

# International Tax Updates Under Tax Reform for the M&D Industry

Presented by: Kyle Dawley

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- Offices coast to coast
- We serve nearly 7,000 privately held manufacturers and distributors



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# Speaker Introductions

## Kyle Dawley, J.D., CPA

Principal, Global Tax Services, Minneapolis, MN

Kyle has more than a decade of experience focusing on the international tax needs of multinational businesses and individuals. Before CLA, Kyle spent time in Big 4 accounting firms developing strategies and managing complex international business and tax projects which includes transfer pricing implementation and pricing. In addition to having experience in international tax matters, Kyle has a deep appreciation of general business issues as he spent more than a year employed in a biotech start-up company where he was tasked with running their daily operations and long-term vision. He has served clients in a wide-range of industries with both inbound and outbound ownership.



# Speaker Introductions

## **Leslie Boyd, CPA**

Tax Principal, Indianapolis, IN

Leslie is a principal in CLA's Manufacturing industry group and leader of the Manufacturing industry for the Indianapolis office. Leslie has more than ten years of experience in public accounting, specializing in tax services for multi-state and multinational C corporations, S corporations, and partnerships.





## Learning Objectives

At the end of this session, you will be able to:

- Discuss the proposed FDII regulations and requirements to meet the new FDII deduction
- Discuss the proposed GILTI regulations and interplay with foreign tax credits and incremental U.S. taxation







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# Agenda

- Tax Reform Review
- GILTI/FDII Interplay
- FDII Rule Summary
- Q&A



# U.S. International Tax Reform Review

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# Tax Reform Review: The Intended Impact

- Lowered top Federal corporate income tax rate to 21%
  - Thus make it more cost-effective for income from global operations to be resident in the U.S.
- New Qualified Business Income (“199A”) 20% deduction for non-corporate taxpayers
  - U.S. “flow-through” manufacturers taxed effectively at 29.6%
- 100% bonus depreciation
  - Makes it attractive to invest capital in new manufacturing assets in the U.S.
- NOL 80% limitation
  - New NOL’s limited to 80% of taxable income with unused NOLs c/f indefinitely.
- Interest Expense Limitation
  - Limited to 30% of EBITDA, for tax years before 1/1/22 and 30% of EBIT thereafter

