BDO KNOWS: **TAX REFORM**

TREASURY CHANGES THE LANDSCAPE WITH NEW GILTI REGULATIONS

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With you today

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I. Overview

Overview - History

- **Section 951A**, *Global intangible low-taxed income included in gross income of U.S. shareholders*, was added to the Code by the TCJA

- **Section 951A** – a U.S. shareholder of any CFC for any taxable year of such U.S. shareholder shall include in gross income such shareholders **"global intangible low-taxed income"** for such taxable year

- **GILTI inclusion amount** = **net CFC tested income** – **net deemed tangible income return** (Net DTIR)

- Domestic C corporations (other than RICs and REITs) generally entitled to up to a 50% **Section 250** deduction for their GILTI and Section 78 gross up attributable to GILTI
  - Subject to various rules and a taxable income limitation

Overview - History

- On October 10, 2018, Treasury published proposed regulations (REG-104390-18) under Sections 951, 951A, 1502 and 6038 (**prior GILTI prop regs**)

- On December 7, 2018, Treasury published proposed regulations (REG-105600-18) providing guidance related to the foreign tax credit (**FTC prop regs**)

Overview – Proposed and Final Regulations

On June 21, 2019:

- Treasury published final regulations (TD 9866) that provide guidance to determine the amount of GILTI (the **GILTI final regs**)
  - TD 9866 also included final regulations relating to certain foreign tax credit provisions (the **FTC final regs**) and final regulations relating to the determination of a U.S. shareholder's pro rata share of a controlled foreign corporation's (CFC's) subpart F income included in the shareholder's gross income, as well as certain reporting requirements relating to inclusions of subpart F income and GILTI

- Treasury also published proposed regulations (REG-101828-19) regarding the treatment of domestic partnerships for purposes of determining amounts included in the gross income of their partners with respect to foreign corporations (the **958 prop regs**)
  - The proposed regulations also include rules under the GILTI provisions regarding gross income subject to a high rate of foreign tax (the **new GILTI prop regs**)

Overview – Key Highlights of Final Regulations

The GILTI final regs:

- Retain the basic approach and structure of the prior GILTI prop regs, with certain revisions
- Significantly modify the approach to domestic partnerships and their partners in the prior GILTI prop regs
- Adopt as final the GILTI High Tax Exclusion (tied to Section 954(b)(4)) from the prior GILTI prop regs
- Scale back the pro rata share anti-abuse rule in prior Prop. Reg. 1.951-1(e)(6)
- Expand the rules disregarding adjusted basis in property transferred during the disqualified period

II. GILTI Final Regulations

Section 951A Aggregate Treatment

- Rather than adopting the hybrid approach that was included in the prior GILTI prop regs, the GILTI final regs provide that, in general, for purposes of Section 951A and the Section 951A regulations, and for purposes of any other provision that applies by reference to Section 951A or the Section 951A regulations (for instance, Sections 959, 960, and 961), a domestic partnership is not treated as owning stock of a foreign corporation within the meaning of Section 958(a). See Reg. 1.951A-1(e)(1)

- Rather, the partners of a domestic partnership are treated as owning proportionately the stock of CFCs owned by the partnership in the same manner as if the partnership were a foreign partnership under Section 958(a)(2). See id.

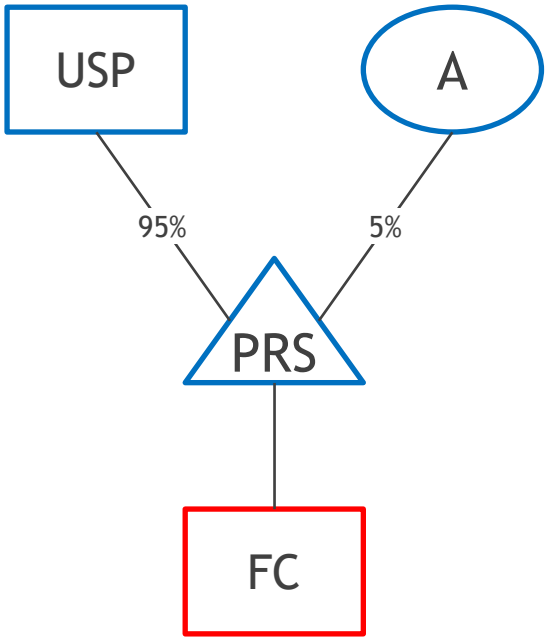
Section 951A Aggregate Treatment

- Because a domestic partnership is not treated as owning Section 958(a) stock for purposes of Section 951A, a domestic partnership does not have a GILTI inclusion amount and thus no partner of the partnership has a distributive share of a GILTI inclusion amount

- Furthermore, because only a U.S. shareholder can have a pro rata share of a tested item of a CFC under Section 951A(e)(1) and Reg. 1.951A-1(d), a partner that is not a U.S. shareholder of a CFC owned by the partnership does not have a pro rata share of any tested item of the CFC

- The GILTI final regs provide that the aggregation rule for domestic partnerships does not apply for purposes of determining whether a U.S. person is a U.S. shareholder, whether a U.S. shareholder is a controlling domestic shareholder (as defined in Reg. 1.964-1(c)(5)), or whether a foreign corporation is a CFC. See Reg. 1.951A-1(e)(2)
  - The rule does not affect the determination of ownership under Section 958(a) for any other provision of the Code (such as Section 1248(a)), nor does it change whether such partner has a distributive share of a domestic partnership's subpart F inclusion under section 951(a) (but see below regarding the 958 prop regs)

Reg. 1.951A-1(e)(3), Example (1)



