GILTI as Charged:

International Tax Provisions of the Tax Cuts and Jobs Act of 2017 **that keep me awake and make me lose sleep at night**

Palm Beach Tax Institute

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Topics to be Covered

A. Changes in corporate tax rates have fundamentally changed the way that non-U.S. persons should carry on business (in particular, single event (i.e., construction) projects).

B. Repeal of CFC 30-Day rule has left many people with tax inefficient holding company structures on death

C. Downward Attribution:

   1. What is it
   2. When Can it Apply
   3. Adverse Consequences
   4. How it adversely affects foreign holding company structures *(See B. above)*

D. Changes in Portfolio Interest Planning

E. Global Intangible Low Taxed Income ("GILTI")

F. Investments in US Property

G. Compliance Issues

II. Principal Provisions of the 2017 Tax Act that Affect Private Clients

Individuals

- Decrease in maximum tax rate

  Maximum rate of 37% (or 29.6% if IRC § 199A applies)

- Opportunity Zones
- Increase in estate tax exemption, but only for US citizens and domiciliaries

Corporate

- Decrease in tax rate effectively eliminates capital gain preference for individuals
- Participation Exemption

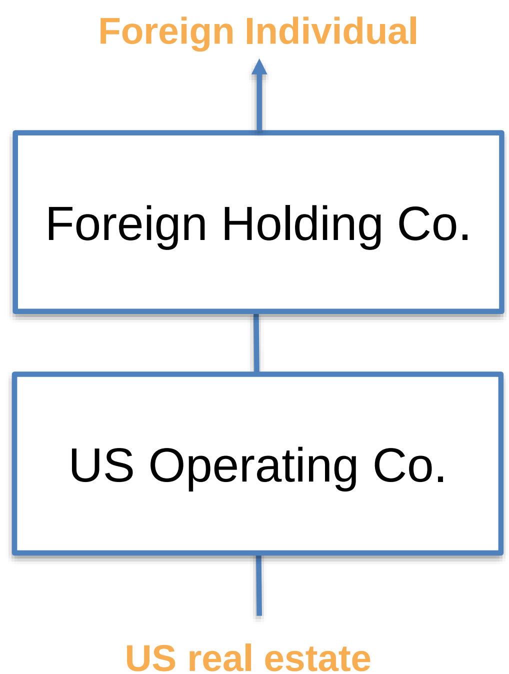
  IRC 245A exempts foreign source dividends received by a 10% corporate shareholder of a foreign corporation

  366 day holding period out of 731 day period before or after ex-div date

- Tax on Global Intangibles Low Taxed Income ("GILTI")
- Change in CFC Rules
  - 30-Day rule
  - Downward attribution
  - Expansion of vote or value test

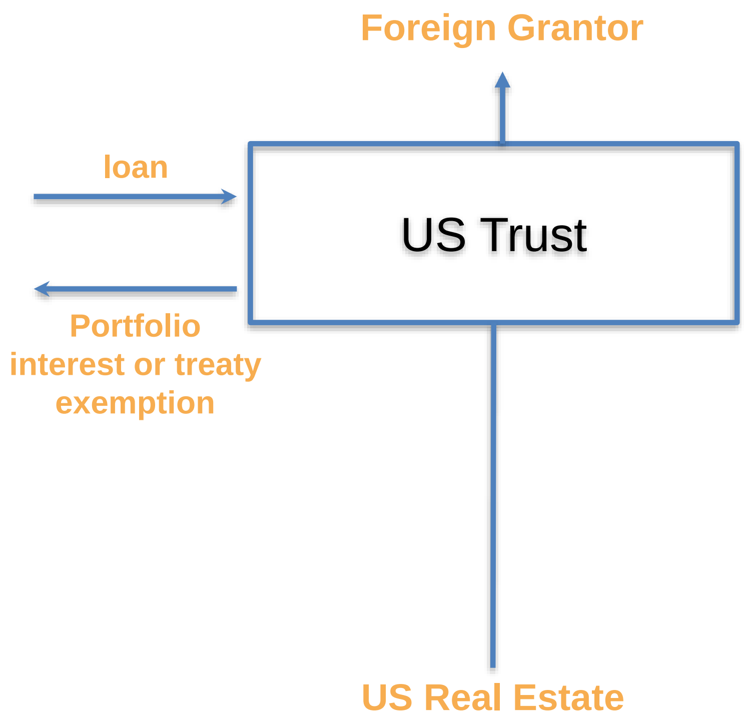
III. Ownership of U.S. Real Estate by Non-US Persons

