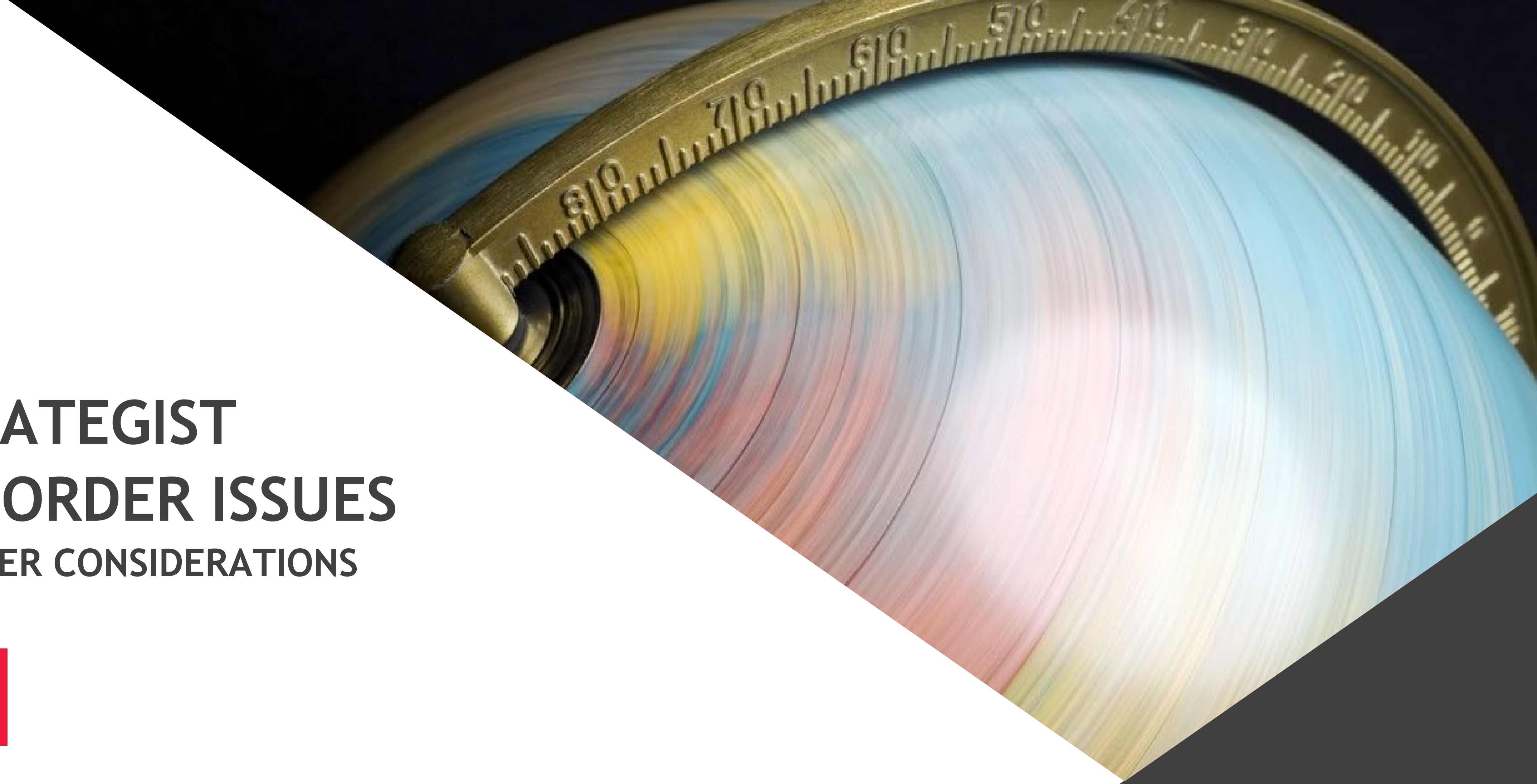
TAX STRATEGIST
CROSS-BORDER ISSUES
FIRST QUARTER CONSIDERATIONS



April 27, 2022

Agenda for Today

- Introductions
- Global Developments - Overview
- Customs Valuation & Transfer Pricing
- Forced Labor
- BEPS 2.0
- Final Foreign Tax Credit (FTC) Regulations

With You Today

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Global Developments - Overview

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Global Developments Impacting Trade and Tax Policy

U.S. Tax Developments

- Build Back Better Bill – seemingly stalled
- Treasury Greenbook priorities
  - Pillar 2 alignment focus
- Final FTC regulations – very invasive

Global Tax Developments

- OECD Pillar 1 advancements
- OECD Pillar 2 framework and status
- ATAD 3
- Brazil transfer pricing advancements – OECD

Global Conflicts & Continued Pandemic Related Fallout

- Trade and supply chain disruption
- Sanctions
- Inflation
- Energy price volatility

Customs Valuation & Transfer Pricing

Customs Valuation & Transfer Pricing

BASICS

TRANSFER PRICING BASICS

- 5 specified methods for tangible goods; choose "best method;" no preference in regulations
- Best method rule
  - Focus is on function and risk of the tested party
  - Degree of comparability
  - Quality of data and assumptions
- Transactional Net Margin Method ("TNMM," or "Comparable Profits Method" in the U.S.) is the most commonly used – but the least favored method by U.S. Customs.
- Contemporaneous documentation generally needed to avoid penalty
- U.S. rules consistent with OECD guidelines

CUSTOMS VALUATION BASICS

- Most duties are assessed ad valorem, so a lower value means lower duties
- Six methods applied in sequential order
- Transaction Value is primary method and based on invoice price ("price actually paid or payable")
- Transaction Value is allowed for related party sales if the relationship did not influence the price, which may be determined by:
  - Test values
  - Circumstances of sale
- Importers prefer Transaction Value; consequently, appropriately documenting "circumstances of sale" is critical

Customs Valuation & Transfer Pricing

DIFFERENCES

	TRANSFER PRICING	CUSTOMS
Item to be taxed:	Annual net income	Specific product
Relevant timeframe:	Return due dates	Date of import
Level of application:	Overall results	Transactional

