The US Tax Cuts and Jobs Act of 2017

What Tax Professionals In Israel US Should Know

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Theme – Act Increases Complexity

- Corporate tax rate reduced
- There are several new regimes that are more complicated than the regimes they replace
- Trying to estimate the precise US tax cost of an investment will be more difficult
- Changes will undoubtedly be made over time but hard to predict what changes will be made

C Corporation Taxation

- Corporate tax rates reduced from 35% to 21% flat rate
- No difference in rates between capital gains and ordinary income
- On ordinary income, corporate rate is now below the current maximum rate imposed on individuals
  - This has not been the case in the US since 1986
- Limitations on deductions that “strip” US earnings

Interest Deductibility Limitations

- No changes to investment interest deductions
- For active business (regardless of form), deduction for business interest is limited to: Business interest income + 30% of adjusted taxable income
- Certain businesses are excluded from the limitation:
  - Businesses with average gross receipts of $25 million or less.
  - Certain real property trades or businesses that elect out.
  - Cost of opt out election is use of ADS depreciation (30 years residential and 40 years commercial)

Transition Tax

- **New Section 965**. To prevent permanent tax forgiveness of pre-2018 active business earnings, all U.S. shareholders of a "specified foreign corporation" (SFC) have a mandatory deemed subpart F inclusion of accumulated post-1986 deferred foreign business income for the last taxable year of the SFC that begins before January 1, 2018 to be included in the U.S. shareholder's tax year in which or with which such foreign corporation's tax year ends.
- Measured as of November 2, 2017 or December 31, 2017, whichever amount is higher
- Tax rate on income: 15.5% rate equivalent percentage on cash or other specified assets; 8% rate equivalent percentage on remainder; election to pay over 8 years (during each of the first five years, 8% of the transition tax liability paid, with 15% paid in year six, 20% in year seven, and 25% in year eight).
- S corporations, REITS and certain trusts have additional timing opportunities.

CFC Changes

- US Shareholder taxed based on vote or value
  - Formerly could have low voting, high value shares
- No “30 day rule” for corporation becoming CFC
  - Formerly liquidation within 29 days of US ownership avoided taxation of Subpart F Income
- Inbound attribution from Non-US shareholders to trusts, estates, partnerships and corporations
  - “Accidental” CFCs from US asset planning and “Generous Grandparent”

Changes to Definition of Controlled Foreign Corporation and US Shareholder

BACKGROUND

- A United States Shareholder of a controlled foreign corporation (CFC) is required to include in gross income his pro rata share of the corporation's subpart F income

OLD RULE

- A CFC was defined as any foreign corporation if more than 50% of the total combined vote or value of all shares was owned by US Shareholders.
- Under prior law, a "US Shareholder" was defined as a US person who owns including certain attribution rules) 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such foreign corporation.

NEW RULE

- **The definition of a US Shareholder is expanded to included a US person that owns 10% of more of a foreign corporation, as measured by vote or value.**
- **The requirement that a CFC be a CFC for an uninterrupted period of 30 days in a tax year before subpart F income inclusions apply has been removed.**
- **As of January 1, 2018, US Shareholders of a CFC may have income tax and reporting exposure even if the CFC was only a CFC for 1 day.**
- **This exception was previously relied on by foreign persons holding US securities through a foreign corporation to obtain certain estate tax benefits, particularly where the foreign corporation shares passed to US children upon death. Following the change to the definition of a CFC, this type of planning will be less effective.**