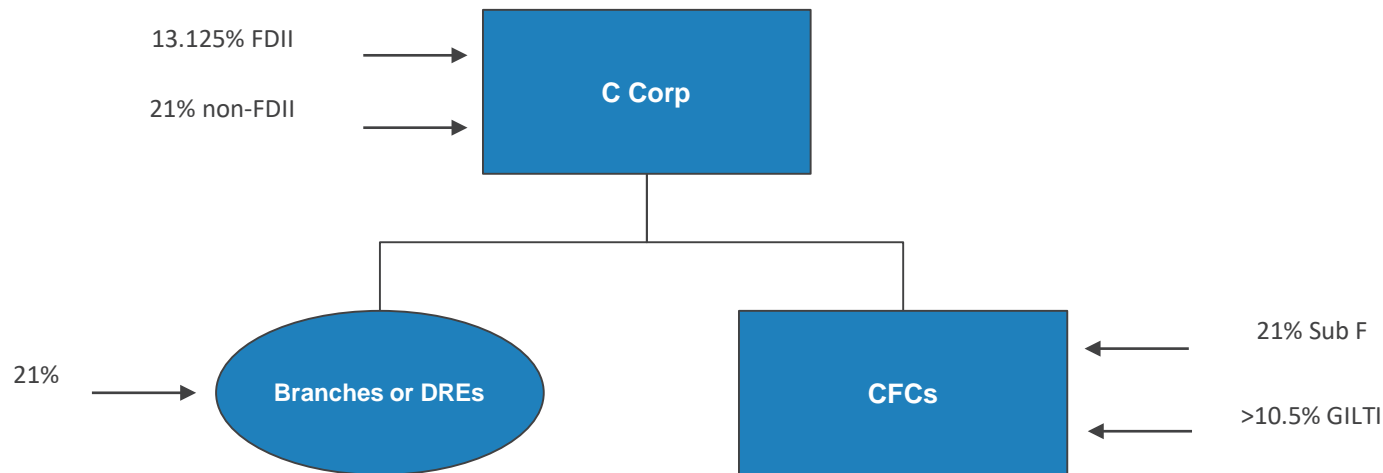


# Tax Reform: Impact on International Structures

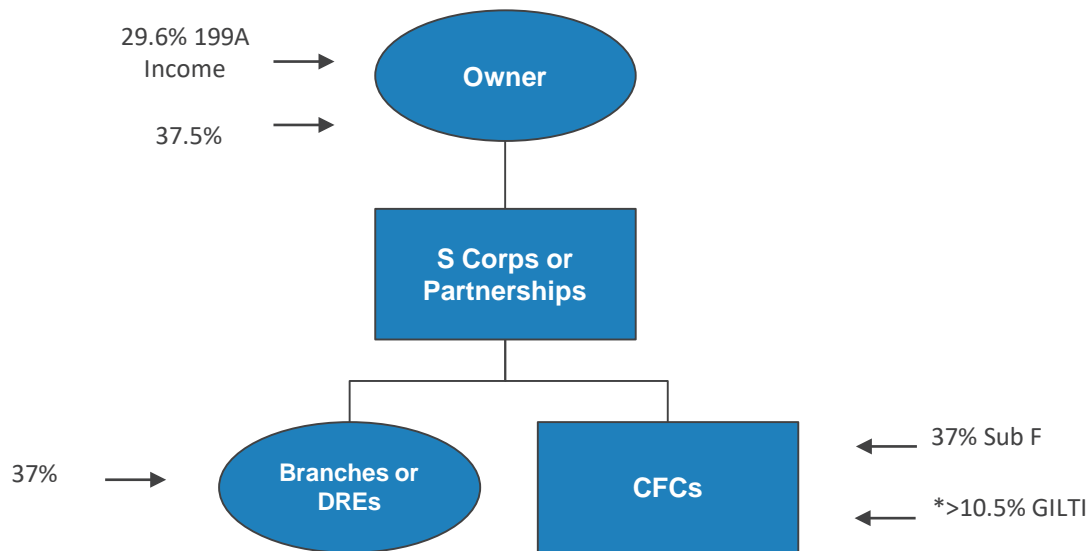
- Eliminated worldwide taxation for C Corporations, but:
  - Kept “anti-abuse” provisions of Subpart F; and
  - New minimum tax of 10-15% on foreign income (aka GILTI).
  - Mandatory repatriation of offshore earnings at 12/31/17
- Incentivized exports (FDII)
  - Temporarily reduces income tax rate on export income to 13.125% (applies to goods and services)
  - Does not require U.S. manufacturing, actually disincentive for U.S. business assets (QBAI).
- Many countries now have higher income tax rates than the U.S.
  - Complicates impact of withholding taxes, transfer pricing and global tax reforms
- New AMT equivalent tax for large C Corporation (BEAT)
  - Affects companies with >\$500m in tax gross receipts and ratio of related foreign party payments to all Non-COGS deductions of >3%



# Tax Reform: Choice of Entity & Applicable Rates



# Tax Reform: Choice of Entity & Applicable Rates



\* Current tax assuming a Section 962 election is made to allow the U.S. owners a 50% deduction and foreign tax credits





