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ADVISING FAMILIES ACROSS GENERATIONS

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The New GILTI Regulations Planning and Compliance Issues:

- High Tax Exclusion
- Partners in Domestic Partnerships Owning Foreign Corporations
- 2018 Compliance Issues

Panelists

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Agenda

- Treasury's View of New International Tax System (§§ GILTI/Subpart F/245A)
- Summary overview of New International Tax System – CFCs owned by corporate and non-corporate U.S. Shareholders
- GILTI Planning for Individuals and Family Offices
- New Rules:
  - GILTI High Tax Exclusion (HTE)
  - Partners in Domestic Partnerships Owing Foreign Corporations and Impact under Subpart F and GILTI
    - Compliance Issues
- Q&A

Background
Definitions: U.S. Shareholder & CFC

U.S. Shareholder

- A U.S. person who owns directly, indirectly or constructively 10% or more of the total combined voting power or value of all classes of stock entitled to vote
  - U.S. person. An individual, a domestic corporation ("C" or "S"), a U.S. partnership, a U.S. trust or a U.S. estate
- TCJA changed U.S. Shareholder definition :
  - *2017*. 10% or more of vote
  - *2018 and forward*. 10% or more of vote or value

Controlled Foreign Corporation (CFC)

- Any foreign corporation in which more than 50% of the *total combined voting power* of all classes of stock entitled to vote is owned directly, indirectly, or constructively by U.S. Shareholders on any day during the taxable year of such foreign corporation ***or*** more than 50% of the *total value* of the stock is owned directly, indirectly, or constructively by U.S. shareholders on any day during the taxable year of the corporation
- "30" day rule repealed

Background
New International Tax Regime

- **Subpart F Regime**
  - U.S. Shareholders subject to current U.S. income tax on a CFC's Subpart F when earned
  - Regime applies to passive and highly mobile income
  - Subpart F income determined by reference to a CFC's E&P
- **GILTI**
  - A base protection/minimum tax provision to prevent taxpayers from allocating mobile income from intangibles to CFCs to avoid U.S. corporate tax through participation exemption and to establish a minimum tax rate for "tested income"
  - GILTI determined by reference to taxable income, based on U.S. tax rules
  - U.S. shareholders subject to current taxation on active (intangible) income earned by a CFC akin to Subpart F
  - Active income equated to intangible income determined on an aggregate basis at the U.S. shareholder level, based on a formulaic approach under which a "normal return" equal to 10% of the basis of certain tangible assets is calculated and then each dollar of income above the "normal" return is effectively treated as intangible income, irrespective of whether the income is actually attributable to intangible income
  - CFC's corporate (but not non-corporate) U.S. shareholders subject to current U.S. tax on CFC's income in excess of CFC's normal return, potentially at a reduced rate through the Section 250 50% deduction
- **Exempt Income**
  - Income not taxed under Subpart F income or GILTI; this type of income not taxed upon distribution to corporate (but not non-corporate) U.S. shareholders under new limited territorial system

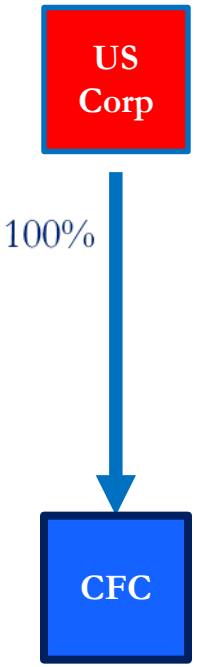
Treasury's View of Coherence of New International Tax System

*The transition tax, the Subpart F and GILTI regimes, and the participation exemption under section 245A together form a comprehensive and closely integrated set of tax rules with respect to the earnings of foreign corporations with requisite levels of U.S. ownership. These related provisions must be read and interpreted together in order to ensure that each provision functions as part of a coherent whole, as intended. Although the section 245A deduction is generally available for untaxed foreign-source earnings, read collectively this integrated set of statutory rules can be reasonably understood to require that the deduction not apply to earnings and profits attributable to income of a type that is properly subject to the Subpart F or GILTI regimes, which address base erosion-type income. ****

The statutory text of the participation exemption system under section 245A, the GILTI regime, the Subpart F regime, and the PTEP rules collectively operate as a comprehensive framework with respect to a CFC's foreign earnings after the application of the transition tax under section 965. A central feature of this regime is that income derived by CFCs is eligible for the section 245A deduction only if the earnings being distributed have not been first subject to the subpart F or GILTI regimes.