Change to Attribution Rules

OLD RULE

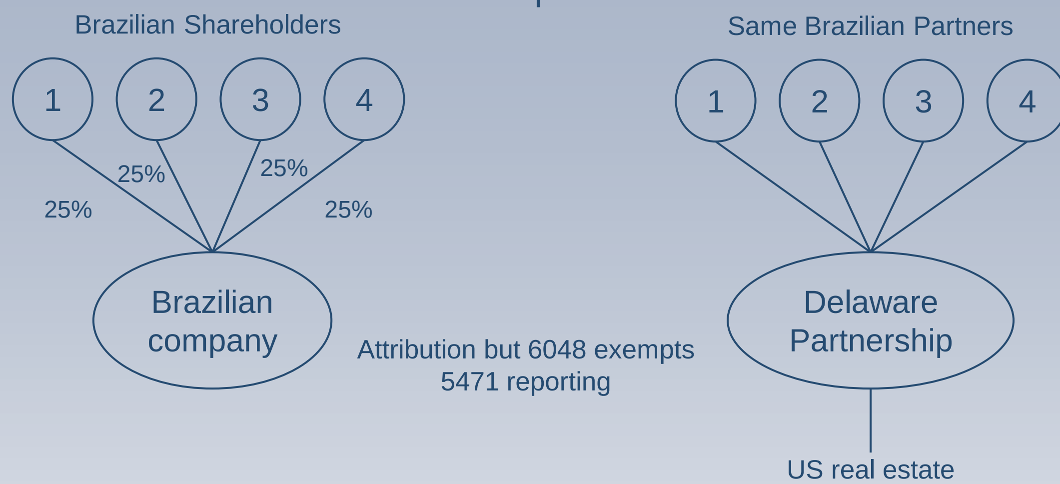
- Section 958 provided certain attribution rules that applied for purposes of determining whether a US person is a "US Shareholder" and whether a foreign corporation is a controlled foreign corporation (such that subpart F income inclusions may apply).
- The attribution rules generally provide that a trust, estate, partnership is considering owning the stock owned by its beneficiaries or partners, as applicable, and that a corporation is considered to own the stock owned by any person owning 50% or more of its stock.
- The rules previously provided that stock owned by a non-US person would not be attributed up to the trust, estate, partnership or corporation.

NEW RULE

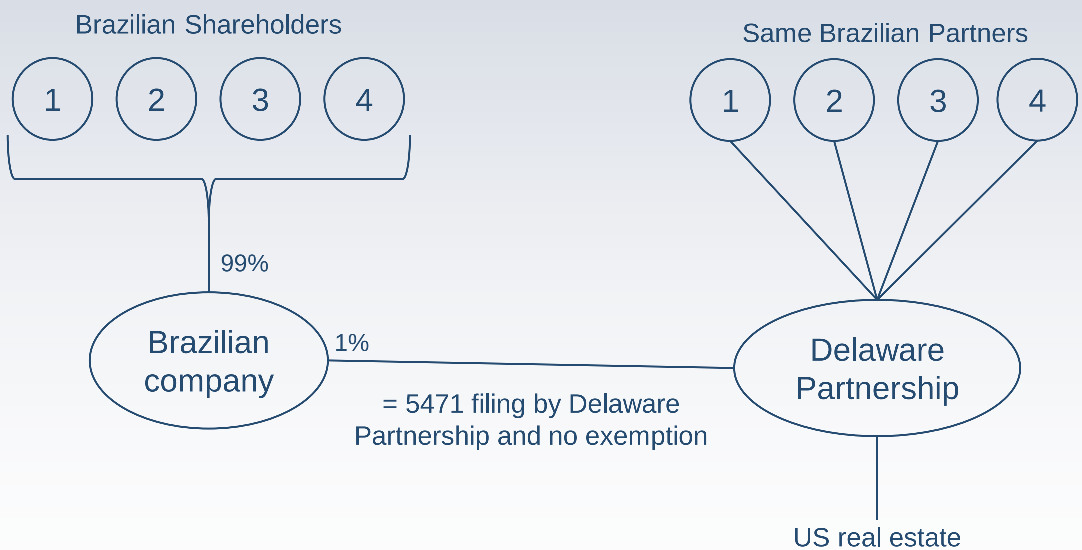
- **This limitation that stock owned by a non-US person would not be attributed up to the partnership, estate, or trust or which the individual was a partner or beneficiary, as applicable, has been removed beginning January 1, 2018.**
- **Now, for example, stock owned by a non-US beneficiary of a US trust could be attributed up to the US trust, so as to make the trust a US Shareholder of a controlled foreign corporation, depending on the percentage of stock owned.**
- **This may cause foreign corporations that were not previously treated as CFCs to be CFCs going forward.**

Downward Attribution

Example 1



Example 2



Reporting Regimes

- FATCA remains in effect and unchanged
- US remains outside CRS regime

Questions?

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