# GILTI and FDII Interplay

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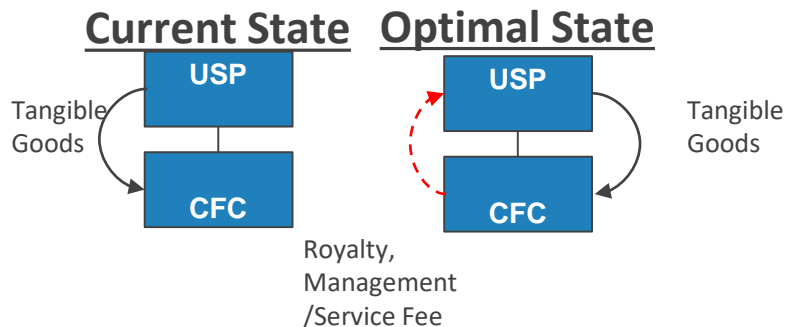
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# GILTI and FDII summary

- These provisions were intended to work together to create a disincentive for offshoring intangibles (by taxing income arising from them) and an incentive for onshoring intangibles (by taxing income arising from them at a lower rate).
- The disincentive: Global Intangible Low-Taxed Income (“GILTI”)
  - Similar to Subpart F in that it requires a U.S. Shareholder to include their CFCs’ GILTI in taxable income.
  - GILTI is derived as excess after a charge of 10% of the tax NBV of certain qualified assets (QBAI). QBAI is reduced by net interest charges.
  - GILTI also generates a deduction which may lower the US effective tax rate on GILTI:
    - ◊ 50% of GILTI for tax years beginning after 12/31/2017 and before 1/1/2026 (i.e., a minimum US ETR on GILTI of 10.5%) and 37.5% thereafter (i.e., a minimum US ETR on GILTI of 13.125%).
    - ◊ However, GILTI and FDII deductions are limited to the extent they exceed taxable income and any such limitation cannot be carried over.
  - Foreign tax credits are allowed at 80% with allocated US expenses to this new basket
- The incentive: Foreign Derived Intangible Income (“FDII”) (for C Corps or C Corp partners)
  - Potential deduction for “new” category of US income earned from foreign sources less allocable deductions.
  - 10% QBAI reduction of FDII for non-intangible earnings also applied without interest charge reduction.
  - Up to 37.5% of FDII may be treated as a deduction to US income (Potential minimum US ETR 13.125%).
  - Many conditions for “foreign” use need to be met depending on type of revenue.



# Related Party Breakout



## Current State Facts

- USP sells tangible goods to CFC
- USP embeds royalty and management costs into cost of sale
- Since rate is greater than 13.125%, USP is protected from GILTI however excess credits in GILTI basket are lost forever

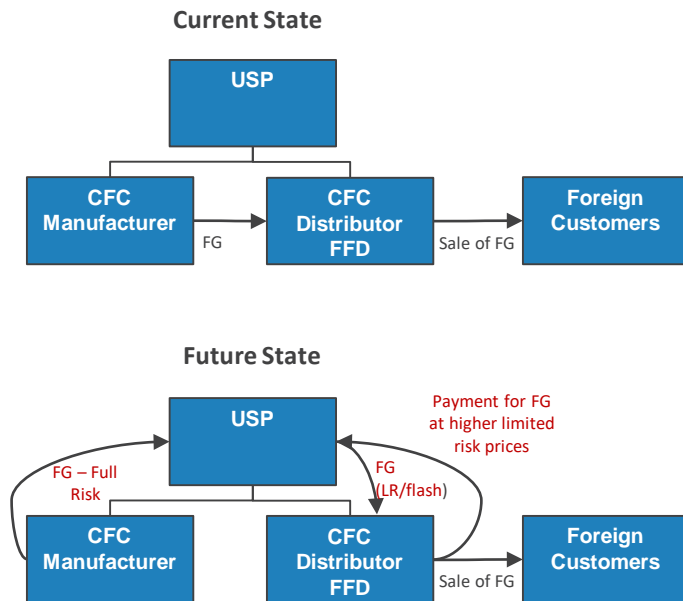
## Optimal State Facts

- USP changes nature of transaction by separating the price of the goods and the IP and services
- USP increases total charges after reviewing market pricing