Preamble to Temporary Section 245A Regulations

CFC: Corporate U.S. Shareholder Taxation Foreign Source Active Income



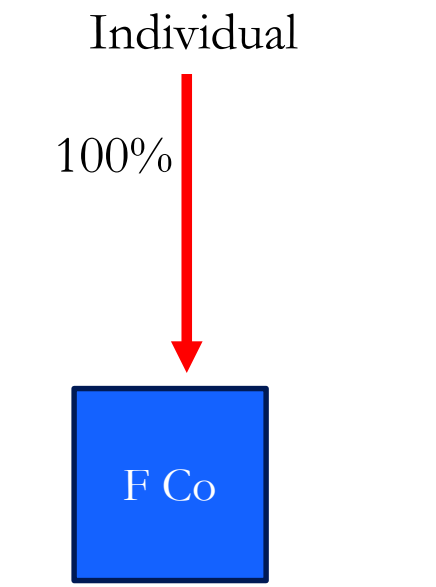
Immediate Tax, FTCs

- Subpart F Income taxed @ 21%, w/ 100% FTC use, carryback/carryforward
- GILTI (tested income) taxed @ 21% rate, 50% deduction (*e.g.*, 10.5%), 80% FTC use, separate FTC basket, no carryback/carryforward
  - FTCs for PTEP upon distribution
- Gain on amounts in excess of retained tax-deferred earnings on sale of CFC stock taxed

Exempt Income –No Tax, no FTCs

- NDTIR (10% return on QBAI over Specified Interest)
- Subpart F High Tax Exclusion Income
- CFC dividends
- FOGEI
- GILTI HTE, if elected (*prospective*)
- Investments in US Property (generally)
- PTEP
- Gain on tax-deferred retained earnings on sale of CFC stock
- **Exceptions**:
  - Hybrid Dividends, @ 21%, no FTCs
  - Section 245A anti-abuse:
    - Transition Dispositions E&P @ 10.50%, no FTCs
    - Ownership Changes E&P taxed @ 21%, no FTCs
      - Includes § 954(b)(6)

CFC: Individual U.S. Shareholder Taxation Foreign Source Active Income

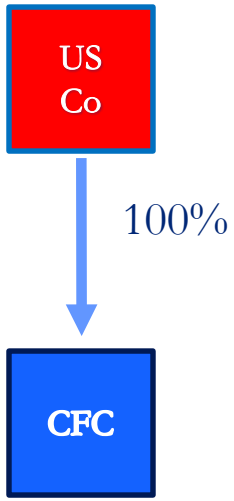


GILTI eliminates U.S. tax deferral generally

- Limited Territoriality Participation Exemption --none
- Immediate Taxation:
  - Subpart F income & § 956:
    - @ 37% rate
    - No indirect FTCs (but reduce E&P) (unless § 962 election, discussed *infra)*
    - Direct FTCs, if any *(e.g.*, W/H taxes)
    - 3.8% NIIT upon repatriation
  - GILTI:
    - @ 37% rate
    - No deduction (but reduce E&P) (unless § 962 election, discussed *infra)*
    - No indirect FTC (but reduce E&P) (unless § 962 election, discussed *infra)*
    - Direct FTCs, if any (*e.g.,* W/H upon repatriation of PTEP; query whether 80% FTC limitation applies?)
    - 3.8% NIIT upon repatriation (but no FTC offset)
  - Remaining Income (primarily, QBAI, Subpart F high-taxed income, GILTI HTE, prospective application)
    - Taxed upon repatriation @ 20% if treaty protected
    - Taxed upon repatriation @ 37 % if non-treaty protected
    - Direct FTCs allowed
    - 3.8% NIIT, generally upon repatriation (but no FTC offset)