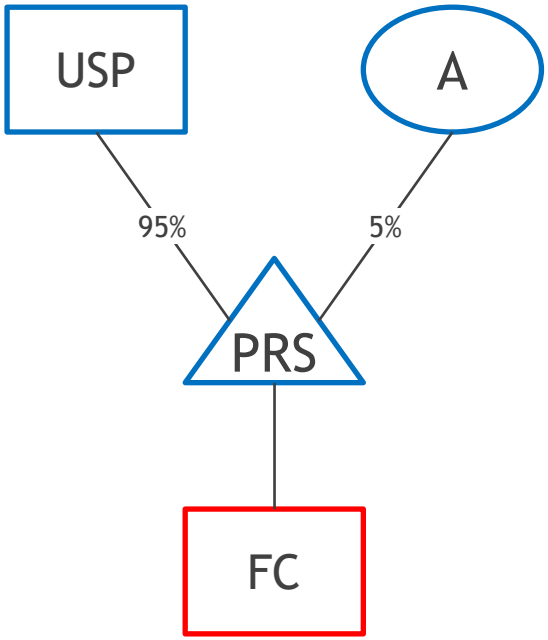
FACTS

- USP, a domestic corporation, and Individual A, a U.S. citizen unrelated to USP, own 95% and 5%, respectively, of PRS, a domestic partnership.
- PRS owns 100% of the single class of stock of FC, a foreign corporation

ANALYSIS – CFC and U.S. shareholder determinations

- Under Reg. 1.951A-1(e)(2), the determination of whether PRS, USP, and Individual A (each a U.S. person) are U.S. shareholders of FC and whether FC is a CFC is made without regard to Reg. 1.951A-1(e)(1)
- PRS, a U.S. person, owns 100% of the total combined voting power or value of the FC stock within the meaning of Section 958(a)
- Accordingly, PRS is a U.S. shareholder under Section 951(b), and FC is a CFC under Section 957(a)
- USP is a U.S. shareholder of FC because it owns 95% of the total combined voting power or value of the FC stock under Sections 958(b) and 318(a)(2)(A)
- Individual A, however, is not a U.S. shareholder of FC because Individual A owns only 5% of the total combined voting power or value of the FC stock under Sections 958(b) and 318(a)(2)(A)

Reg. 1.951A-1(e)(3), Example (1)



ANALYSIS – Application of Section 951A

- Under Reg. 1.951A-1(e)(1), for purposes of determining a GILTI inclusion amount under Section 951A and Reg. 1.951A-1(b), PRS is not treated as owning (within the meaning of Section 958(a)) the FC stock; instead, PRS is treated in the same manner as a foreign partnership for purposes of determining the FC stock owned by USP and Individual A under Section 958(a)(2)
- Therefore, for purposes of determining the GILTI inclusion amount of USP and Individual A, USP is treated as owning 95% of the FC stock under Section 958(a), and Individual A is treated as owning 5% of the FC stock under Section 958(a)
- USP is a U.S. shareholder of FC, and therefore USP determines its pro rata share of any tested item of FC based on its ownership of Section 958(a) stock of FC
- However, because Individual A is not a U.S. shareholder of FC, Individual A does not have a pro rata share of any tested item of FC

Contrast this approach from the hybrid approach in the prior GILTI prop regs where PRS would determine its GILTI inclusion amount and Individual A would take into account his distributive share of PRS's GILTI inclusion amount. USP would determine its pro rata share of FC tested items based on FC stock that USP owned.

Final GILTI High Tax Exclusion

- The GILTI final regs retain the GILTI High Tax Exclusion (tied to Section 954(b)(4)) from the prior GILTI prop regs (the **Final GILTI High Tax Exclusion**)

- The **Final GILTI High Tax Exclusion** applies only to items of gross income that are excluded from FBCI or insurance income **solely** by reason of an election under Section 954(b)(4) and Reg. 1.954-1(d)(5). See Reg. 1.951A-2(c)(1)(iii)
  - This exclusion does not apply to any item of gross income excluded from FBCI or insurance income by reason of an exception other than Section 954(b)(4), regardless of the effective rate of foreign tax to which such item is subject

- See discussion below regarding the **Proposed GILTI High Tax Exclusion** and its prospective applicability date from the new GILTI prop regs

Pro-rata Share Anti-abuse Rule

Prior Prop. Reg. 1.951-1(e)(6) stated:

- *For purposes of this paragraph (e), any transaction or arrangement that is part of a plan a principal purpose of which is the avoidance of Federal income taxation, including, but not limited to, a transaction or arrangement to reduce a United States shareholder's pro rata share of the subpart F income of a controlled foreign corporation, which transaction or arrangement would avoid Federal income taxation without regard to this paragraph (e)(6), is disregarded in determining such United States shareholder's pro rata share of the subpart F income of the corporation. This paragraph (e)(6) also applies for purposes of the pro rata share rules described in §1.951A-1(d) that reference this paragraph (e), including the rules in §1.951A-1(d)(3) that determine the pro rata share of qualified business asset investment based on the pro rata share of tested income*

Pro Rata Share Anti-abuse Rule

- The GILTI final regs clarify that the rule applies only to require appropriate adjustments to the allocation of allocable E&P that would be distributed in a hypothetical distribution with respect to any share outstanding as of the hypothetical date. See Reg. 1.951-1(e)(6)

- If applicable, adjustments will be made solely to the allocation of allocable E&P in the hypothetical distribution between shareholders that own, directly or indirectly, stock of the CFC as of the relevant hypothetical distribution date

- As clarified, the rule will not apply to adjust the allocable E&P allocated to a shareholder by reason of a transfer of CFC stock, except by reason of a change to the distribution rights with respect to stock in connection with such transfer (for example, an issuance of a new class of stock, including by recapitalization)