## Likely results

- Increase in charges increases pre-FTC U.S. tax
- Decreases foreign tax
- Decreases GILTI
- Increases FDII,
- Increases general basket foreign source income

# U.S. distributor in foreign-to-foreign transactions



## Current State Facts

- CFC Manufacturer sells FG to CFC Distributor who then on-sells to third parties

## Optimal State Facts

- USP takes on role as full-fledged distributor ("FFD") in otherwise foreign-to-foreign transactions:
  - USP purchases goods from CFC Manufacturer, bearing full risk as FFD
  - Sales price reflects risk assumed by USP
- USP sells goods to CFC, which operates as a limited risk distributor ("LRD")
  - Sales price reflects limited risk assumed by CFC LRD

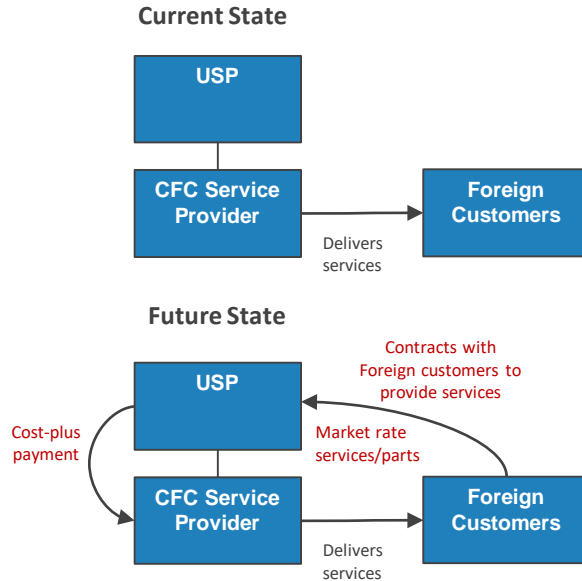
## Likely result

- USP's sales income should constitute FDII eligible income

## Considerations

- FDDEI benefit may be limited
- Potential increase in QBAI
- Need to evaluate any PE and other local country tax exposures

# Post-sale service managed by the U.S.



## Current State Facts

- CFC Service Provider contracts and provides services to foreign customers

## Optimal State Facts

- USP assumes role of managing post-sale services to customers, enters into service contracts with foreign customers, manages the contracts and arranges for services to be provided
- Services to customers are provided by foreign (i.e., local) Contract Servicers
- USP makes cost-plus payments to Contract Servicers
- Services may include provision of replacement parts, acquired by Contract Servicers from US or foreign affiliates or third parties

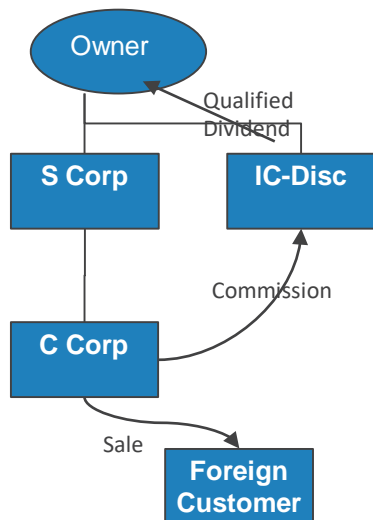
## Likely result

- USP's income constitutes FDII

## Considerations

- Does income to USP satisfy requirement for FDII?
  - Services/sales "performed by" USP
- Is this a sale versus a service
- VAT/customs impact
- BEAT?