“Whipsaw” Effect

- Same overall objective: arm’s length pricing.
- CBP concerned about transfer prices because of a possibility the seller will charge buyer lower prices for goods that attract duty – and charge higher prices for duty-free goods.
- IRS also concerned about transfer prices because of a possibility seller will manipulate them in an effort to shift profits to countries with lowest tax rates.
- DISCUSSION ON TP/CUSTOMS SCENARIO

Post Importation TP Adjustments

- In U.S., post-importation price adjustments may have to be reported to CBP if the adjustment meets the requirements of the "5-factor" test enumerated in CBP HQ Ruling W548314 (May 16, 2012).
- In the context of related party transaction, "5-factor" test requires that TP policy is set in writing before importation and followed by the importer. In such cases, TP policy may be considered an "objective formula" for transaction value purposes.

The 5-Factor Test

CBP Identified five factors for determining whether an objective formula is in place prior to importation:

1. A written “Intercompany Transfer Pricing Determination Policy” is in place prior to importation and the policy is prepared taking IRS code section 482 into account;
2. The U.S. taxpayer uses its transfer pricing policy in filing its income tax return, and any adjustments resulting from the transfer pricing policy are reported or used by the taxpayer in filing its income tax return;
3. The company’s transfer pricing policy specifies how the transfer price and any adjustments are determined with respect to all products covered by the transfer pricing policy for which the value is to be adjusted;
4. The company maintains and provides accounting details from its books and/or financial statements to support the claimed adjustments in the United States; and,
5. No other conditions exist that may affect the acceptance of the transfer price by CBP.

Forced Labor

U.S.-China Policy

FORCED LABOR IN THE XINJIANG UIGHUR AUTONOMOUS REGION (XUAR) OF CHINA

- Section 307 of the Tariff Act of 1930 prohibits the importation of merchandise mined, produced or manufactured, wholly or in part, in any foreign country by forced or indentured labor – including forced prison or child labor.
- If U.S. Customs and Border Protection (CBP) receives information that reasonably but not conclusively indicates that imported merchandise is being made with forced labor, the agency issues a Withhold Release Order (WRO).
- On January 13, 2021, CBP issued a WRO on cotton and tomato products (including downstream products that incorporate such raw material inputs) produced in Xinjiang based on information it received during its investigation regarding the apparent use of forced labor of the Uyghur people and other ethnic and religious minority groups.
- CBP issued another WRO on silica-based products on June 23, 2021, covering a specific manufacturer (Hoshine Silicon Industry Co. Ltd. and Subsidiaries). The WRO applies to this entity's silica products no matter where they (or their constituent materials) are manufactured.

WRO Process

- Once a WRO is issued, CBP withholds release of merchandise allegedly made with forced labor.
- Then, an importer has three months to submit evidence substantiating that the specific merchandise on each withheld shipment was not produced with forced labor. In other words, the importer must prove a negative — an extremely hard task.
- It must also substantiate the country of origin of all materials used in making the finished good.
- If the importer fails to timely submit this evidence, the detained shipment will be excluded from entry and may also be subject to seizure.

ILO Indicators of Forced Labor

CBP uses the following factors set forth in the International Labour Organization's ("ILO") published guidelines to indicate whether the imported merchandise was produced using forced labor:

- Abuse of Vulnerability
- Deception
- Restriction of Movement
- Isolation
- Physical and Sexual Violence
- Intimidation and Threats
- Retention of Identity Documents
- Withholding of Wages
- Debt Bondage
- Abusive Working and Living Conditions
- Excessive Overtime

Considerations

Consult ILO Indicators of Forced Labor

Confirm documentation of raw material inputs used in the production of U.S. imported goods

Third party risk assessment of current supply chain

Establish procedures to assess suppliers' labor practices

Consult DOL's list of Goods Produced by Child and Forced Labour and CBP's List of Withhold Release Orders to assess supplier relationships

Supplier contract language covering the prohibition on forced, convict and child labor and the applicable wage and hour requirements

Uyghur Forced Labor Prevention Act

(H.R. 6256)

On December 16th 2021, U.S. Congress passed H.R. 6256, also known as the Uyghur Forced Labor Prevention Act, a bill prohibiting imports from China's Xinjiang region unless evidence is provided the goods were produced without forced labor. The bill was signed into law by President Biden on December 23rd and provided the following:

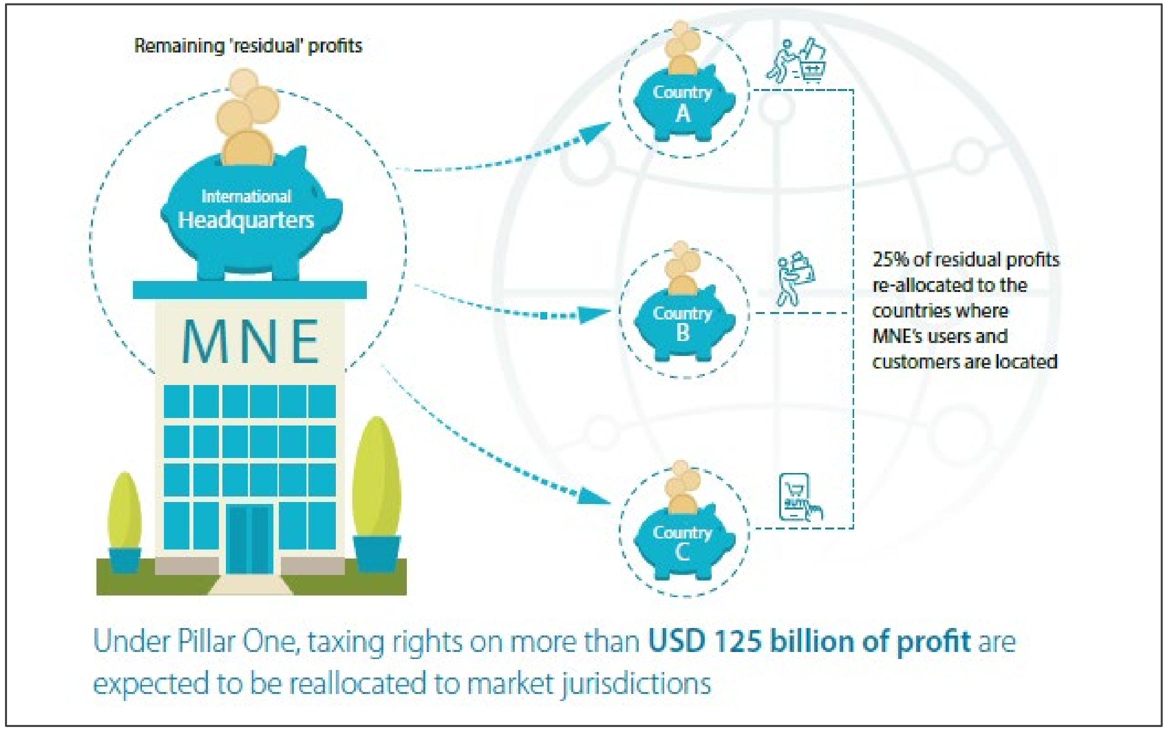
- The Forced Labor Enforcement Task Force opened a public comment period that ended on March 10, 2022, to determine how goods mined, produced, or manufactured wholly or in part with forced labor in the People's Republic of China, specifically the Xinjiang region, will be prevented from being imported into the United States.
  - Witnesses were invited to testify on use and prevention of forced labor.
- Based on these comment periods, the Task Force will develop strategy and provide guidance to importers on determining whether goods originating in China were manufactured with forced labor. The bill cites cotton, tomatoes, and polysilicon as materials that will be high priority for enforcement.

The new law becomes effective on June 21, 2022. Any importer with manufacturing in China (especially in Xinjiang) should be proactively taking steps to document that its supply chain is free of forced labor.

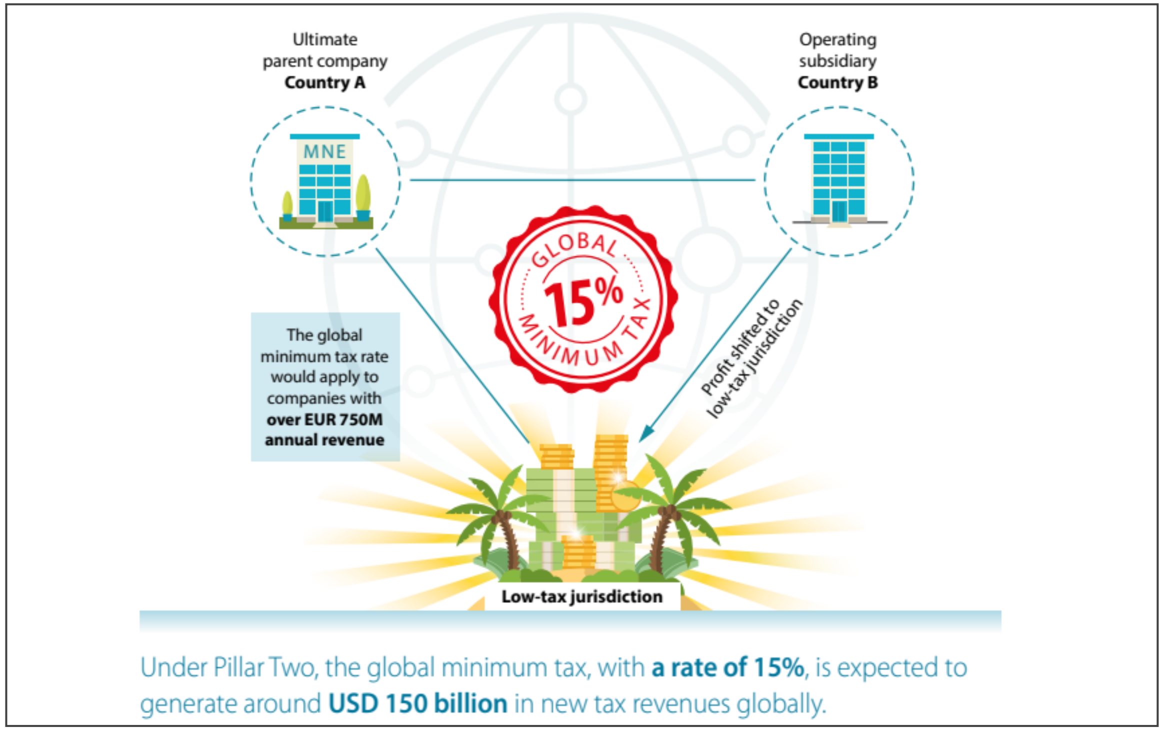
BEPS 2.0

BEPS 2.0

PILLAR ONE
Realigning who is taxed



PILLAR TWO
Ensuring minimum tax is paid somewhere



Source: OECD

BEPS 2.0 Timeline

PILLAR ONE

2021
OECD and G20 agreement on Inclusive Framework and Declaration

February 2022
Public consultation on Pillar one Amount A

Mid 2022
Multilateral Convention (Amount A) signing ceremony

End of 2022
Release of Amount B framework

2023
Amount A to come into effect?

2023

2024

Pillar Two

December 2021
Release of OECD Pillar Two Model Rules for GloBE and EU Pillar Two Directive

March 2022
Release of Commentary to Model Rules and public consultation

Mid 2022
Release of model treaty provisions and MLI for STTR

2022
Pillar Two brought into law?

2023
IIR to come into effect?

2024
UTPR to come into effect?

OVERVIEW

BEPS 2.0

PILLLAR ONE

- Scope: Groups with > Euro 20bn revenue and profitability before tax of at least 10%
- Allocate profits to market jurisdictions irrespective of any physical presence in those jurisdictions

