FBC service income, FBC sales income
- Why important: No foreign tax credit; WH and other foreign taxes become final tax cost

Key Changes to International Tax Rules II

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Deemed Repatriation of Deferred Income

- One time toll-tax on the undistributed previously untaxed pre-1986 earnings and profits of a „specified foreign corporation" (SFC)
- SFC: At least one US shareholder (at least 10% of vote or value)
- Increase of subpart F income for the last tax year that begins before 2018
- Effective tax rates: 15.5% for foreign cash position and 8% for others
- Reached by allowing deductions
- Payable over 8 years
- Recapture (i.e. mandatory inclusion subject to tax of 35%) if inversion within 10 year following the bill

Key Changes to International Tax Rules III

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GILTI: Tax on Global Intangible low-taxed Income (Sec 951A IRC)

- In short: tax on a US shareholder‘s CFC combined net income above a routine equity return on tangible depreciable business assets
- GILTI income is reduced by a deduction of 50% (for the years 2017-2025) and 37.5% (for the years 2026 onwards)
- Note: It is neither restricted to income from intangibles nor to low-taxed income

FDII: Deduction for foreign-derived intangible income (Sec 250 IRC)

- Allows a deduction of 37.5% of „foreign derived intangible income"
- FDII calculation: deemed intangible income multiplied by a fraction of fincome derived in connection with property sold, leased, or licensed to and, services provided for foreign persons, over the corporations gross income
- Policy: deterring taxpayers from holding IP offshore

Key Changes to International Tax Rules IV

BEAT: Base Erosion and Anti-Abuse Tax

- Additional tax liability for base eroding payments made to foreign related persons if these account for more than 3% (2% in case of certain banks) of the overall deducted expenses
- Applies only to US corporations that (together with their affiliates) have annual gross receipts of at least 500 mio USD for a three year period
- Base eroding payments: payments to a related foreign person (i) that are deductible, (ii) for the acquisition of depreciable property and (iii) for certain reinsurance payments
- BEAT calculation: 10% of the so called „modified taxable income“ (=taxable income without base erosion benefits) minus regular tax liability
- Issue: Violation of non-discrimination rule stipulated in DTAs?

Key Changes to International Tax Rules V

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Hybrids

- Hybrid transactions and hybrid entities
  - No deduction for interest and royalties paid to related foreign party to the extent there is no income inclusion by foreign party
- Hybrid Dividends
  - No 100% DRD if dividend received from CFC was deductible or subject to other tax benefit in CFC's state of residence
  - Hybrid dividend paid from a CFC to another CFC (i.e. foreign-to-foreign dividend): Subpart F income inclusion
  - Impact for anti-hybrid rules in European jurisdictions?

Thank you for your attention!

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