Deduction or Loss Attributable to Disqualified Basis

- The prior GILTI prop regs included a rule that generally disallowed, for purposes of calculating tested income or tested loss, any deduction or loss attributable to disqualified basis in depreciable or amortizable property (including, for example, intangible property) resulting from a disqualified transfer of the property. See Prop. Reg. 1.951A-2(c)(5)

- The GILTI final regs treats any deduction or loss attributable to disqualified basis as not "properly allocable" to gross tested income, subpart F income, or effectively connected income of the CFC. See Reg. 1.951A-2(c)(5)(i)

Deduction or Loss Attributable to Disqualified Basis

- In addition, this rule in the GILTI final regs applies to deductions or losses attributable to disqualified basis in any property, other than property described in Section 1221(a)(1), regardless of whether the property is of a type with respect to which a deduction is allowable under Section 167 or 197 (as compared to the rule in the prior GILTI prop regs that only applied to deductions or losses attributable to property that is of a type with respect to which a deduction is allowable under Section 167 or 197). See Regs. 1.951A-2(c)(5)(iii)(A) and 1.951A-3(h)(2)(ii)

- The GILTI final regs permit taxpayers to make an election pursuant to which the adjusted basis in each property with disqualified basis held by a CFC or a partnership is reduced by the amount of the disqualified basis and the disqualified basis is eliminated. See Reg. 1.951A-3(h)(2)(ii)(B)(3)
  - This reduction in adjusted basis is for all purposes of the Code, including Section 901(m)

- Certain successor rules relating to transfers

Coordination Rules

- The GILTI final regs revise the **Section 952(c) coordination rule** to apply also to disregard the effect of a qualified deficit or a chain deficit in determining gross tested income. See Reg. 1.951A-2(c)(4)(iii)

- The GILTI final regs also include rules coordinating with the **De Minimis rule**, the **Full Inclusion rule** and the **High Tax Exception.** See Reg. 1.951A-2(c)(4)(iii)(C)

Regulations under Sections 78, 861 and 965

The FTC final regs also finalize certain rules included in the FTC prop regs including:

- Rules that do not treat dividends under Section 78 that relate to taxable years of foreign corporations that begin before January 1, 2018 (as well as Section 78 dividends that relate to later taxable years), as dividends for purposes of Section 245A. See Reg. 1.78-1(c)

- Rules on adjusting stock basis in CFC stock taking into account Section 965 basis adjustment elections. See Reg. 1.861-12(c)(2)(i)

- Rules related to the Section 965(n) election to forgo use of a net operating loss. See Reg. 1.965-7(e)

Items to be Addressed in Future Guidance

- Issues related to the application of Reg. 1.952-2 including whether, and to what extent, Section 245A should apply to dividends received by a CFC
- The use of foreign statement reserves for purposes of measuring qualified insurance income under Section 954(i)
- Interaction of basis adjustments under Section 961(c) and Section 951A
- Address comments relating to the validity of the definition of interest expense and interest income when regulations under Section 163(j) are finalized
- Basis adjustment rules for tested loss CFCs

Other Items

The GILTI final regs also include, among other items:

- Rules clarifying the application of Section 951(a)(2)(B) to subpart F income and tested income in the same taxable year. See Reg. 1.951-1(b)(1)(ii)
- Revisions to the cumulative preferred stock rule. See Reg. 1.951-1(e)(4)(ii)
- Modifications to the "CFC inclusion date." See Regs. 1.951A-1(d)(1), 1.951-1(e)(1)(i) and 1.951A-1(f)(3)
- Modifications to the excess QBAI rule. See Reg. 1.951A-1(d)(3)(ii)(A) and (C)
- Rules clarifying that a deemed payment under Section 367(d) is treated as an allowable deduction for purposes of determining tested income and tested loss. See Reg. 1.951A-2(c)(2)(ii)
- Rules revising the definition of tangible property in Reg. 1.951A-3(c)(2) to exclude certain intangible property to which Section 168(k) applies, namely, computer software, qualified film or television productions, and qualified live theatrical productions described in Section 168(k)(2)(A)

Other Items

The GILTI final regs also include, among other items:

- Rules for determining basis under ADS, an election to not determine basis under ADS under certain limited circumstances, guidance confirming that using ADS for purposes of determining QBAI is not a method change (though a change to ADS for purposes of computing tested income/loss is a method change) along with other guidance for calculating basis. See Reg. 1.951A-3(e)
- Rules regarding dual use property. See Reg. 1.951A-3(d)
- Rules regarding partnership QBAI. See Reg. 1.951A-3(g)
- Revised rules relating to disregarding basis in specified tangible property held temporarily. See Reg. 1.951A-3(h)(1)
- Definitions of tested interest expense and tested interest income. See Reg. 1.951A-4(b)

Other Items

The GILTI final regs also include, among other items (continued):

- Rules for interest expense paid or accrued by a tested loss CFC. See Reg. 1.951A-4(b)(1)(i) and (iv) and (c) Example 5
- Rules treating GILTI inclusion amounts as subpart F inclusions for purposes of the personal holding company rules. See Reg. 1.951A-5(d)
- Reserving on the rules included in the prior GILTI prop regs related to adjustments to stock of tested loss CFCs. See Reg. 1.951A-6(c)
  - Treasury notes in the preamble that any rules issued under Reg. 1.951A-6(c) will apply only with respect to tested losses incurred in taxable years of CFCs and their U.S. shareholders ending after the date of publication of any future guidance
- Reserving on the special rules for consolidated groups related to basis adjustments to member stock. See Regs. 1.1502-32(b)(3)(ii)(E) and (b)(3)(iii)(C), and 1.1502-51(c) and (d)
  - The GILTI final regs also do not finalize the rules in the rules in Prop. Reg. 1.1502-32(b)(3)(ii)(F) that would treat a member as receiving tax-exempt income immediately before another member recognizes income, gain, deduction, or loss with respect to a share of the first member's stock (the "F adjustment"). As a result, taxpayers may not rely on the F adjustment