PILLAR TWO

- Scope: Groups with annual consolidated group revenue > Euro 750m in at least two of the four immediately preceding fiscal years
- Excluded entities: investment funds/real estate investment vehicles that are ultimate parent entities (UPE)
- Pension funds, government entities, international organizations and non-profit organizations
- Country de minimis exclusion: < Euro 10m revenue and < Euro 1m profit in a country

PILLAR 2

Allocation of tax

GLOBE: INCOME INCLUSION RULE (IIR)

- Primary rule: A Top-Up Tax is imposed at the level of the ultimate parent entity (UPE) or intermediate parent entity for low-taxed profits
- Minimum ETR: 15%

GLOBE: UNDERTAXED PAYMENT RULE (UTPR)

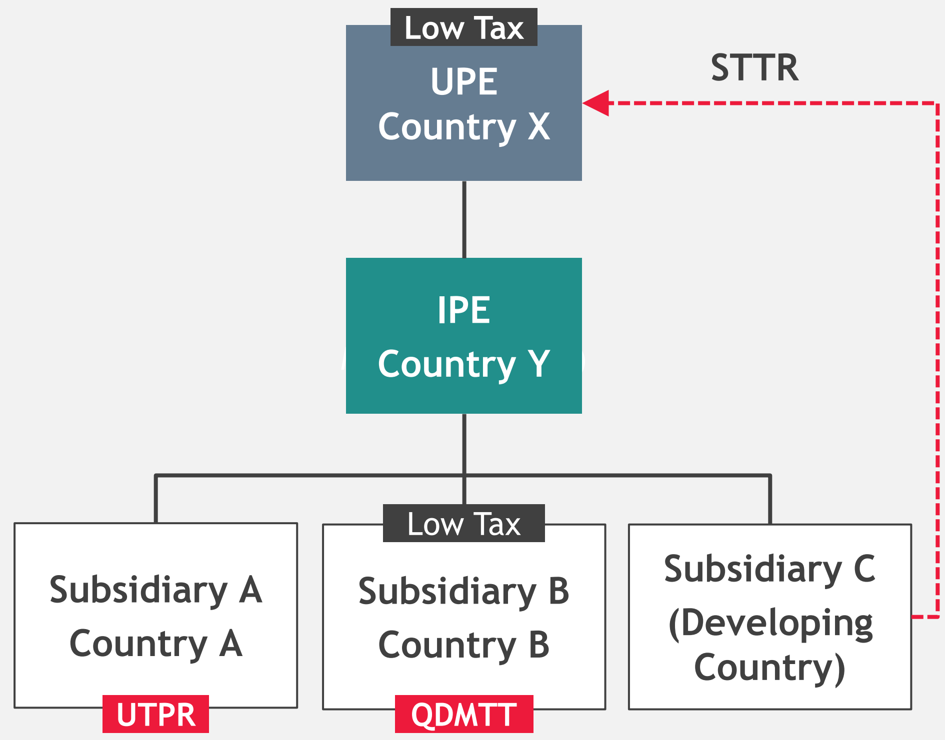
- Backstop to IIR – applies if no IIR imposed
- Top-Up Tax is allocated to countries with constituent entities based on employees and tangible assets.
- Imposed by denying deductions or requiring equivalent adjustment
- Minimum ETR: 15%

SUBJECT TO TAX RULE

- Applies before GloBE Rules
- Treaty based rule taxing related party payments that are subject to tax below the minimum rate
- Applies to interest, royalties and other defined payments
- Minimum nominal rate: 9%

GLOBE: QUALIFIED DOMESTIC MINIMUM TOP-UP TAX (QDMTT)

- Applies before IIR and UTPR
- Top-Up Tax is assessed by low-tax jurisdiction itself under a computation consistent with Pillar 2 Top-Up Tax computation
- Minimum ETR: 15%



PILLAR 2

Key Observations

- Covered Taxes may not match income taxes for financial statement purposes
- Treatment of temporary differences in calculating Accounting Income is different to Acceptable Financial Accounting Standards
- Several elections available in determining GloBE income
  - Share-based compensation
  - Determining gains or losses using realization principle or impairment accounting
- Interaction with U.S. tax reform
- Significant compliance burden for organizations – safe harbors?

Final FTC Regulations

Overview

- On December 28, 2021, the Treasury released final foreign tax credit ("FTC") regulations ("2021 final regulations") related to certain parts of the prior released proposed FTC regulations (issued in November 2020).
- While the areas addressed in the 2021 FTC regulations generally follow the 2020 proposed regulations, there are several significant changes in comparison.

The 2021 final regulations address the following topics

- FTC or deduction disallowance under IRC Section 245A
- Allocation and apportionment of foreign income taxes and interest expense under IRC Section 861, including CFC netting rule
- Allocation and apportionment of IRC Section 818(f) expenses of life insurance companies
- Creditability of foreign taxes under IRC Sections 901 and 903
- Foreign taxes considered paid and noncompulsory payments
- Foreign branch category rules and definition of financial services entity for purposes of IRC Section 904
- FTC timing rules under IRC Sections 901 and 905
- Impact of the repeal of Section 902 on the regulations under Section 367(b)
- Sourcing of Subpart F inclusions, GILTI inclusions, and qualified electing-fund inclusions under the passive foreign investment company rules
- Allocation of foreign income tax liabilities in connection with certain mid-year ownership transfers and reorganizations
- Electronically supplied services and oil and gas extraction income under IRC Section 250

FTC or Deduction Disallowance Under IRC Section 245A

The 2021 final regulations overhaul the 2020 proposed regulations regarding section 245A to deny an FTC or deduction for certain foreign income taxes paid or accrued by domestic corporations, successors, and foreign corporations.