Pre-2017 Tax Act



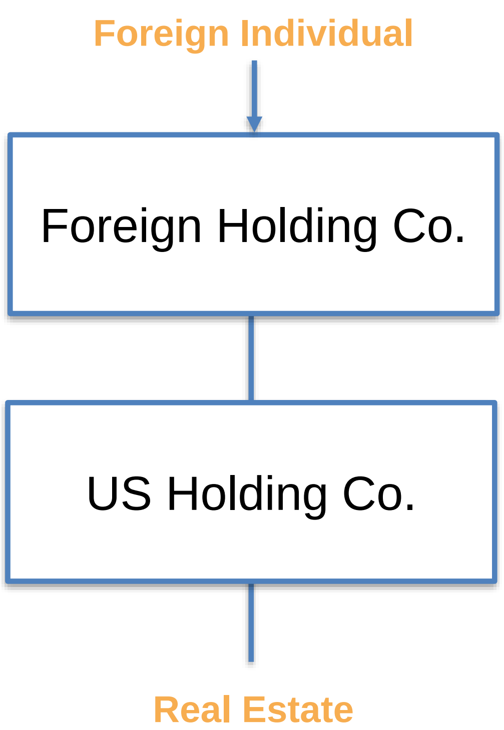
III. Ownership of U.S. Real Estate by Non-US Persons (cont'd)

Pre-2017 Tax Act



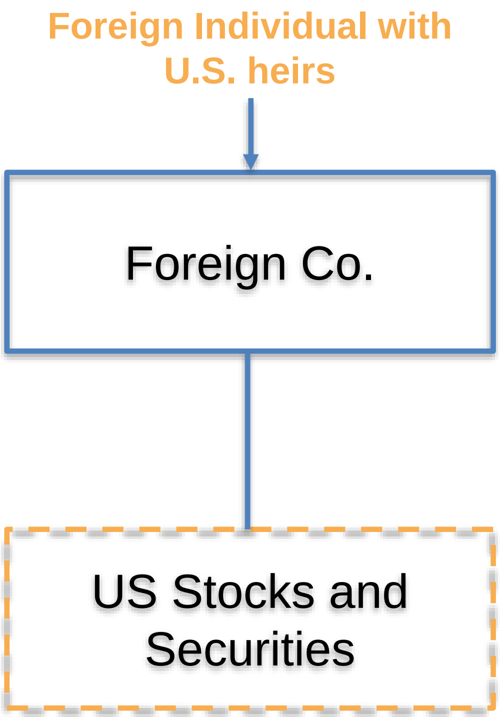
III. Ownership of Real Estate by Non-US Persons (cont'd)

Post 2017 Tax Act Ownership in Real Estate



1. 21% flat corporate tax rate
2. Minimal capital gain differential
3. No withholding tax if US Holding Co. completely liquidates. Desirable to avoid interim dividends prior to liquidation.
4. Accumulated earnings tax exposure. Need to document reasonable business needs.
5. But is this structural optimal if foreign individual holds extensive private equity funds or other illiquid investments?

IV. Repeal of the CFC 30-Day Rule



1. Under prior law, the foreign estate would check the box of the foreign corporation effective the day after the death of individual
2. If 50% or more of the stock (by vote or value) is held by US persons after the death of the foreign individual, then the foreign company will be a CFC.
3. Revocable Trust Trap: IRC Section 1014 limits basis step-up for assets held by a foreign person in a revocable trust unless income is payable to or for the benefit of the decedent. (*See* IRC § 1014(a)(2) and 1014(a)(3), compared to IRC § 1014(a)(9).

IV. Repeal of the CFC 30-Day Rule (cont'd)

Consequences of the repeal of the 30-Day Rule

1. Foreign company can be a CFC on death of foreign indvidual
2. Treas. Reg. 1.951-1(b) provides that a US Shareholder picks up the Subpart F income (including capital gains) in accordance with the ratio that the number of days that the company was a CFC in the year bears to total days in the year.
   a. Death on January 1: deemed liquidation on January 2: 50% inclusion
   b. Death on February 18: liquidation on February 19: 2% inclusion
   c. Revisit real estate holding company example 1

IV. Repeal of the CFC 30-Day Rule (cont'd)

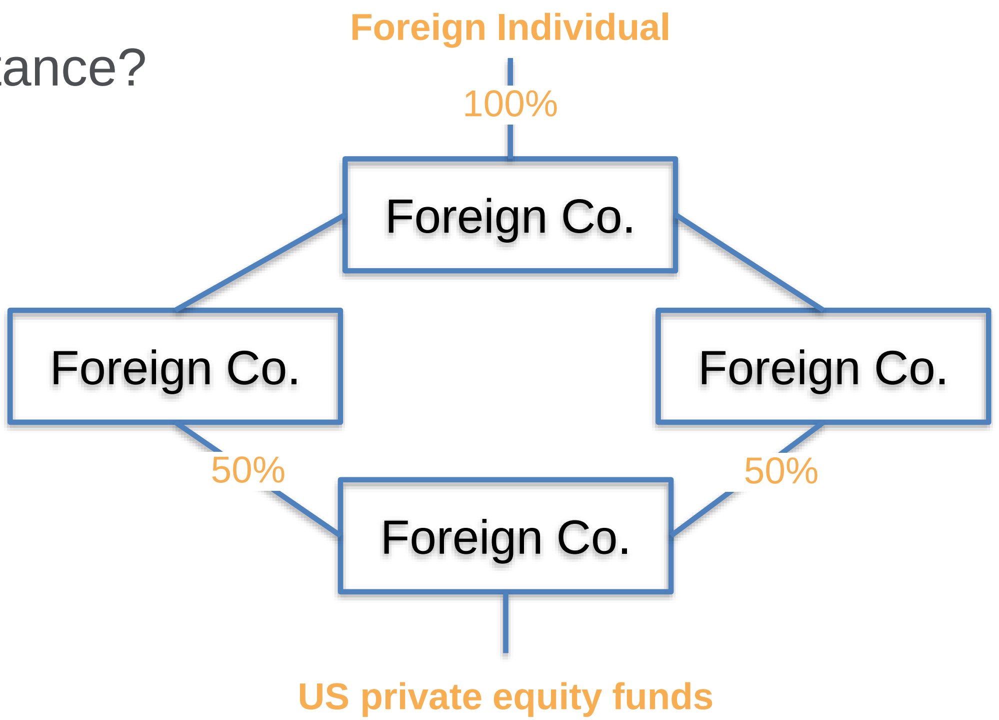
A. Leave CFC assets to non-US shareholders, non-CFC assets to US shareholders

