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Rapidly Changing Landscape of Multinational Tax

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Today’s Speakers

M. Linda Weigand, CPA, JD

Through her expertise as an international tax specialist, Linda has been able to offer her clients significant tax advantages in structuring cross-border transactions. Prior to joining Barnes Dennig, Linda’s tax experience included leadership roles in the tax practice of two large, regional CPA firms and working in the tax department of a Cincinnati-based multinational Fortune 100 company. Linda earned her Bachelor of Science degree in Accounting and her Juris Doctorate degree from The University of Akron.

Ellen T. Juram, CPA

Ellen has more than 20 years of international tax experience and is an integral part of the firm’s tax compliance and consulting services. As a director, Ellen works with international clients in numerous industries, which gives her unique insights into best practices of successful companies. Prior to joining Barnes Dennig, Ellen spent 16 years at a Big Four firm, where she led tax engagements for multi-billion dollar, multinational companies. Ellen earned a Bachelor of Business Administration in Accounting and a Masters of Science in Taxation from the University of Cincinnati.

Michael O'Hara, CPA

Over the past five years, he has developed broad background in tax including federal tax, state tax, international tax while working with US based clients and internationally based clients. Michael has increased his international tax knowledge through study and testing that earned him the US International Tax Certificate from the Association of Certified Professional Accountants. Michael is a graduate of Northern Kentucky University with a Bachelor of Science in Accounting.

Agenda

1. Overview and Build Back Better Act
2. Corporation vs S corporation ownership of Foreign Entity
3. Disclosures and Compliance
4. Questions

International Tax Provisions - Summary

Topic	Prior Tax Law (2017)	Current Tax Law (2018)	Proposed Changes
Taxation of Foreign Income	Worldwide Taxation with limited deferral	Participation Exemption System of Taxation of Foreign Income	N/A
Taxation of Foreign Dividends	Dividends subject to corporate tax with FTC	100% Dividend Received Deduction (DRD) for foreign source dividends received by domestic corporations from specified 10% owned foreign corporations	100% Dividend Received Deduction for foreign source dividends received by U.S. corporation only from CFC (i.e. 50% U.S owned foreign corporation)
Foreign Tax Credits	FTC or deduction for direct and indirect taxes paid or accrued	No foreign tax credit or deduction allowed for any taxes including withholding taxes paid or accrued w/r/t dividends that qualify for the DRD.	FTC to be calculated on a country-by-country basis (prevents blending of high and low foreign tax rates); no carryback of FTC – 10 year carryforward, except for GILTI credits
Transition Tax	Deferred foreign income not subject to current US tax	Tax rates: 15.5% cash assets/ 8% on remainder; proportional reduction on Sec 902 credits Election to pay over 8 years	N/A
Interest Expense Limitation	Earnings stripping – denied interest expense to the extent based on debt/equity ratio greater than 1.5 to 1	Business interest expense cannot exceed the sum of the taxpayers business interest income, 30% of ATI and floor plan financing	Limit interest for certain domestic corporations that are part of an international reporting group. Limitation would be the allowable percentage of 110% of their net interest expense.

International Tax Provisions - Summary

Topic	Prior Tax Law (2017)	Current Tax Law (2018)	Proposed Changes
Foreign Tax Credit		Provide a separate IRC 904 limitation “basket” for foreign branch income	FTC computed on country-by-country basis. Elimination of the foreign branch “basket”
Subpart F definition	10% or more of the combined voting power	Expand subpart F definition of “US Shareholder” to include US person who owns 10% or more of the value of a foreign corporation.	Change to definition of foreign base company sales income
Global intangible low-taxed income (“GILTI”)		US shareholder of CFCs include in gross income its GILTI. Partial credits for foreign taxes attributable to GILTI amount; 50% deduction for C corporation owner	GILTI computed on country-by-country basis; GILTI deduction drops to 28.5%; GILTI deductions in excess of taxable income can be included in NOL
Base erosion and anti-abuse tax (“BEAT”)		Imposes, on a corporation that is an “applicable taxpayer” (>$500M in revenue), a tax equal to its “base erosion minimum tax amount” (“BEMTA”)	Increases minimum BEAT from 10% to 18%, progressively, beginning in 2023
Foreign Derived Intangible Income (“FDII”)		New 37.5% deduction for C-corporations on FDII (i.e. export sales and services which exceed a fixed return on fixed assets)	Reduces deduction to 28.5%; FDII in excess of taxable income can be included in NOL
Intangible property		Amend the definition of intangible property to include workforce in place, goodwill, and going concern	No change