Domestic Corporations
Taxes paid are disallowed if…
Attributable to section 245A income

Sucessors
Taxes paid are disallowed if…
Attributable to section 245A income

Foreign Corporations
Taxes paid are disallowed if…
Attributable to section 245A income or non-inclusion income

FTC or Deduction Disallowance Under IRC Section 245A

<table>
<tr><th colspan="3">Section 245A(d) Income</th></tr>
<tr><th>Domestic Corporations</th><th>Successor Corporations</th><th>Foreign Corporations</th></tr>
<tr><td>Dividends</td><td rowspan="5">A distribution of section 245A(d) PTEP</td><td>An item of subpart F income that gives rise to an inclusion where a 245A(a) deduction is allowed</td></tr>
<tr><td>Section 951(a)(1)(A) inclusions where a 245A(a) deduction is allowed</td><td>A tiered hybrid dividend</td></tr>
<tr><td>Distribution of section 245A(d) PTEP</td><td rowspan="3">A distribution of section 245A(d) PTEP</td></tr>
<tr><td>Hybrid dividends</td></tr>
<tr><td>Subpart F inclusions for tiered hybrid dividends</td></tr>
</table>

Non-inclusion Income
Foreign Corporations (income other than…)
Subpart F
Tested income
Items of income constituting post-1986 undistributed U.S. earnings

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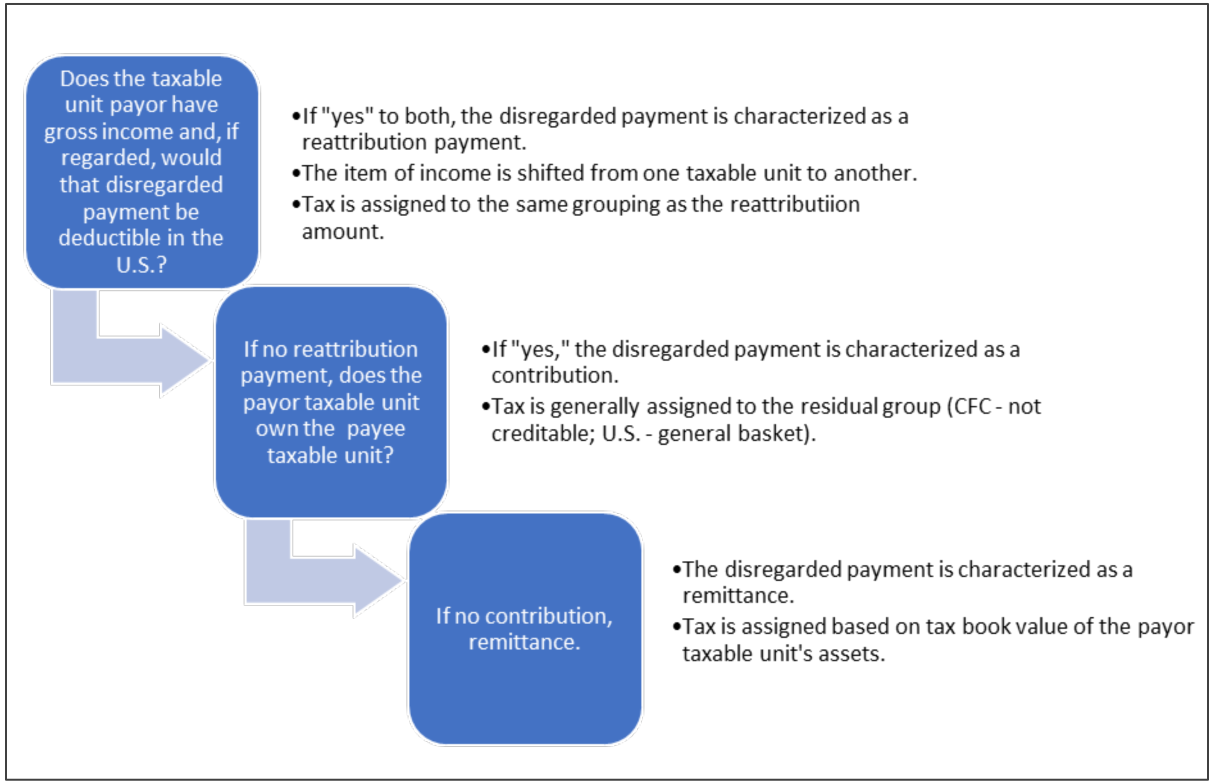
Allocation and Apportionment of Foreign Taxes Under IRC Section 861

The 2021 final regulations also finalized new guidance regarding the allocation and apportionment of foreign income taxes with respect to disregarded payments between taxable units.

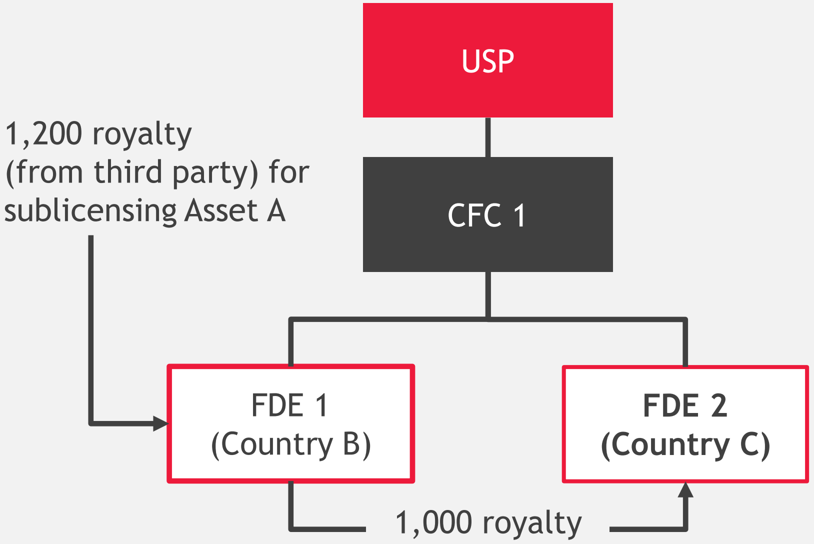
- “Taxable units,” as defined in the 2021 final regulations, include:
  - Foreign branches;
  - Foreign branch owners; and
  - Non-branch taxable units (such as foreign disregarded entities that don’t give rise to branches for U.S. tax purposes).
- When the taxpayer is a foreign corporation, the rules apply to disregarded payments made between taxable units that are tested units (as defined in section 1.951A-2) of the same taxpayer.



