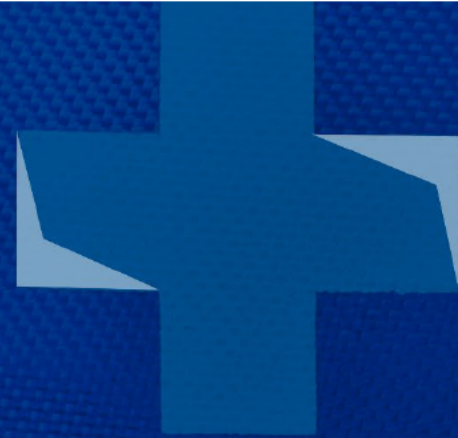


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WHAT'S NEW: MAXIMIZING BENEFITS AND MINIMIZING TAX BURDENS

SEPTEMBER 17, 2020



BARNES DENNIG
Accounting • Tax • Business Insight

AGENDA



Overview



Global structuring for optimal benefits



Outbound considerations



Your questions answered

CONTINUING INTERNATIONAL CHANGES

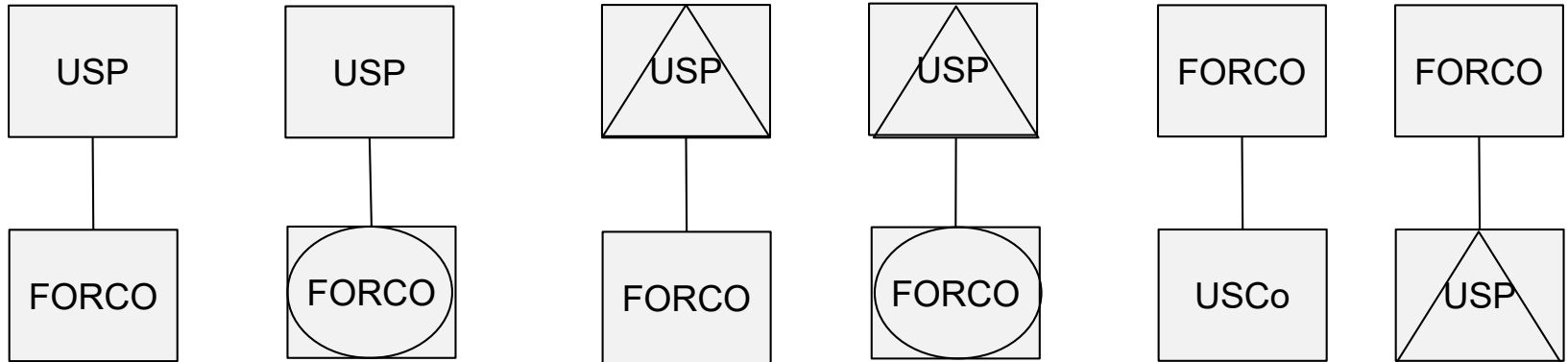
Pre-TCJA	TCJA	CARES Act/New Guidance
<ul style="list-style-type: none"> - Worldwide taxation of foreign income with limited deferral - Dividends from foreign corporations subject to corporate tax with FTC - Foreign tax credit for direct and indirect taxes paid or accrued - Deferred foreign income not subject to US current tax - Corporate tax rate: 15-35% graduated rates 	<ul style="list-style-type: none"> - Partial exemption system of taxation of foreign income - 100% dividend received deduction for foreign source dividends received by domestic corporations from specified 10% owned foreign corporations - 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 - Corporate tax rate: 21% flat rate - Transition tax applied for specified foreign corporation earnings and profits - Foreign tax credit basket changes - Global intangible low taxed income (GILTI) - Base erosion and anti-abuse tax (BEAT) - Foreign Derived Intangible Income ("FDII") - Sale/Disposition of US partnership interest by foreign partner 	<ul style="list-style-type: none"> - Net Operating Losses - Interest expense limitations/modifications - GILTI/Passthrough - GILTI – High Tax Exception - FDII/GILTI deduction

DISCLAIMER

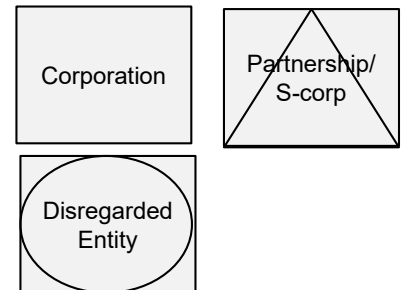


- Please note that the CARES Act, estimated at over \$2.2 trillion, is the most expensive piece of legislation in U.S. history! To add context, it is more than double the cost of FDR's New Deal, even when adjusted for inflation. Given the size, the Act passed in lightning speed. As such, more guidance is needed and being published practically daily. The information presented today is subject to change!
- We encourage you to contact your Barnes Dennig service provider for more information.