What is GILTI -- Overview

- Application: CFCs/**all** U.S. Shareholders
- Consequence: Immediate taxation of most non-Subpart F income
- **U.S. Corp. Shareholder:**
  - Special corporate level deduction
  - 80% deemed paid FTCs
  - Taxable income limitation
- **Individual or non-corporation U.S. Shareholder taxed @ 37% rate**
  - No GILTI deduction or indirect FTCs (assuming no § 962 election)



U.S. Shareholder	Pre- 2026	Post-2025
GILTI deduction rate	50% x 21% tax rate	37.5% x 21% tax rate
US Tax Rate on GILTI	10.5%	13.125%
Foreign ETR above which no residual U.S. tax owed*	10.5% / 80% = **13.125%**	13.125% / 80% = **16.406%**

*Computation: Assumes (unrealistically) no U.S. Shareholder level expenses allocable to GILTI and U.S. Shareholder eligible to claim full GILTI deduction

GILTI Taxation
Individual v. Corporate Tax Rates

Assumptions: Gross Income $100 | Foreign Tax Rate 13.125 | No Deductions |No QBAI
No taxable income limitation | No § 962 Election by Individual

Corporate

- GILTI: $100
  - (86.875 (Tested Income + 13.125 (FTC) =$100
  - 50% Deduction
    ($50 x 21%)
  - U.S. tax: 0
    (80% of 13.125 = 10.50)
  - **ETR:** 13.125% (before repatriation)

Individual

- GILTI: 86.875
  - ($100 Tested Income minus 13.125 local corporate tax)
  - No deduction
  - No deemed-paid FTC
- U.S. tax: $ **32.14**
- **ETR:** 45.265% (*i.e. $ 32.14 + $13.125* before repatriation)

GILTI Planning For Individuals

- Interpose U.S. corporation between CFC and Individual
- Section 962 Election
- "Check-the-box" of CFC
- Subpart F planning
- *GILTI High Tax Exclusion (HTE) – Prospective only*
- *Investment in CFC through domestic partnership*

Interpose U.S. Corporation

Benefits

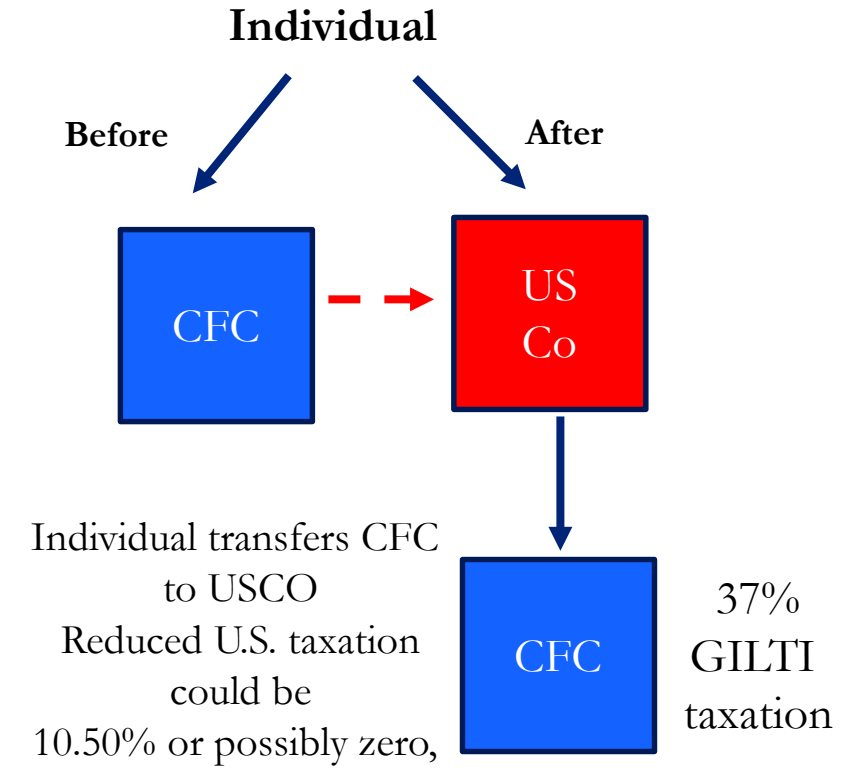
- 21% corporate tax rate
- GILTI:
  - Benefit from GILTI deduction (subject to taxable income limitation)
  - Benefit from 80% deemed-paid FTCs