# IC-Disc and FDII



## Facts

- S Corp Owner utilizes a IC-Disc and has significant exports
- S Corp uses C-Corp to make foreign sales and provide services to foreign parties = \$100
- C Corp make commission payment to IC-Disc = \$50
- IC-Disc pays dividend = \$50
- C Corp may distribute profits = \$50

## Results

- C Corp tax: \$6.5  $((\$100 \text{ Sales} - \$50 \text{ commission}) * 13.125\%)$
  - Owner tax: \$10  $(\$50 \text{ Disc dividend} * 20\%)$
- Total CURRENT tax **16.5%**
- Additional tax upon distribution of C Corp E&P: \$8.7  $((\$50 \text{ Net Income} - \$6.5 \text{ Tax}) * 20\%)$
- Total Tax 25.2%



# FDII Rules

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# Sales Income

	General property	IP
General Rule	<ul style="list-style-type: none"> <li>Property is not subject to domestic use within three years of delivery or</li> <li>Property is subject to manufacture, assembly or other processing outside the US before domestic use                             <ul style="list-style-type: none"> <li>There is physical and material change to property or</li> <li>Property is incorporated as a component into a second product and is more than 20% of the FMV of the second product</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>Foreign use to extent revenue is earned from exploiting IP outside the US                             <ul style="list-style-type: none"> <li>Revenue is generally considered earned in the location of the end-user customer licensing the IP or purchasing a product for which the IP is used</li> </ul> </li> </ul>
Related party transactions	<ul style="list-style-type: none"> <li>Generally property sold to a foreign related party is not an eligible sale unless the property is:                             <ul style="list-style-type: none"> <li>Ultimately sold to an unrelated non-US person (sale needs to occur before filing date, if occurs afterwards taxpayer needs to amend 1120),</li> <li>Used by a related party in connection with property that is sold to an unrelated non-US person, or</li> <li>Used by a related party in connection with the provision of services to an unrelated non-US person                                     <ul style="list-style-type: none"> <li>For latter two types of property used in connection other property sold or services to unrelated foreign party the U.S. seller needs to be able to reasonably expect that an unrelated party transaction will occur and that more than 80% of the revenue earned by the foreign related party with respect to the property will be earned from such unrelated party transactions</li> </ul> </li> </ul> </li> </ul>	
Documentation	<ul style="list-style-type: none"> <li>Written statement from recipient attesting foreign use</li> <li>Binding contract providing that sale is foreign use</li> <li>Documentation of shipment to location outside the U.S.</li> </ul>	<ul style="list-style-type: none"> <li>Similar to General property but also a written statement of annual revenue from sales generated by IP and global sales</li> <li>Audited financials with foreign and U.S. breakouts of revenue</li> </ul>

# Services Income

	Proximate	Property	Transportation	General
General Rule	<ul style="list-style-type: none"> <li>Service substantially all of which is performed in the physical presence of the recipient outside the U.S.</li> <li>Substantially all =&gt;80%</li> </ul>	<ul style="list-style-type: none"> <li>Service provided w/r/t property if substantially all of the services is performed at location (outside U.S.) and services results in physical manipulation</li> <li>Substantially all =&gt;80%</li> </ul>	<ul style="list-style-type: none"> <li>Service to transport a person or property as a mode of transportation</li> <li>If both origin and destination is outside U.S. then 100% eligible if one is outside the U.S. then 50% eligible</li> </ul>	<ul style="list-style-type: none"> <li>Everything else</li> <li>For B2C, residence of consumer when service is provided is outside the U.S. is eligible</li> <li>For B2B, location of business operations that receive benefit of if service is outside U.S. is eligible</li> </ul>
Related party transactions				<ul style="list-style-type: none"> <li>Services provided to a foreign related party is not eligible if the services are used by the foreign related party to provide services to persons located in the U.S. and at least 60% of the benefits conferred by the related party service are to persons in the U.S. or at least 60% of the price paid by persons located in the U.S. for the service provided by the foreign related party is attributable to the U.S. related party service</li> </ul>
Documentation				<ul style="list-style-type: none"> <li>Written statement from consumer or business indicating location</li> <li>For business, contracts and publically available information</li> <li>For B2C any government issued ID</li> </ul>

Questions?





# Questions?

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