GLOBAL STRUCTURING



Symbol Chart:



GLOBAL STRUCTURING – TRANSFER PRICING

- Transfer pricing rules govern the price in which related parties transact with each other.
- Transactions should be conducted at an “arm’s length price”
- Documentation requirements
- Governs virtually all intercompany transactions (e.g., products, royalties, services, loans)
- Intercompany prices charged across borders drive the level of taxes paid on a global basis
- Planning opportunities
- COVID impacts on transfer pricing

INTEREST EXPENSE LIMITATIONS

- TCJA limited deductibility of business interest to 30% of Adjusted Taxable Income
- Depreciation, Amortization and Depletion only allowed for tax years beginning between 1/1/18 and 12/31/21.
- Small business exemption for taxpayers with average annual gross receipts of \$25M or less for the three preceding taxable years.

INTEREST EXPENSE LIMITATIONS

- CARES Act relaxes the limitation temporarily
- Corporations – interest expense limitation at corporate level
 - Limitation increased to 50% for 2019 and 2020
 - Consider using 2019 ATI to calculate 2020 ATI to increase deductibility
- Partnerships – limitation at the partner level
 - Limitation increased to 50% for 2020
 - Consider using 2019 ATI to calculate 2020 ATI to increase deductibility
- Taxpayers automatically subject to 50% limitation unless they elect out.

INTEREST EXPENSE LIMITATIONS

- Final regulations for Interest Expense were released on July 28, 2020.
 - Expect 2021 to be the first tax year for calendar year taxpayers to adopt.
 - Can early adopt for tax years beginning after 12/31/17 but needs to be consistently applied for taxpayers and its related parties.
- Domestic Changes
 - ATI starts with Tentative Taxable Income “TTI” instead of Taxable Income
 - ATI allows for depreciation, amortization, and depletion deductions that are part of COGS to be added back for tax years beginning before 12/31/21.

INTEREST EXPENSE LIMITATIONS

➤ International Changes

- Confirms interest expense limitations applies to controlled foreign corporations “CFCs”
 - Can make an election to treat CFCs as a group
- Global Intangible Low-Taxed Income “GILTI”, Section 78 Gross Up and Subpart F inclusions excluded from U.S. Shareholder ATI
- Partnership level GITLI and Subpart Part F inclusions generally excluded from U.S. Shareholder ATI
- IRS did not conclude on interaction of Section 250 and 163j

OUTBOUND CONSIDERATIONS

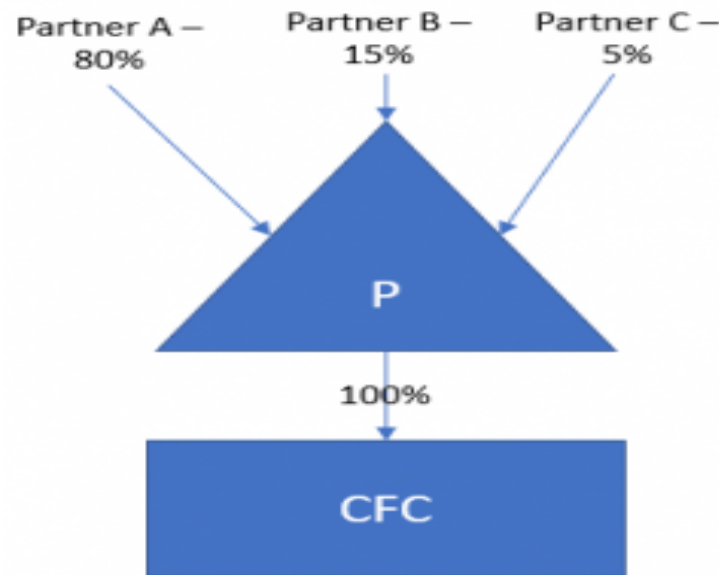
- Current U.S. tax regime for offshore income
 - GILTI
 - FDII – deduction for U.S. corporations
 - Dividends – 100% dividends received deduction or PTI
- Use of net operating losses (NOLs)
- IC-DISCs

GILTI



- Global Intangible Low-Taxed Income (“GILTI”)
 - Pre-TCJA deferral of U.S. tax on controlled foreign corporation (CFC) income was replaced with annual taxation of such income.
 - Applies to earnings of 10% owned CFCs to the extent that such earnings exceed 10% of CFC’s foreign assets (i.e. the QBAI)
 - Disadvantages distributors and service providers with limited assets
- C Corporations advantages
 - Allowed an 80% foreign tax credit against tax on GILTI
 - Allowed a 50% deduction of GILTI inclusion
 - Individual can make an election to be subject to tax at corporate rates – allows foreign tax credit and 50% GILTI deduction
- Example: CFC ownership transferred from S corporation to C corporation