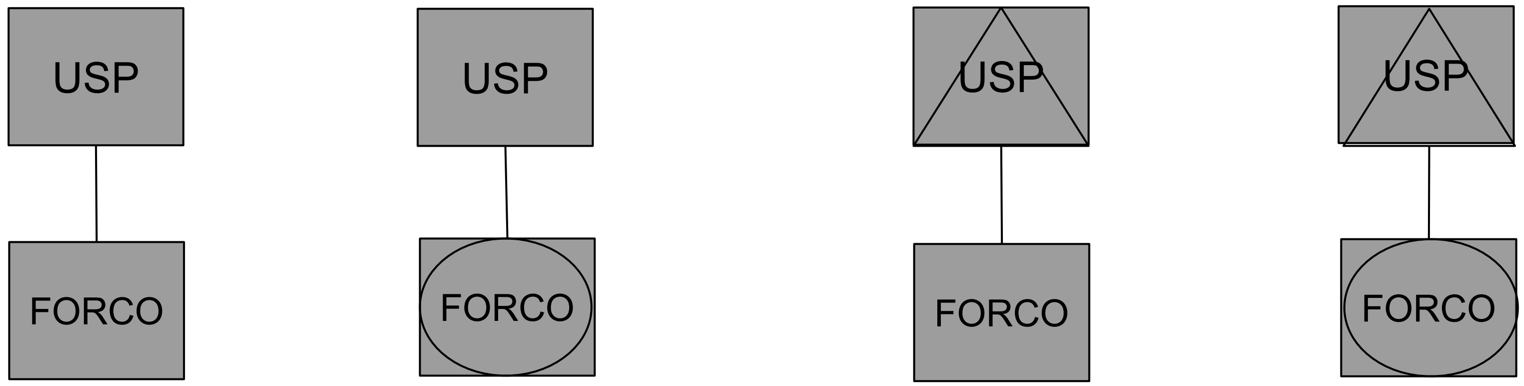
Foreign Tax Credit Example

Simplified calculation for illustrative purposes only

	Country A	Country B	Total
Pretax Income	100	100	200
Tax Rate	30%	10%	
Tax	30	10	40
Limitation			
US Inclusion	100	100	200
Limitation	21%	21%	21%
FTC Limitation	21	21	42
FTC Available	30	10	40
FTC	21	10	40
Country by Country	31		
Blended	40		

Limitation assumes corporate tax rate

Common Holding Structures



Ownership of Controlled Foreign Corporation

	Owned by C corporation	Owned by S corporation
Taxation of CFC income	Taxed currently under GILTI; 50% (28.5% after 12/31/22) deduction	Tax currently under GILTI; no deduction for GILTI
Foreign tax credit	Credit against GILTI for taxes paid by CFC; owner often has no residual tax after credits	No credit against GILTI for taxes paid by CFC
Tax on income	Income taxed at entity level; shareholder distribution taxed to SH as dividend at 15/20%	Income taxed at shareholder level in current year; no tax on distribution
20% QBI deduction	No QBI deduction for corporations	No QBI deduction on foreign source income
Net Investment Tax (NIT) – 3.8%	NIT applies only to dividends paid to shareholders	NIT applies to all pass-through income

Ownership of Foreign Disregarded Entity (FDE)

	Owned by C corporation	Owned by S corporation
Taxation of FDE income	All income taxed currently	All income taxed currently
Foreign tax credit	Credit against foreign source income for tax paid by FDE	Credit against foreign source income for tax paid by FDE; cannot offset NIT
Tax on income	Income taxed at entity level; shareholder distribution taxed to SH as dividend at 15/20%	Income taxed at shareholder level in current year; no tax on distribution
20% QBI deduction	No QBI deduction for corporations	No QBI deduction on foreign source income
Net Investment Tax (NIT) – 3.8%	NIT applies only to dividends paid to shareholders	NIT applies to all pass-through income

Example of C corp ownership vs S corp ownership

- Assumed facts
  - Foreign income, pre-tax $1,100
  - GILTI 1,000
  - Foreign taxes 200
  - Corporate tax rate 21%
  - Individual tax rate 35%
  - Net Investment Tax rate 3.8% for MFJ if MAGI > 500k (400k single)