Detriments

- Double taxation
- Anti-Abuse Rules
  - AET
  - PHC
- State Taxation

Traps

- Section 965 "acceleration event"
  - Transfer agreement/filed within 30 days
- When to distribute PTE, before or after transfer)?
- 3.8% NIIT



Section 962 Election

Election

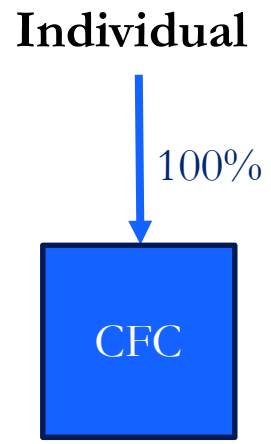
- Individual U.S. Shareholders of a CFC taxed on Subpart F or GILTI at corporate tax rates to benefit from 50% deduction and deemed paid FTCs

Benefits:

- Annual election
- No restructuring
- Less complicated
- Inclusion taxed @ 21% corporate rate
- GILTI deduction
- Use of 80% deemed paid FTCs
- AET and PHC rules don't apply
- No need to repatriate PTEP
- Corporate anti-abuse rules don't apply
- Provides much flexibility

Detriments:

- Double Tax (on amount distributed in excess of U.S. corporate tax paid)
  - When distributed, non-treaty E&P, taxed @ 37% rate +3.8 NIIT
  - When distributed, treaty E&P, taxed @ 20% + 3.8% NIIT
- NOLs excluded
- Election applies to all CFCs with respect to which U.S. Shareholder has an inclusion
- Can't be used to come within § 245A reduction of § 956 inclusion



Elect to be treated as C corporation

Check-the-Box Planning (CTB)

What is it?

- Treats "eligible" entities as transparent ***solely*** for U.S. Federal income tax purposes

Benefits:

- Useful if CFC subject to high rate of local corporate and/or W/H tax
- Avoids Subpart F and GILTI
  - Under GILTI: no FTC carrybacks/carryforwards
- Now, consider benefits/detriments of of proposed GILTI HTE?

Detriments:

- Consider consequences resulting from making the election:
  - Taxable liquidation for U.S. tax purposes
  - Possible "acceleration" event under Transition Tax
  - If U.S. income, potential mismatch of tax credits (foreign country may not allow FTC paid by individual)
  - Potential self-employment tax exposure
  - Upon CTB
    - Subpart F income
    - GILTI
  - After, when owned by U.S. Individual:
    - New branch FTC basket limitation
    - Potential passive basket limitation
    - Anti-hybridity deduction rule
    - Dual consolidated losses
- Effective date of election

Subpart F Planning

Subpart F

- ***Rewire brain*** – structure to generate Subpart F income, rather than GILTI
- Although full income inclusion, obtain full use of general basket FTC, subject to expense allocation
- *Compare* 80% FTC for GILTI, separate GILTI FTC basket, no GILTI FTC carry back or carry over

Subpart F

High Tax Exception

- Under TCJA, Subpart F high tax exclusion can be elected if foreign **ETR** is >18.9% (*i.e.*, 90% of U.S. 21% corporate rate)
- If circumstances warrant, it may be advantageous to take advantage of this rule, as it avoids GILTI and, if domestic corporate shareholder, income can be repatriated under § 245A (provided not an Extraordinary Disposition or Extraordinary Reduction, but deemed paid FTCs lost)