GILTI PARTNERSHIP



- GILTI is determined at partner level – K-1 provides information to make the determination
- In the example above, Partner A and B would have GILTI, but Partner C would not as it owns only 5% of CFC

GILTI HIGH-TAX EXCEPTION

➤ GILTI High-Tax Exception (HTE) – New Rule

- Allows exclusion of GILTI
- HTE rate is 18.9% (i.e. CFC's foreign effective tax rate must be 18.9% or higher on tested unit)
 - Negative rate is deemed to be high-taxed
- HTE election is binding for all CFCs and to all CFC shareholders (i.e. controlling shareholder makes the election and notifies noncontrolling shareholder)
- Election is made on a yearly basis
- No foreign tax credit on excluded income
- Applies to tax years of CFCs beginning on or after 7/23/2020 and to taxable years of U.S. shareholders that for which these taxable year end
 - Can make the HTE election retroactively to 2018 tax return

GILTI HIGH-TAX EXCEPTION

➤ What is a Tested Unit?

1. A CFC

2. An interest in a pass-through entity that is held directly or indirectly by the CFC that is either

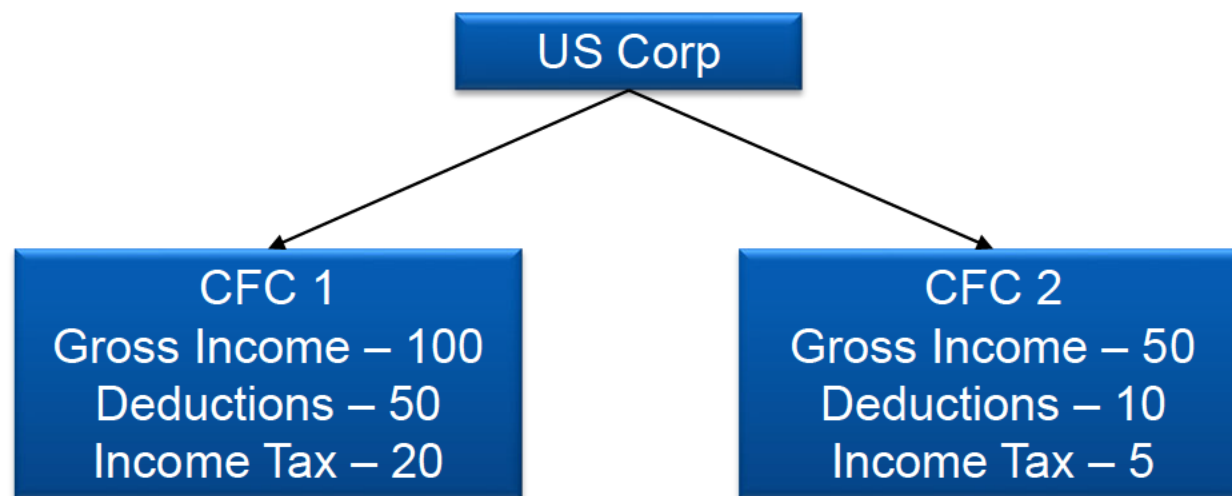
- Tax resident of any foreign country
- NOT treated as fiscally transparent in the country of tax residency

3. A branch operated by a CFC

➤ Must group together tested units of a CFC within the same foreign country when looking at the HTE

- Not necessary to have the same functional currency or effective or statutory tax rate

GILTI HIGH-TAX EXCEPTION



Step		CFC 1	CFC 2
1	Tentative Gross Tested Income	100	50
2	Deductions	-50	-10
2	Foreign Income Tax Deduction	-20	-5
2	Tentative Tested Income	30	35
3	Foreign Income Taxes Paid	20	5
4	Effective Foreign Tax Rate	66.7%	14.3%

**CFC 1 would qualify
CFC 2 would NOT qualify**

GILTI HIGH-TAX EXCEPTION

- Should I elect HTE (or retroactively adopt)?
 - Did you utilize or generate NOLs?
 - Will you still meet the requirements for the dividends received deduction (since excluded income is not considered to be previously tax earnings)?
 - Was most GILTI high-taxed?
 - If not, HTE may negatively impact ability to use foreign tax credit
 - Was the company affected by expense apportionment on the foreign tax credit utilization?
 - Foreign source income (upon which the foreign tax credit is based) is reduced by certain expenses incurred by U.S. parent (e.g. R&D expenditures, interest expense)
 - If foreign tax credits are reduced due to these expenses, may want to consider the HTE

GILTI HIGH-TAX EXCEPTION

➤ Should I elect HTE (cont'd)?