Applicability Dates

- Reg. 1.78-1 applies to taxable years of foreign corporations that begin after December 31, 2017, and to taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end. The second sentence of Reg. 1.78-1(a) applies to section 78 dividends that are received after December 31, 2017, by reason of taxes deemed paid under section 960(a) with respect to a taxable year of a foreign corporation beginning before January 1, 2018. Reg. 1.78-1(c)

- Reg. 1.861-12 applies to taxable years that both begin after December 31, 2017, and end on or after December 4, 2018. Reg. 1.861-12(c)(2)(i)(A) and (c)(2)(i)(B)(1)(ii) also apply to the last taxable year of a foreign corporation that begins before January 1, 2018, and with respect to a U.S. person, the taxable year in which or with which such taxable year of the foreign corporation ends. Reg. 1.861-12(k)

- Reg. 1.951-1(a), (b)(1)(ii), (b)(2), (e)(1)(ii)(B), and (g)(1) apply to taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end. Except for Reg. 1.951-1(e)(1)(ii)(B), Reg. 1.951-1(e) applies to taxable years of U.S. shareholders ending on or after October 3, 2018. Reg. 1.951-1(h) applies to taxable years of domestic partnerships ending on or after May 14, 2010. Reg. 1.951-1(i)

Applicability Dates

- Regs. 1.951A-1 through 1.951A-6 apply to taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end. Reg. 1.951A-7

- Except as otherwise provided in Reg. 1.1502-51(g), this section applies to taxable years of U.S. shareholders for which the due date (without extensions) of the consolidated return is after June 21, 2019. However, a consolidated group may apply the rules of this section in their entirety to all taxable years of its members that are described in Reg. 1.951A-7. In such a case, the consolidated group must apply the rules of this section to all taxable years described in Reg. 1.951A-7 and with respect to all members. Reg. 1.1502-51(g)

- Reg. 1.6038-2 applies to taxable years of foreign corporations beginning on or after October 3, 2018. See 26 CFR 1.6038-2 (revised as of April 1, 2018) for rules applicable to taxable years of foreign corporations beginning before such date. Reg. 1.6038-2(m)

- Reg. 1.6038-5 applies to taxable years of controlled foreign corporations beginning on or after October 3, 2018. Reg. 1.6038-5(e)

III. Proposed Regulations

The 958 Proposed Regulations

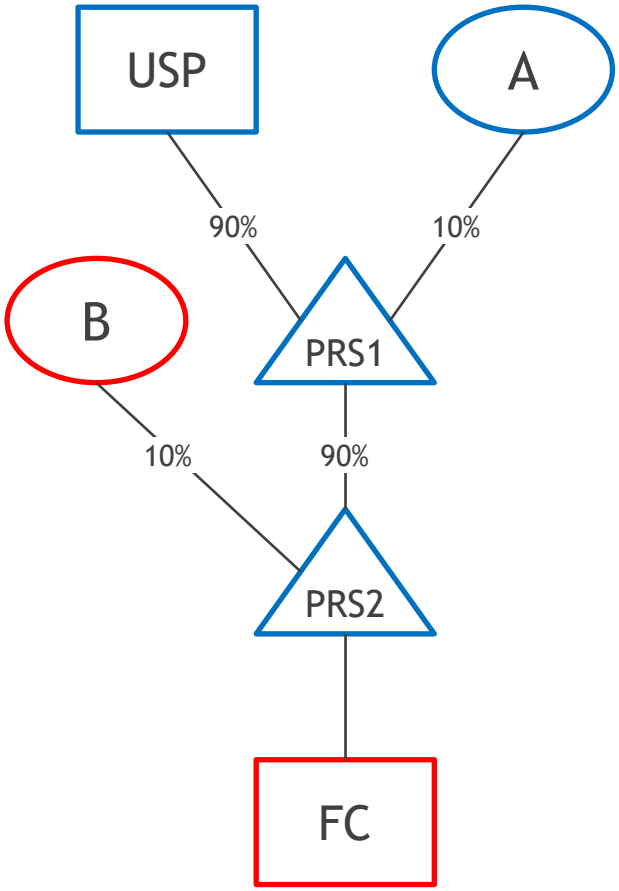
- Domestic partnerships have generally been treated as entities for purposes of treating a domestic partnership as the U.S. shareholder that has the subpart F inclusion with respect to the domestic partnership's CFCs
  - The U.S. partners in the domestic partnership generally include their distributive share of the domestic partnership's subpart F inclusion

- Under the 958 prop regs, a domestic partnership that owns a foreign corporation is treated as an entity for purposes of determining whether the partnership and its partners are U.S. shareholders, whether the partnership is a controlling domestic shareholder, and whether the foreign corporation is a CFC

- However, the partnership is treated as an aggregate of its partners for purposes of determining whether, and to what extent, its partners have inclusions under Sections 951 and 951A and for purposes of any other provision that applies by reference to Sections 951 and 951A
  - This aggregate treatment does not apply for any other purpose of the Code, including for purposes of Section 1248

- See Prop. Reg. 1.958-1(d) for additional details

Prop. Reg. 1.958-1(d)(3), Example (2)