Allocation and Apportionment of Foreign Taxes Under IRC Section 861

EXAMPLES

Example 12: Disregarded payment that is a reattribution payment



FDE 1

- 20% foreign tax imposed

FDE 2

- 15% foreign tax imposed
- Owns intangible property (Asset A) with a tax book value of 12,000x

FACTS

- The payment to FDE 2 is disregarded; however, the amount would be deductible if regarded.
- Country B net income and foreign taxes.
  - 1,200 – 1,000 = 200 (net income).
  - 200 x 20% = 40 (foreign taxes).
- Country C net income and foreign taxes.
  - 1,000 (net income).
  - 1,000 x 15% = 150 (foreign taxes).

ANALYSIS

- FDE 1 has gross income of 1,200, and the 1,000 royalty payment to FDE 2 would generally be deductible if regarded for U.S. tax purposes.
  - As a result, the 1,000 is characterized as a reattribution payment.
- The 1,200 royalty is assigned to the FDE 1 income group without regard to the reattribution payment.
  - Therefore, the 40 of foreign income tax is allocated to the FDE 1 income group.
- The 1,000 reattribution payment is "shifted" from FDE 1 to FDE 2's income group.
  - Therefore, the 150 of foreign income tax is allocated to the FDE 2 income group.

Assumptions:

1. Country B and C taxes imposed are foreign income taxes and separate levies for U.S. tax purposes.
2. All foreign entities are tested units.
3. All income would qualify for Subpart F exceptions, if applicable.
4. No apportionment is required, as the foreign gross income is allocated to a single statutory grouping.

Creditability of Foreign Taxes Under IRC Sections 901 and 903

- Section 901 allows a credit for, among others, income taxes paid to a foreign country, while section 903 provides that "income taxes" also includes taxes paid in lieu of an income tax.
- A foreign levy is a foreign income tax only if it meets the following:
  - It is a foreign tax; and
  - It is a (1) net income tax or (2) is a tax in lieu of an income tax.
- As part of determining whether a foreign tax is a net income tax, the foreign tax must meet the net gain requirement under previous regulations, which historically set forth three requirements: (1) realization; (2) gross receipts; and (3) net income.
  - Given the complexity in applying these tests, the 2020 proposed regulations provided guidance that the determination of whether a foreign tax satisfies the net gain requirement would be based on whether the terms of the foreign tax laws governing computation of the tax base meet the three requirements.

Allocation and Apportionment of Foreign Taxes Under IRC Section 861

The 2021 final regulations mostly follow the 2020 proposed regulations for allocating and apportioning foreign income taxes related to the following:

Disposition of Stock

- First assigned to the same statutory or residual grouping as the U.S. dividend, if applicable.
- Any excess is assigned to the same statutory or residual grouping as the US capital gain amount, if any.
- Finally, any excess is assigned to the same statutory or residual grouping as the earnings under the tax book value of the stock under the asset method.

Disposition of Partnership Interests

- First assigned to the same statutory or residual grouping as the U.S. capital gain amount, if any.
- Any excess is assigned to the same statutory or residual grouping as the distributive share of income of the partnership if such amount were recognized for U.S. tax purposes.

Distributions by Partnerships

- First assigned to the same statutory or residual grouping as the U.S. capital gain amount, if any.
- Any excess is assigned to the same statutory or residual grouping as the distributive share of income of the partnership if such amount were recognized for U.S. tax purposes.

Creditability of Foreign Taxes Under IRC Section 901

- As part of the 2021 final regulations, the “attribution requirement” was incorporated into the existing net gain requirement.
  - The net gain requirement under the 2021 final regulations now includes the following four requirements: (1) realization; (2) gross receipts (with some minor changes); (3) cost recovery (which replaced net income and removed the predominant character test); and (4) the new attribution requirement
- Under the attribution requirement, a foreign tax generally will not be creditable unless the foreign tax law requires sufficient nexus between the country and the taxpayer’s activities.
  - The standard for whether sufficient nexus exists depends on what type of income the tax is being imposed on and whether the tax is being imposed by the local country on a resident or a nonresident.

Residents	Nonresidents		
Arm's length	**Activities**	**Sourcing**	**Property**
•Requires that profit allocation rules in the foreign jurisdiction be consistent with arm's length transfer pricing principles •This new standard may result in foreign taxes generated in jurisdictions that don't follow arm's length transfer pricing principles not being creditable in the U.S., such as tax generated in Brazil	•Applies to income generated, under reasonable principles, as a result of a nonresident's activities in the foreign jurisdiction •Similar to the U.S. rules for effectively connected income (ECI) under section 864(c)	•Applies to income where source-based rules apply, such as services or royalties •Sourcing rules in the foreign jurisdiction must be reasonably similar to those of the U.S. (e.g. service income sourced based on where the services are performed, royalty income sourced based on where the IP is used, etc.) •When foreign law and U.S. law characterize gross income or gross receipts differently, foreign law characterization will generally govern	•Applies to gains generated from sales or dispositions of real property located in the jurisdiction under rules similar to the U.S. Foreign Real Property Tax Act (FIRPTA) •Also applies to business property that creates a taxable presence in the jurisdiction similar to the U.S. rules for ECI under section 864(c)

Thank You

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Appendix

BDO Service Offerings

Review and Design Audit Program

- Provide specific guidelines
- Review due diligence
- Prepare and identify testing parameters
- Supply instruction

On-site/Virtual Audit Coordination

- Provide guidelines
- On-site interviews
- Virtual conferences
- Continuous communication with client during audit

Establish Internal Compliance Procedure

- Implementing an internal process to prevent sourcing products from high-risk areas/countries involving any forced labor issues
- Drafting a written internal customs compliance document

Success Story

BDO worked with a client purchasing certain cotton yarns and greige fabrics from factories in XUAR region. BDO partnered with a prominent Chinese law firm to design and execute an “on the ground” audit for the client. BDO and the law firm conducted:

1. On-site review of the factory and working conditions, including dormitories where selected workers chose to live;
2. Assessment of the internal controls/documents to support full traceability of the origin of the cotton used in the production of the yarns/fabrics; and
3. Interviews with management and workers to gauge whether any of the 11 ILO forced labor indicators were present during the normal course of the factories’ daily operations.