GILTI HTE Background

- *Complaint*. GILTI applies to high taxed income but ostensibly targeted to low-taxed income; *i.e.,* 13.125%
- Final GILTI regulations *did not* provide for a GILTI HTE
- Proposed GILTI regulations *do* provide for an HTE on an elective basis
- Reasons for HTE exclusion from GILTI:
  - Income not of the type that raises base erosion concerns; *e.g.,* FOGEI
  - Income already taxed (under Subpart F or ECI)
  - Reduced incentive to convert income into Subpart F income
- Treasury/IRS proposed an elective "framework" for an HTE for income subject to GILTI inclusions, effective for taxable years of CFCs beginning on or after the date of publication of final regulations , and to taxable years of U.S. Shareholders in which, or with which, such taxable years of foreign corporations end
  - Treasury/IRS encourages comments on proposed framework of HTE

HTE Overview

- U.S. Shareholders of CFCs can *elect* to exclude a CFC's items of gross "tested" income subject to foreign income tax at rates exceeding 18.9% (greater than 90% of current corporate maximum tax rate of 21%) from GILTI inclusion
- If election made:
  - HTE is excluded from GILTI inclusion
    - For corporate U.S. Shareholders : Can repatriate tax free
    - For non-corporate U.S. Shareholders: Can repatriate at treaty rate (23.8%) or non-treaty rate (40.8%)
  - Lose QBAI associated with production of HTE
  - Lose FTCs attributable to HTE
  - Determined on a QBU basis: rate calculate by aggregating all gross income items attributable to a CFC's QBU
  - Applies to all CFC members of the same controlling domestic shareholder group
  - Binding on all U.S. Shareholders of CFC
- HTE Election: By controlling U.S. Shareholder
  - But if election revoked, re-election can only be made after a 60 month waiting period
  - HTE not applicable until published as a final regulation, so HTE **prospective**

HTE Mechanics

1. HTE computed at CFC qualified business unit level (QBU)
   - QBU. A separate and clearly identified unit of a trade or business that maintains separate books and records
2. Identify each QBU of a CFC
   - A CFC's QBU includes QBUs owned by the CFC and the CFC itsefl
3. Determine "tentative gross tested income," by FTC basket, *attributable* to a single QBU of a CFC
   - Tentative gross tested income is aggregate of all items of gross income attributable to a single QBU of a CFC that would otherwise be gross" tested income" within a singed tested income group but for HTE
   - Gross income is attributable to a QBU if properly reflected on the QBU's books and records
   - CFC may have multiple tentative gross tested income items
4. Adjust QBU's income for disregarded items
5. Allocate and apportion QBU deductions to gross test income to determine "tentative net tested income items"
6. Determine foreign income taxes "properly attributable" to each tentative net tested income item
7. Determine foreign effective tax rate separately for each category of tentative net tested income item
   - Calculation: USD amount of properly attributable taxes to the tentative net tested income ***divided*** by USD amount of the tentative net tested income item grossed up by attributable foreign taxes
8. HTE applies if item's effective tax rate ***exceeds*** 18.9% threshold

HTE Election

- Made by ***controlling domestic shareholders*** of a CFC (U.S. Shareholder(s) who in the aggregate own more than 50% of total combined voting power in a CFC who undertake to act on its behalf) by attaching statement to such effect with original or amend return for the U.S. shareholder inclusion year in which, or with which, the CFC inclusion year ends
- Applies with respect to all gross "tested" income items of *all* CFCs that are ***members of a controlling domestic shareholder group*** (determined by reference to a more than 50% vote test)
- Binding on all U.S. Shareholders of CFC
- Duration: for the CFC(s) inclusion year(s) and all subsequent CFC(s) inclusion years, unless revoked
- Revocation: if revoked, new election cannot be made with respect to the CFC until 60 months after the close of the CFC's inclusion year for which the election was revoked and is irrevocable for 60 months
- *Comment.* Consider planning implications based on GILTI HTE irrevocable election with that of *annual* election under Section 962