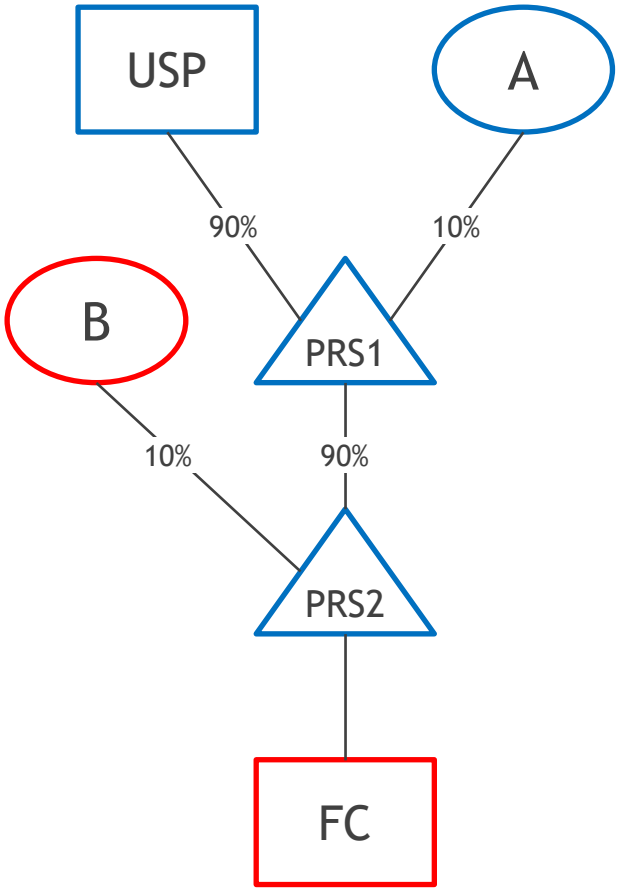
FACTS

- USP, a domestic corporation, and Individual A, a U.S. citizen, own 90% and 10%, respectively, of PRS1, a domestic partnership
- PRS1 and Individual B, a nonresident alien individual, own 90% and 10%, respectively, of PRS2, a domestic partnership
- PRS2 owns 100% of the single class of stock of FC, a foreign corporation
- USP, Individual A, and Individual B are unrelated to each other

ANALYSIS – CFC and U.S. shareholder determinations

- Under Prop. Reg. 1.958-1(d)(2), the determination of whether PRS1, PRS2, USP, and Individual A (each a U.S. person) are U.S. shareholders of FC and whether FC is a CFC is made without regard to Prop. Reg. 1.958-1(d)(1)
- PRS2 owns 100% of the total combined voting power or value of the FC stock within the meaning of Section 958(a)
- Accordingly, PRS2 is a U.S. shareholder under Section 951(b), and FC is a CFC under Section 957(a)
- Under Sections 958(b) and 318(a)(2)(A), PRS1 is treated as owning 90% of the FC stock owned by PRS2
- Accordingly, PRS1 is a U.S. shareholder under Section 951(b)

Prop. Reg. 1.958-1(d)(3), Example (2)



ANALYSIS – CFC and U.S. shareholder determinations

- Further, under Section 958(b)(2), PRS1 is treated as owning 100% of the FC stock for purposes of determining the FC stock treated as owned by USP and Individual A under Section 318(a)(2)(A)
- Therefore, USP is treated as owning 90% of the FC stock under Section 958(b) (100% x 100% x 90%), and Individual A is treated as owning 10% of the FC stock under Section 958(b) (100% x 100% x 10%)
- Accordingly, both USP and Individual A are U.S. shareholders of FC under Section 951(b)

ANALYSIS – Application of Sections 951 and 951A

- Under Prop. Reg. 1.958-1(d)(1), for purposes of Sections 951 and 951A, PRS1 and PRS2 are not treated as owning (within the meaning of Section 958(a)) the FC stock; instead, PRS1 and PRS2 are treated in the same manner as foreign partnerships for purposes of determining the FC stock owned by USP and Individual A under Section 958(a)(2) and Prop. Reg. 1.958-1(b)
- Therefore, for purposes of determining the amount included in gross income under Sections 951 and 951A, USP is treated as owning 81% (100% x 90% x 90%) of the FC stock under Section 958(a), and Individual A is treated as owning 9% (100% x 90% x 10%) of the FC stock under Section 958(a)
- Because USP and Individual A are both U.S. shareholders of FC, USP and Individual A determine their respective inclusions under Sections 951 and 951A based on their ownership of FC stock under Section 958(a)

The 958 Proposed Regulations – Applicability

- The 958 prop regs are proposed to apply to taxable years of foreign corporations beginning on or after the date of publication of the Treasury decision adopting these rules as final regulations in the Federal Register (the **finalization date**), and to taxable years of a U.S. person in which or with which such taxable years of foreign corporations end. See Prop Reg. 1.958-1(d)(4)
  - Once Prop. Reg. 1.958-1(d) applies as a final regulation, the proposed regulations would revise the applicability dates of Reg. 1.951A-1(e) and Reg. 1.951-1(h), so that those provisions do not apply once the final regulations under Section 958 apply

- With respect to taxable years of foreign corporations beginning before the **finalization date**, a domestic partnership may apply these rules to taxable years of a foreign corporation beginning after December 31, 2017, and to taxable years of the domestic partnership in which or with which such taxable years of the foreign corporation end, provided that the partnership, its partners that are U.S. shareholders of the foreign corporation, and other domestic partnerships that bear relationships described in Section 267(b) or 707(b) to the partnership (and their U.S. shareholder partners) consistently apply Prop. Reg. 1.958-1(d) with respect to all foreign corporations whose stock the domestic partnerships own within the meaning of Section 958(a) (determined without regard to Prop. Reg. 1.958-1(d))