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Success Story

(CONT.)

- To confirm whether the producer's documentation was sufficient to support the provenance of its product and the raw materials used in connection with the related upstream production processes, BDO also reviewed the following:
  - Affidavit from yarn producer and source(s) of raw cotton that identifies where the raw cotton was sourced;
  - Purchase Order, Invoice, and Proof of Payment for yarn and raw cotton materials used;
  - List of production steps and production record for the yarn (including specific records of the cotton grower);
  - Transportation documents evidencing the shipment between the cotton grower and the yarn maker;
  - Documents detailing employee timecards, wage payment receipts, and daily process reports; and
  - Any forensic testing report to identify the origin of cotton, if available.
- **Result:** The imported merchandise was not subject to the WRO on cotton products from XUAR.

Approach

Below is an outline of the approach to calculate the impact of Pillar 2

1 Scope

- Identify the Ultimate Parent Entity (UPE)
- Identify relevant Constituent Entities (CE) (including branches) within the Group

2 GloBe Income

- Determine the GloBE Income or Loss for each CE
  1. Determine financial accounting income or loss
  2. Adjusting financial accounting net income or loss to GloBE Base

3 Covered Taxes

- Determine taxes attributable to Income of each CE
  1. Identifying Covered Taxes
  2. Adjusting Covered Taxes for temporary differences and losses

4 ETR and Top-Up Tax

- Calculate the ETR of all CE located in the same jurisdiction
- Determine Top-Up Tax

5 IIR and UTPR

- Determine and allocate IIR to UPE, IPE or POPE
- Where relevant determine and allocate UTPR to CE (excluding Investment Entities

PILLAR 2

Key Actions

Monitor Implementation Status

Monitor developments over next few months:

- GILTI interaction with global rules
- EU ECOFIN meeting 24 May
- UK consultation process
- U.S. legislative developments
- Introduction of Qualified Domestic Minimum Top-Up Tax – Switzerland, UAE, Hong Kong, UK

1. Impact Assessment

- Identify low-taxed profits
- Assess potential Top-Up Tax impact (U.S. Parent vs IPE/UTPR)
- Evaluate impact to compliance and reporting
- Assess restructuring options, in particular in light of other tax developments (e.g., ATAD 3) – entity rationalization?

2. Restructuring

- Identify need for remedial action in next 12-18 months
  - Entity rationalization/ simplification
  - Operating structure/ supply chain redesign

3. Compliance road map

- Assess impact to financial statement reporting and compliance and design road map to implement plan for Pillar Two compliance

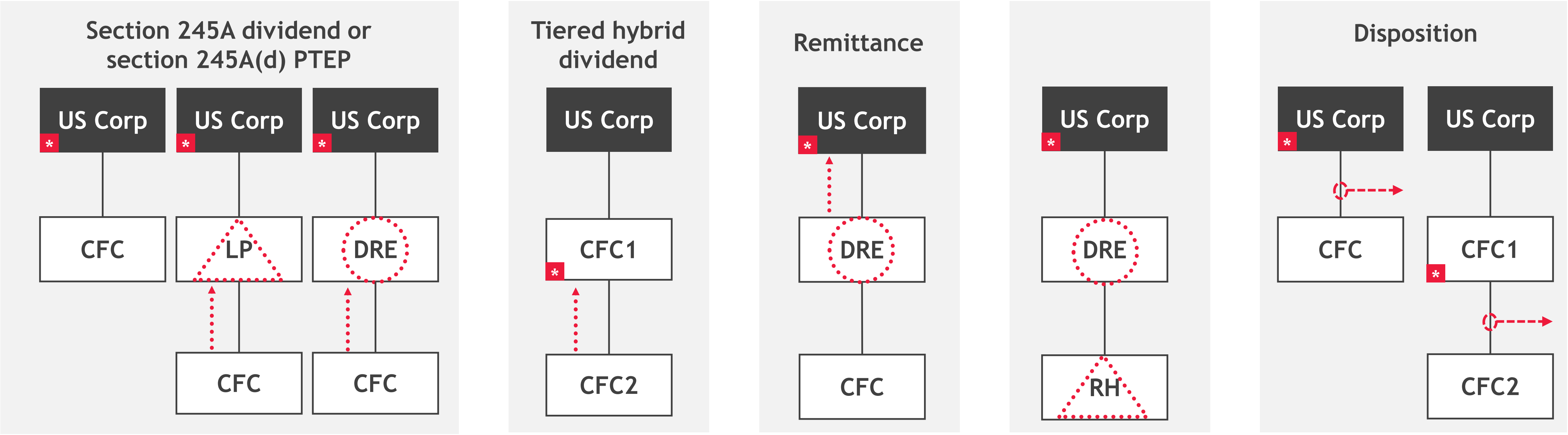
Communication with stakeholders

- Develop communication strategy to Board and other stakeholders
- Assess cadence for ongoing updates to appropriate stakeholders

1.245A(d)

EXAMPLES

- Section 245A(d) generally denies a deduction or a FTC for foreign taxes paid or accrued on dividends for which a Section 245A deduction is allowed
- Final regulations apply retroactively to tax years beginning on or after 12/31 19 and ending on or after 11/2/2020