HTE Comments

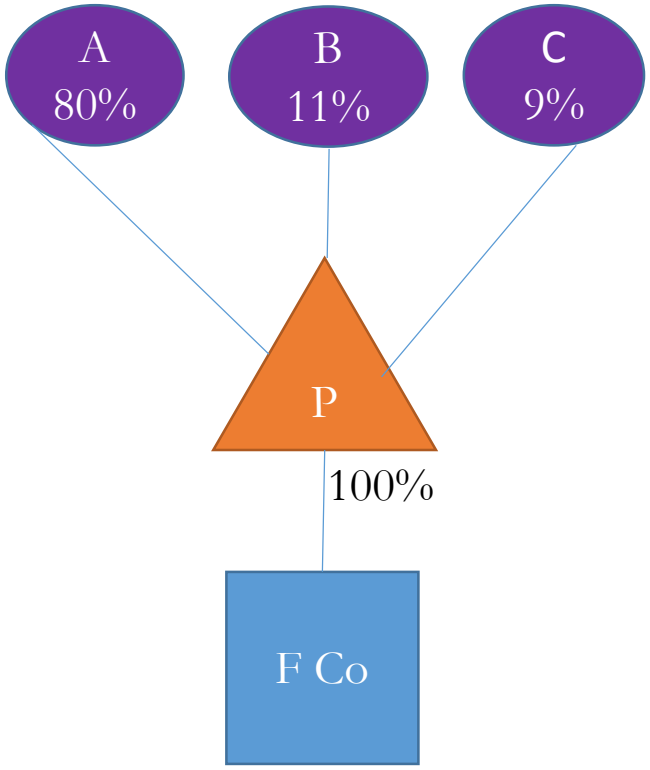
- As an initial matter, a CFC's tested income is determined as if the CFC were a domestic corporation, which could impact effective foreign tax rate
- Separate computation made for each of the CFC's tentative net tested income items to prevent blending of tax rates between high-tax QBUs and low-tax QBUs
- Do not overlook requirement to "regard" disregarded payments, particularly where disregarded payments reduce payor's high-taxed income and increase payee's income
- HTE not available to taxpayers with only low-taxed CFCs income
- Do not overlook Section 250 taxable income limitation
- Does HTE work when there are NOLs in U.S. and tested income highly taxed?
- HTE causes loss of deemed paid FTC and QBAI; thus, taxpayers with more than one CFC that have mix of high-taxed/low-taxed income (determined on a QBU-by-QBU basis) need to evaluate benefit of eliminating GILTI inclusion through HTE with cost of foregoing use of FTCs/QBAI
- HTE applies to all controlled CFCs and binds all U.S. Shareholders of the CFC(s); so some U.S. Shareholders may benefit while others may have a detriment
- Consider nature of irrevocable election and terms of revocability (60 month rule)
- Subpart F planning may still be beneficial
- Modeling essential
- Treasury/IRS receptivity to comments: whether (1) election should be on an item-by-item basis, a CFC-by-CFC basis, or on a QBU-by-QBU basis; and (2) items of multiple CFCs in a single country should be combined; so, there may be future modifications

U.S. Partners Investing in Foreign Corporations through Domestic Partnership

- **Overview**. New rule for GILTI and Subpart F inclusion purposes; current Code rules continue to apply for classification and certain other purposes
- **New Rule**. For purposes of determining the amount of an inclusion under GILTI or Subpart F to a U.S. partner, domestic partnership treated as aggregate of its partners in same manner as a foreign partnership
- **Consequences**. Under the aggregate approach:
  - U.S. partner of domestic partnership that is a U.S. Shareholder of a CFC will have a GILTI or Subpart F inclusion determined by reference to its proportionate ownership interest in domestic partnership.
  - U.S. partner of domestic partnership that is not a U.S. Shareholder will ***not*** have a GILTI or Subpart F inclusion
- **Regulations.**
  - GILTI. Treasury/IRS adopted New Guidance in final regulations
  - Subpart F Income. Treasury/IRS *extended* New Guidance to Subpart F income under proposed regulations
    - Note, taxpayer can elect to apply proposed regulation prior to finalization, *see* Slide 25, Effective Dates

Comparison of Old Rule to New Rule For Inclusion Purposes

Assume: Partner (P) owns 100% of F Co; F Co is a CFC; F Co derives GILTI and Subpart F inomce. P has three unrelated U.S. Partners: A has a 80% interest in P; B has an 11% interest n P; and C has a 9% interest in P