New GILTI Proposed Regulations

- The new GILTI prop regs provide that an election (the **Proposed GILTI High Tax Exclusion**) may be made for a CFC to exclude from gross tested income, gross income subject to foreign income tax at an effective rate that is greater than 90 percent of the rate that would apply if the income were subject to the maximum rate of tax specified in Section 11 (= 18.9% based on the current rate of 21%). See Prop. Reg. 1.951A-2(c)(6)(i)

- The election is made by the CFC's controlling domestic shareholders with respect to the CFC for a CFC inclusion year by attaching a statement to an amended or filed return in accordance with forms, instructions, or administrative pronouncements. See Prop. Reg. 1.951A-2(c)(6)(v)(A)

- If an election is made with respect to a CFC, the election applies to exclude from gross tested income all the CFC's items of income for the taxable year that meet the effective rate test in Prop. Reg. 1.951A-2(c)(6)(iii) and is binding on all the U.S. shareholders of the CFC. See Prop. Reg. 1.951A-2(c)(6)(v)(B)
  - Special rules with regards to revoking the election. See Prop. Reg. 1.951A-2(c)(6)(v)(D)

New GILTI Proposed Regulations

- The election to apply the Proposed GILTI High Tax Exclusion with respect to any high-taxed income allows taxpayers to eliminate the need to use foreign tax credits to reduce GILTI tax liability on such income by removing such income from gross tested income

- However, taxpayers choosing the election will not be able to use the foreign tax credits associated with that income against other Section 951A category income, and they will not be able to use the tangible assets owned by high tax QBUs in their QBAI computation

New GILTI Proposed Regulations

- If a CFC is a member of a **controlling domestic shareholder group**, the election applies with respect to each member of the controlling domestic shareholder group. See Prop. Reg. 1.951A-2(c)(6)(v)(E)(1)

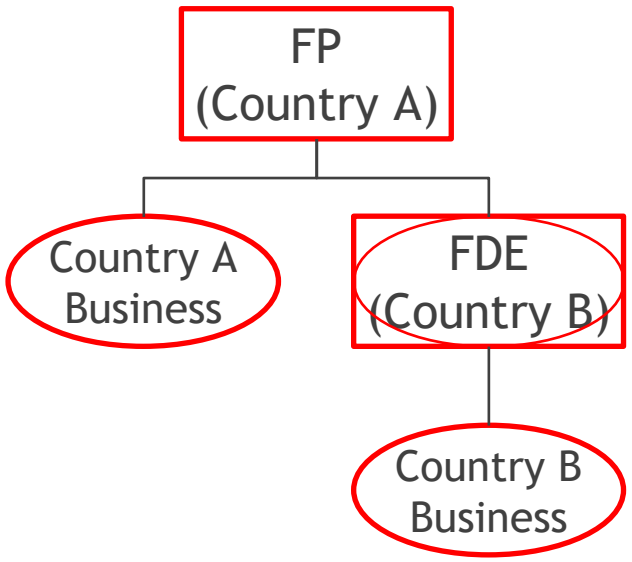
- A **controlling domestic shareholder group** is defined as two or more CFCs if more than 50% of the stock (by voting power) of each CFC is owned (within the meaning of Section 958(a)) by the same controlling domestic shareholder (or persons related to such controlling domestic shareholder) or, if no single controlling domestic shareholder owns (within the meaning of Section 958(a)) more than 50% of the stock (by voting power) of each corporation, more than 50% of the stock (by voting power) of each corporation is owned (within the meaning of Section 958(a)) in the aggregate by the same controlling domestic shareholders and each controlling domestic shareholder owns (within the meaning of Section 958(a)) the same percentage of stock in each CFC. See Prop. Reg. 1.951A-2(c)(6)(v)(E)(2)
  - Accordingly, an election made under Prop. Reg. 1.951A-2(c)(6)(v) applies with respect to each item of income of each CFC in a group of commonly controlled CFCs that meets the effective rate test in Prop. Reg. 1.951A-2(c)(6)(iii)

New GILTI Proposed Regulations

- In general, the relevant items of income for purposes of the Proposed GILTI High Tax Exclusion are all items of gross tested income attributable to a qualified business unit (QBU as defined in Section 989(a) and the regulations thereunder). See Prop. Reg. 1.951A-2(c)(6)(ii)(A)(1)
  - Gross income is attributable to a QBU if the gross income is properly reflected on the books and records of the QBU. Such gross income must be determined under Federal income tax principles, except that the principles of Reg. 1.904-4(f)(2)(vi) (without regard to the exclusion described in Reg. 1.904-4(f)(2)(vi)(C)(1)) apply to adjust gross income of a QBU to reflect disregarded payments. See Prop. Reg. 1.951A-2(c)(6)(ii)(A)(2)

- The GILTI prop regs provide that for purposes of both the exception under Section 954(b)(4) and the Proposed GILTI High Tax Exclusion, the effective rate of foreign tax imposed on an item of income is determined solely at the CFC level by allocating and apportioning the foreign income taxes paid or accrued by the CFC in the current year to the CFC's gross income in that year based on the rules described in the regulations under Section 960 for determining foreign income taxes "properly attributable" to income