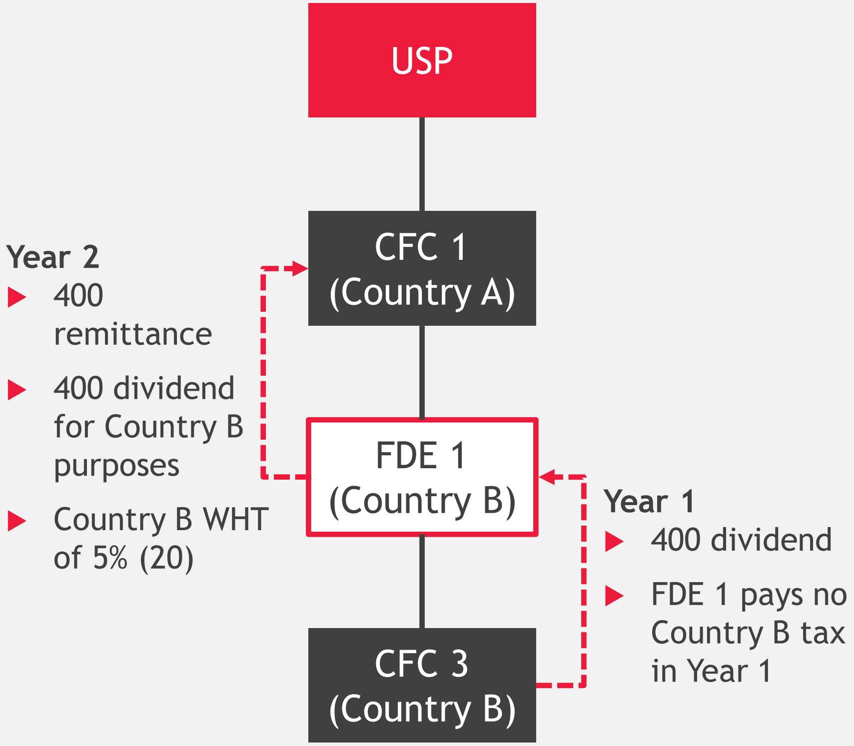


* Technical taxpayer

Allocation and Apportionment of Foreign Taxes Under IRC Section 861

EXAMPLES

Example 11: Disregarded payment as a remittance



FACTS

- Year 1:
  - 400 dividend payment to FDE 1.
  - No Country B tax.
- Year 2:
  - 400 remittance to CFC 1 (dividend in Country B).
  - 20 in foreign WHT assessed on the dividend.
- The 400 remittance from FDE 1 to CFC 1 is disregarded.
- For U.S. tax purposes, in Year 2, the stock of CFC 3 owned by FDE has a tax book value of 1,000 (750 assigned to the general category tested income group and 250 assigned to the passive category FPHCI group).

ANALYSIS

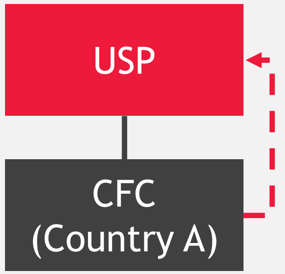
- The 400 remittance in Year 2 is assigned ratably to the statutory and residual groupings under the asset method as follows:
  - 300 (400 x 750/1000) deemed made from the general category tested income of the FDE tested unit.
  - 100 (400 x 250/1000) of the remittance is deemed made from the passive category FPHCI of the FDE tested unit.
- Accordingly, the 20 of WHT is apportioned as follows:
  - 15 (20 x 300/400) apportioned to the CFC 1 tested unit's general category tested income group.
  - 5 (20 x 100/400) apportioned to the CFC 1 tested unit's passive category FPHCI income group.

Assumptions:
1. Country B taxes imposed are foreign income taxes and separate levies for U.S. tax purposes.
2. All foreign entities are tested units.
3. All income would qualify for Subpart F exceptions, if applicable.

Creditability of Foreign Taxes Under IRC Section 901

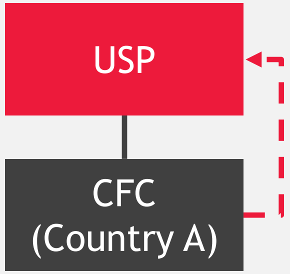
Some taxes potentially impacted by the attribution requirement:

- Digital services taxes.
- WHT and other taxes imposed on services performed outside the country imposing the tax and royalties not based on a sourcing rule similar to the U.S. rule.
- Taxes imposed by jurisdictions that do not follow the arm’s length principle (such as Brazil).
- Certain Puerto Rican excise and income taxes.
- Nonresident capital gain taxes imposed on stock sales.



Example 1

- 100 payment for services performed by USP in the U.S.
- Country A imposes a 10% WHT regardless of where services are performed.
- As a result of the services being performed in the U.S., the services would generally be U.S. source for U.S. tax purposes.
- Because Country A does not source the services based on where the services are performed (source-based nexus), the 10 WHT paid in Country A is not creditable.



Example 2

- 100 royalty for use of IP in Country A.
- Country A imposes a 10% WHT regardless of where the IP is used.
- As a result of the IP being used in Country A, the WHT would generally be foreign source for U.S. tax purposes.
- Because Country A’s rule to tax the royalty is not based on where the IP is used, the 10 of WHT paid in Country A is not creditable.

Creditability of Foreign Taxes Under IRC Section 903

- An in "lieu of tax" under IRC Section 903 was generally creditable if it met the substitution test.
- As part of the 2021 final regulations, such amount will only be creditable if it meets the revised substitution test or is a covered withholding tax.

Revised Substitution Test

- Foreign country generally imposes a net income tax;
- No net income tax is imposed on the same base as the tested foreign tax ("excluded income");
- Income tax would be otherwise imposed on the excluded income "but for" the existence of the tested foreign tax; and
- The tax imposed also meets the new attribution requirement.

Covered WHT Test

- Foreign country generally imposes a net income tax;
- The WHT imposed must be gross basis that is imposed on nonresidents;
- The WHT cannot be in addition to a net income tax imposed by the foreign country on any portion of the same income (no duplication); and
- The WHT must also meet the source-based attribution requirement.