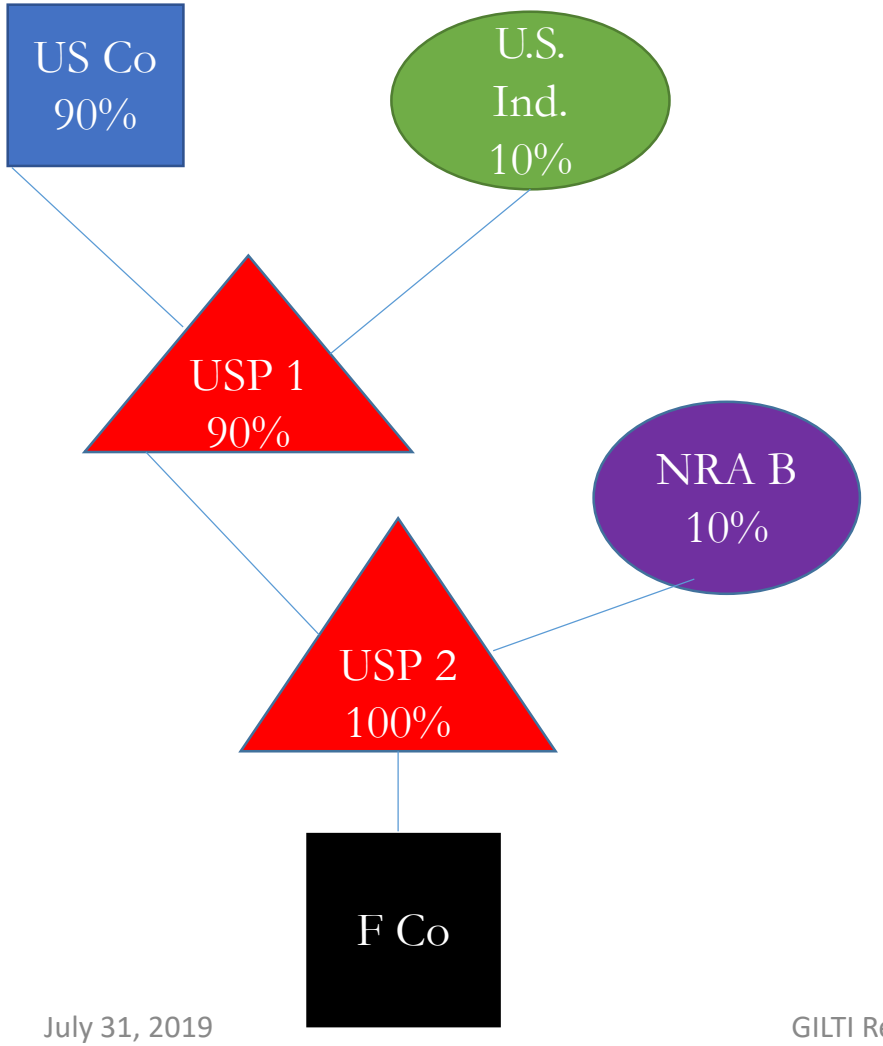
Old Rule

- P treated as entity
- P is a U.S. Shareholder
- P has Subpart F Income/GILTI inclusion
- A, B, and C have Subpart F and GILTI inclusion

New Rule

- P treated as aggregate
- A, B, and C own F Co stock by reference to the amount of their respective partnership interests
- A has an 80% ownership interest, is a U.S. Shareholder, and has an 80% inclusion
- B has a 11% ownership interest, is a U.S. Shareholder, and has a 11% inclusion
- **C, has a 9% interest, is not a U.S. Shareholder, and has no inclusion**,