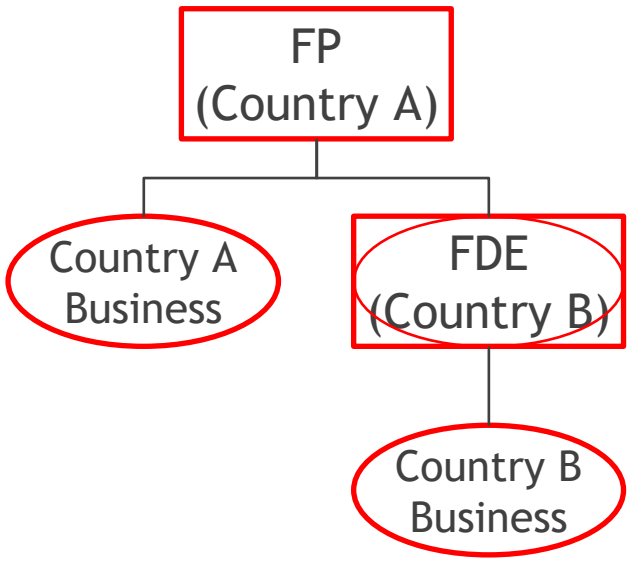
Prop. Reg. 1.951A-2(c)(6)(vi), Example



Facts

- FP, a CFC organized in Country A, conducts a trade or business in Country A (the Country A Business) and reflects items of income, gain, loss, and expense attributable to the Country A Business on the books and records of FP's home office
- Under Reg. 1.989(a)-1(b)(2)(i)(A), FP is a QBU
- FP's functional currency is the U.S. dollar
- FP has a calendar year taxable year in both the U.S. and Country A
- An election is made under Prop. Reg. 1.951A-2(c)(6)(v)(A) that is effective for FP's CFC inclusion year
- FP owns FDE, a Country B disregarded entity (within the meaning of Reg. 1.904-4(f)(3)(i))
- FDE conducts activities in Country B that constitute a trade or business within the meaning of Reg. 1.989(a)-1(c) (the Country B Business), and reflects items of income, gain, loss, and expense attributable to the Country B Business on the books and records of FDE
- Under Reg. 1.989(a)-1(b)(2)(ii)(B), the Country B Business conducted through FDE is a QBU
- The Country B Business's functional currency is the U.S. dollar
- FDE has a calendar year taxable year in Country B
- On Date A in Year 1, FDE accrues $100x of interest income from X, an unrelated third party, and reflects the accrual on the books and records of the Country B business

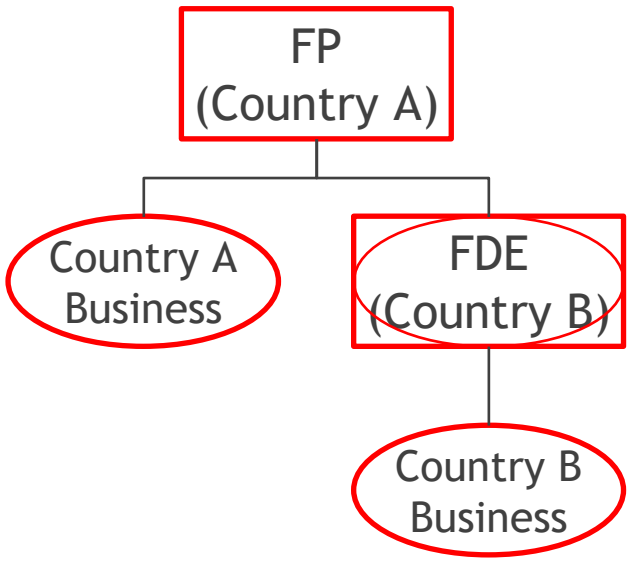
Prop. Reg. 1.951A-2(c)(6)(vi), Example



Facts

- FP excludes the $100x from foreign personal holding company income by reason of Section 954(h)
- Subsequently, on Date B in Year 1, FDE accrues and pays $20x of interest to FP
- FP reflects the interest income item on the books and records of the Country A Business
- FDE reflects the $20x of interest expense on the books and records of the Country B Business
- Country A imposes no tax on income
- Country B imposes a 25% tax on income
- For Country B income tax purposes, FDE (which is not disregarded under Country B income tax principles) recognizes $80x of taxable income ($100x interest income, less a $20x deduction for the interest paid to FP)
- Accordingly, FDE incurs a Country B income tax liability with respect to Year 1, the U.S. dollar amount of which is $20x
- For Federal income tax purposes, if FDE were not a disregarded entity (within the meaning of Reg. 1.904-4(f)(3)(i)), FP would recognize $20x of income in Year 1, and FDE would recognize $80x of taxable income in Year 1
- Other than the $20x expense accrued with respect to the income tax imposed by Country B, FP incurs no deductions in Year 1 for Federal income tax purposes.