- How would the HTE impact the GILTI that is not excluded?

- GILTI is calculated as the excess of the CFCs' foreign earnings over 10% of the foreign assets (the QBAI)

- Aggregated, so removing HTE CFCs with significant foreign assets could cause more GILTI to be recognized for the remaining CFCs
- Need to evaluate against the available foreign tax credit for the remaining CFCs

FDII DEDUCTION

- “Carrot and stick” – FDII and GILTI
- Deduction applies to U.S. C corporations that sell goods or services to foreign customers
- Designed to discourage offshore location of intangibles and associated income
- FDII deduction allows the following deduction for C corporations
 - 37.5% (21.875% after 2025) of its Foreign-Derived Intangible Income (“FDII”)
 - This is in addition to the 50% (37.5% after 2025) deduction for GILTI income
- Deduction results in a U.S. effective tax rate of 13.125% (16.41% after 2025) on FDII

FDII: FOREIGN-DERIVED DEDUCTION ELIGIBLE INCOME (FDDEI)

- FDDEI sales are defined as sales of general property or intangible property to a foreign person for foreign use
 - Sales to related parties can qualify as long as the property is ultimately sold to an unrelated party
 - Foreign use is generally determined by where the end user is located
- FDDEI services are services provided to persons or property located outside the U.S.
 - Advertising services are deemed provided where the advertisements are viewed
 - Electronically supplies services are deemed provided where the recipient's IP Address
- FDDEI excludes GILTI – already entitled to 50% deduction for C corporations

FDII DEDUCTION

- Similar to GILTI, FDII deduction is based on excess of foreign-sourced income over a 10% return on tangible assets
- Total FDII and GILTI deductions cannot exceed taxable income
 - Need better guidance as to the ordering rules for the limitations for FDII deduction, NOLs, and interest expenses, all of which have limitations based on taxable income.

FDII DEDUCTION

- Calculation and substantiation of the FDII deduction is time consuming
 - Need proof of:
 - Customer's foreign status
 - Foreign use of property
 - Foreign location of services
 - Foreign use of intangibles – based on where revenue earned
 - Substantiation must be in existence before filing the tax return and must be provided upon IRS request within 30 days

NET OPERATING LOSS (NOL) RULES

Pre-TCJA	Post-TCJA – Pre-CARES Act	Post-CARES Act
<ul style="list-style-type: none">- 2-year carryback- 20-year carryforward	<ul style="list-style-type: none">- No carryback- Unlimited carryforward subject to 80% taxable income limitation	<ul style="list-style-type: none">- 5-year carryback for post-2017 and pre-2021 NOLs (2018 -2020 tax returns)- Unlimited carryforward subject to 80% taxable income limitation in 2021

- NOLs must be carried back to the earliest tax year (e.g. 2014 for NOL arising in 2019)
 - Potential to apply for a “quick” refund
- Must waive the carryback – election is irrevocable on timely filed, original return for tax year ending after March 27th, 2020
 - May have to file amended 2018 or 2019 to waive carryback
- Cannot use NOL to reduce Transition Tax income
 - Deemed election to waive carryback to a year with a Transition Tax (generally, 2018 tax return), i.e. taxpayer can use foreign tax credits instead of the NOL

“SHOULD I CARRY BACK A TAX LOSS?”

➤ International considerations

- FDII deduction – would be reduced since the deduction is limited to taxable income
- GILTI position
 - GILTI is offset first by the NOL; therefore, the 50% deduction benefit for C corporations may be substantially reduced, resulting in less tax reduction than expected
 - For non-C corporations, the benefit of using the NOL carryback would be greater since these taxpayers are not entitled to the GILTI deduction
- Foreign tax credits – can use the FTC and “save” the NOL
- Transition tax – NOL carryback cannot offset transition tax income

IS AN IC-DISC STILL A VIABLE OPTION?

- Interest Charge Domestic International Sales Corporation (IC-DISC)
 - Mechanism for export income to be taxed at lower capital gains rate
 - Income is “housed” in separate corporation (the IC-DISC)
 - IC-DISC pays no entity tax
 - Tax is paid when dividend is paid to the shareholder, generally an individual or S corporation
 - Pre-TCJA, benefit was significant (39.6% vs. 23.8% tax rate)
 - Post-TCJA, rate differential could be as low as 5.8% (29.6% with QBI deduction vs 23.8%)
 - General rule of thumb is that export sales should be at least \$2 million for the IC-DISC benefits to outweigh the costs

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QUESTIONS?

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