Ownership Rules
For Classification and Inclusion Purposes



- ***Classification Purposes.*** Old law and not New Guidance applies to determine whether US Co, U.S. Ind., USP 1 and USP 2 are U.S. Shareholders of F Co and whether F Co is a CFC.
  - Since USP 2 owns 100% of F Co, it is a U.S. Shareholder of F Co and F Co is a CFC
  - Since USP 1 owns 90% of the F Co stock owned by USP 2 it is a U.S. Shareholder of F Co
  - Since USP 1 constructively is treated as owning 100% of F Co stock for ***classification*** purposes:
    - U.S. Co is treated as owning 90% of F Co stock and is a U.S. Shareholder
    - U.S. Ind. A is treated as owning 10% of F Co stock and is a U.S. Shareholder
- ***Inclusion Purposes***.
  - USP 1 and USP 2 are not treated as owning F Co stock
  - U.S. Co and U.S. Ind. A **are** U.S. Shareholders (see above) for inclusion purposes:
    - U.S. Co owns 81% of F Co and has an 81% inclusion
    - U.S. Ind. A owns 9% of F Co and has a 9% inclusion

Corollary Consequences

- **Code classification rules**. New guidance does not change pre-existing Code rules: Hence, a domestic partnership will continue to be treated as an entity for purposes of determining whether:
  - Any person is a U.S. Shareholder
  - A foreign corporation is a CFC
  - Any U.S. Shareholder is a "controlling U.S. Shareholder"
- **Constructive Attribution Rules**. New guidance does not modify these expansive rules, to include new Downward Attribution rules (*see* prior slide)
- **Section 1248.** A domestic partnership that disposes of the stock of a CFC in which it is a U.S. Shareholder is subject to Section 1248, with the consequence that its partners would pick up their distributive shares
- **Reporting**. Reporting requirements remain unchanged for purposes of Form 5471, but Minority U.S. Partners no longer would have to report on Form 8992 (GILTI inclusion form)

Effective Dates

- **GILTI Inclusions**
  - Applies to tax years of foreign corporations beginning after Dec. 31, 2017, and to tax years of U.S. Shareholders in which, or within which, the foreign corporation's tax year ends
- **Subpart F Inclusions**
  - Applies to tax years of foreign corporations beginning on or after the date of publication of the New Guidance as a final Treasury Department regulation, which will be a prospective date
  - *Early Adopter Rule. U.S. taxpayers may elect to apply the New Guidance to tax years of foreign corporations beginning after Dec. 31, 2017, and tax years of U.S. shareholders with or within which the foreign corporation's tax year ends, provided that the New Guidance is applied consistently by the domestic partnership, its U.S. Shareholder(s) and related parties*

Tax Reporting
New GILTI Minority Partner Rule

- New GILTI Minority U.S. Partner guidance Elimination raises numerous 2018 U.S. tax reporting issues for domestic partnerships with Minority U.S. Partners, as well as for Minority U.S. Partners, depending on circumstances
- Scenarios:
  - ***Partnership filed partnership return/K-1 prior to statutory due date, no extension***
    - Minority U.S. Partner received Schedule K-1 reflecting GILTI inclusion, partner should consider filing Form 8082 (Notice of Inconsistent Treatment or Administrative Adjustment Request)
    - *But see Rev. Proc. 2019-32, released on July 25, 2019, which grants a six month extension in time to "eligible" BBA partnerships to file a "superseding" Form 1065 and corresponding Schedule K-1 even though the partnership did not request an extension (same consequences as immediately below)*
  - ***Partnership filed partnership return/K-1 prior to statutory due date, but with extension***
    - Partnership can file "superseding" return (treated as an *original return),* provided filed prior to extended due date
    - If partnership return filed after extended due date, return is an "amended" return; consider BBA impact
    - *Comment.* "Superseding" return more expedient than "amended" return under BBA partnership audit rules
  - ***Partnership filed timely extension but has not filed return/Schedule K-1***
    - Should not create issues for partnership or partners

PFIC Exposures

- CFC/PFIC overlap rule; under New Guidance, Minority U.S. Partners no longer would have a Subpart F inclusion; query, does overlap rule continue to apply?
- Other PFIC exposures may arise as a result of issuance of recently proposed PFIC regulations
- Measurement of assets: default rule is FMV, but non-publicly traded CFCs required to use adjusted basis for purposes of valuing assets
- Who makes elections?
- Other?

QUESTIONS

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Thank you!

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