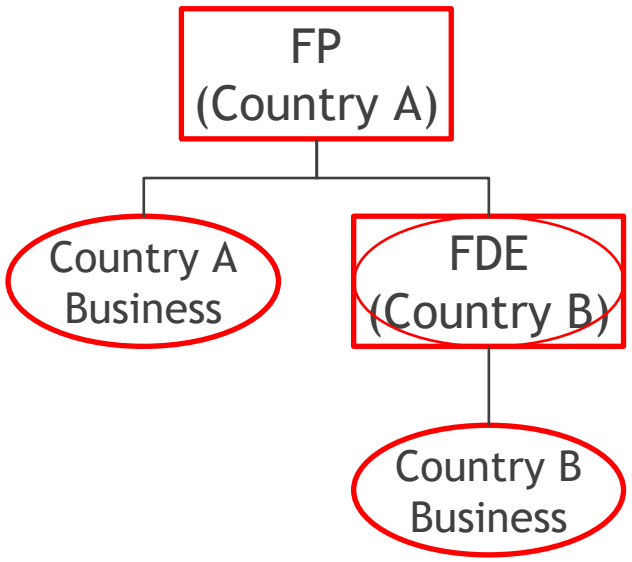
Prop. Reg. 1.951A-2(c)(6)(vi), Example



Analysis

- Under Prop. Reg. 1.951A-2(c)(6)(ii)(A)(1), a separate tentative gross tested income item must be determined with respect to FP's Country A Business and Country B Business (each of which is a QBU)
- To determine the separate tentative gross tested income items with respect to its Country A Business and Country B Business, FP must determine the gross income that is attributable to the Country A Business and the Country B Business under Prop. Reg. 1.951A-2(c)(6)(ii)(A)(2)
- Without regard to the $20x interest payment from FDE to FP, gross income attributable to the Country A Business would be $0 (that is, $20x of interest income reflected on the books and records of the Country A Business, reduced by $20x attributable to a payment that is disregarded for Federal income tax purposes)
- Similarly, without regard to the $20x interest payment from FDE to FP, gross income attributable to the Country B Business would be $100x (that is, $100x of interest income reflected on the books and records of the Country B Business, unreduced by the $20x payment from FDE to FP)
- However, the $20x payment from FDE to FP is a disregarded payment within the meaning of Reg. 1.904-4(f)(3)(ii), and would, under the principles of Reg. 1.904-4(f)(2)(vi) (without regard to the exclusion described in Reg. 1.904-4(f)(2)(vi)(C)(1)), adjust the gross income of the Country A Business from $0 to $20x and the gross income of the Country B Business from $100x to $80x (in each case, by virtue of the $20x disregarded interest payment from FDE to FP)

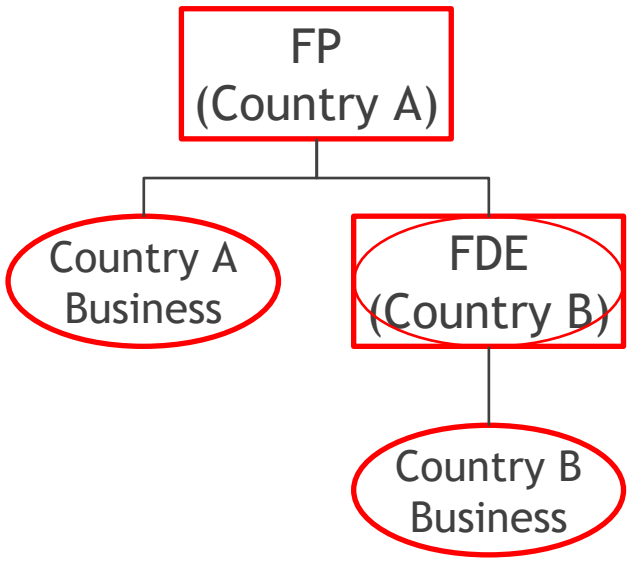
Prop. Reg. 1.951A-2(c)(6)(vi), Example



Analysis

- Accordingly, FP's tentative gross tested income attributable to the Country A Business is $20x and its tentative gross tested income attributable to the Country B Business is $80x
- Under Prop. Reg. 1.951A-2(c)(6)(ii)(B), because there are no deductions allocated or apportioned under Reg. 1.960-1(d)(3) to the tentative gross tested income items of the Country A Business, FP's tentative net tested income item attributable to the Country A Business is $20x
- Taking into account the $20x deduction for Country B income taxes that are allocable to the Country B Business under Reg. 1.960-1(d)(3), FP's tentative net tested income item attributable to the Country B Business is $60x under Prop. Reg. 1.951A-2(c)(6)(ii)(B) (tentative gross tested income of $80x less the $20x deduction)
- Under Prop. Reg. 1.951A-2(c)(6)(iii) and (iv), for Year 1 (a CFC inclusion year of FP), the effective rate with respect to FP's $60x tentative net tested income item attributable to its Country B Business is 25%: $20x (the U.S. dollar amount of the Country B taxes accrued with respect to FP's tentative tested net income item attributable to the Country B Business) divided by $80x (the U.S. dollar amount of FP's $60x tentative net tested income item, increased by the $20x amount of Country B income taxes accrued with respect to that tentative net tested income item), expressed as a percentage

Prop. Reg. 1.951A-2(c)(6)(vi), Example



Analysis

- Therefore, FP's tentative net tested income item attributable to the Country B Business was subject to foreign income taxes at an effective rate (25%) that is greater than 18.9% (which is 90% of the rate that would apply if the income were subject to the maximum rate of tax specified in Section 11, which is 21%)
- Accordingly, the requirement of Prop. Reg. 1.951A-2(c)(6)(i)(B) is satisfied with respect to FP's tentative gross tested income item attributable to the Country B Business in Year 1
- Further, the requirement of Prop. Reg. 1.951A-2(c)(6)(i)(A) is satisfied because an election described in Prop. Reg. 1.951A-2(c)(6)(v)(A) was made with respect to FP for Year 1
- Accordingly, FP's $80x item of tentative gross tested income attributable to its Country B Business qualifies for the high tax exception of Section 954(b)(4) under Prop. Reg. 1.951A-2(c)(6)(i)
- FP's $20x item of tentative net tested income attributable to its Country A Business is not subject to foreign income tax, and therefore does not satisfy the requirement of Prop. Reg. 1.951A-2(c)(6)(i)(B)
- Accordingly, FP's $20x item of tentative gross tested income attributable to the Country A Business does not qualify for the high tax exception of Section 954(b)(4) under Prop. Reg. 1.951A-2(c)(6)(i)

New GILTI Proposed Regulations - Applicability

- The Proposed GILTI High Tax Exclusion is proposed to apply to taxable years of foreign corporations beginning on or after the date that final regulations are published in the Federal Register, and to taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end

- Until the Proposed GILTI High Tax Exclusion regulations are effective, a taxpayer may not exclude any item of income from gross tested income under Section 951A(c)(2)(A)(i)(III) unless the income would be foreign base company income (FBCI) or insurance income but for the application of Section 954(b)(4) and Reg. 1.954-1(d)
  - See discussion above of the Final GILTI High Tax Exclusion from the GILTI final regs

Questions?

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