Example – Ownership of CFC

	S Corp Owner	C Corp Owner
GILTI	$1,000	$1,000
Gross-up	N/A	200
GILTI deduction (28.5% under BBB)	N/A	(285)
Taxable Income	1,000	915
Entity tax	N/A	192
Foreign tax credit (95% X foreign tax)	N/A	190
Net entity tax	0	2
Shareholder tax on foreign income	350	N/A
NIT on foreign income	38	N/A
Distribution to shareholder	1,000	998
Tax on distribution (20% + 3.8% NIT)	0	238
Total tax	$388	$240

Example – Ownership of FDE

	S Corp Owner	C Corp Owner
Pre-tax foreign income	$1,100	$1,100
Entity tax	N/A	231
Entity foreign tax credit	N/A	(200)
Net U.S. entity tax on foreign income	0	31
Shareholder tax on foreign income	385	N/A
Shareholder foreign tax credit	(200)	N/A
NIT on foreign income	42	N/A
Distribution to shareholder	1,100	1,069
Tax on distribution (20% + 3.8% NIT)	N/A	254
Total tax	227	285

C corp ownership vs. S corp ownership under BBB

- Careful consideration to structuring U.S. ownership
- Best tax scenario is usually S corporation owner of foreign disregarded entity (FDE)
  - For legal protection purposes, entity can be an LLC for which an election is made to tax as an S corporation
  - FDE is usually treated as corporation in foreign jurisdiction, so dividend may not be taxable in U.S., but may still be treated as a taxable dividend in the foreign country

Compliance & Disclosures

- Withholding requirements
- Compliance
- Disclosures
- International Tax Penalties
- Takeaways

Withholding Requirements

- Types of international transactions subject to withholding
  - Interest
  - Dividends
  - Royalties
  - Payments for services performed in U.S. by foreign person
  - Foreign partner’s share of U.S. partnership income
  - Sale of U.S. real property

- Treaty Benefits
  - Withholding tax can be reduced or eliminated under a treaty

- Payments subject to withholding must be reported each year on Form 1042

Disclosures

- Forms to be filed
  - U.S. ownership in controlled foreign corporations (CFC) – Form 5471
    - Most complex foreign reporting form
    - Annual reporting increased from 30 pages of information per CFC to 50+ pages per CFC
      - Country by country reporting of income and foreign taxes for each CFC
      - Reporting of all intercompany transactions
      - Reporting of previously taxed income
    - Taxed on GILTI Income – all CFC income in excess of a specified return of assets
  - Foreign Partnership/ Branches – Forms 8858, 8865
    - Informational reporting only
    - Income flows into US owner tax return

Disclosures (cont'd)

- Forms to be filed
  - Foreign Tax Credit – Form 1118 / 1116
    - Tax Cuts & Jobs Act of 2017
      - ➢ Buckets of Passive/ General/ GILTI/ Foreign Branch
    - Proposed Build Back Better Act
      - ➢ Reporting on country by country basis for each CFC
  - Foreign Bank and Financials Accounts Reporting (FBAR)
    - Informational Return
    - Must report highest balance of all foreign financial accounts if aggregate balance is at least $10,000 at any point during the year
      - ➢ Financial accounts include bank accounts, brokerage accounts, retirement accounts, life insurance policies with CSV, etc.
    - Amnesty program still available for individuals
  - Other – foreign trusts, gifts, inheritances, payments to foreign persons and tax withheld, etc.

International Tax Penalties

- Basis for assessment of penalties
  - Late Filing
  - Inaccurate Filing
  - Failure to File
- Penalty Amounts
  - $10,000 or $25,000
  - Per form, per year
    - Statue of limitations doesn't start until form is initially filed
    - Penalty may apply to timely filed incorrect/incomplete form

Information Needed for Foreign filings

- Information needed on an annual basis includes:
  - Foreign Operations/Entity financials (Income Statement/ Balance Sheet), by country for each foreign entity
  - List of all related party transactions, accrued and paid, for each related party
    - Sales of inventory
    - Purchases of inventory
    - Loans
    - Commissions and services
    - Payments for intangibles
  - Highest balance during the year for each foreign financial account
  - Contributions to and distributions from foreign trusts
  - Gifts or inheritances from foreign sources
  - Payments of interest, dividends, royalties, compensation, etc. to foreign persons and tax withheld, if any
  - Treaty provisions for which a treaty benefit is claimed

Takeaways

- Careful consideration of worldwide entity structure
  - What is the right type of entity structure?
    - Consider tax cost
    - Compliance burden
    - Legal protection
- Discussion with your tax and legal advisors <u>before</u> final decisions are made

Questions?

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