B. Tax Gain Harvesting

   1. No 30-day rule

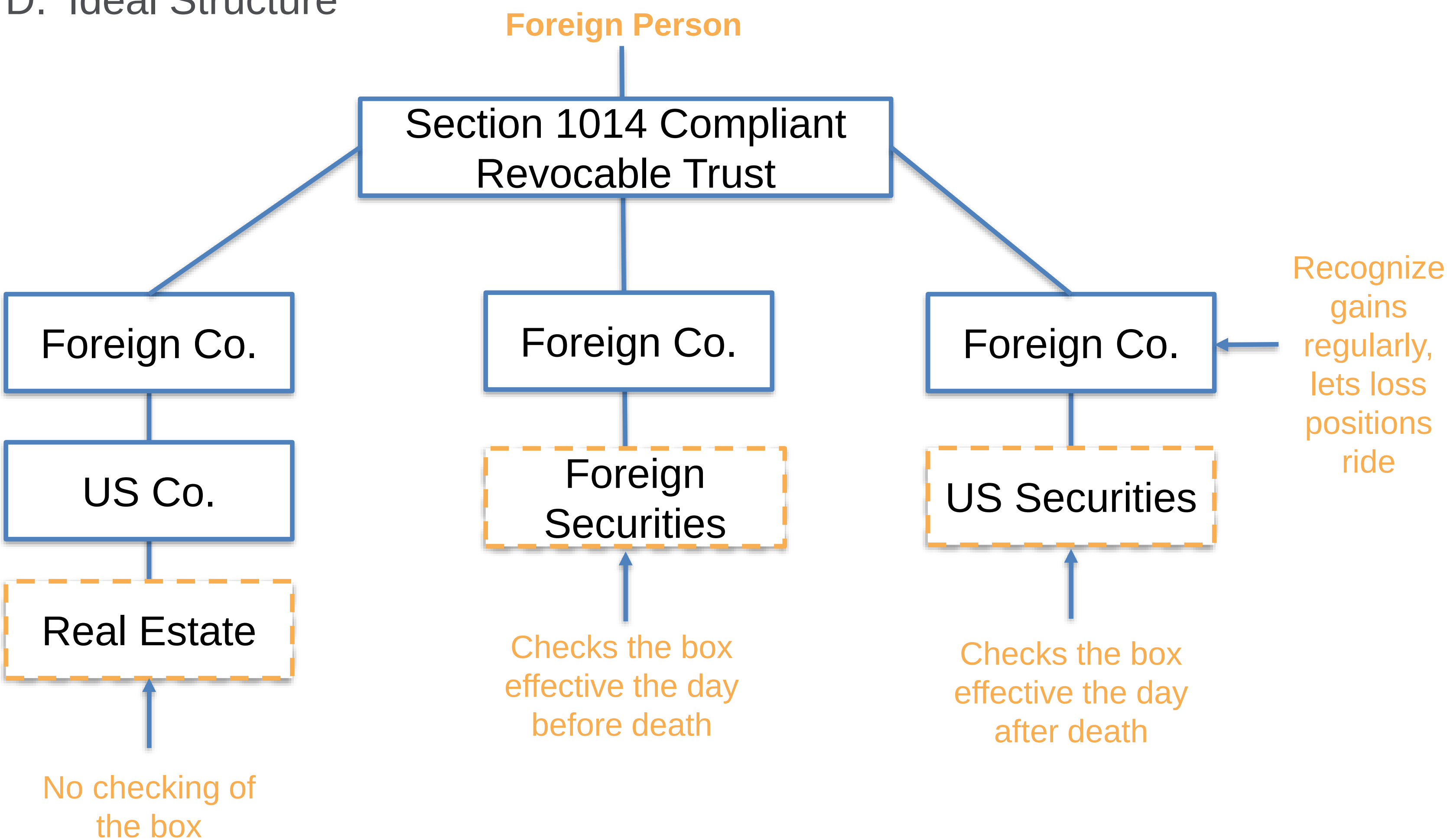
   2. Economic Substance?

C. Diamond Structure



IV. Repeal of the CFC 30-Day Rule (cont'd)

D. Ideal Structure



V. Downward Attribution

A. **Prior to 2017 Tax Act**

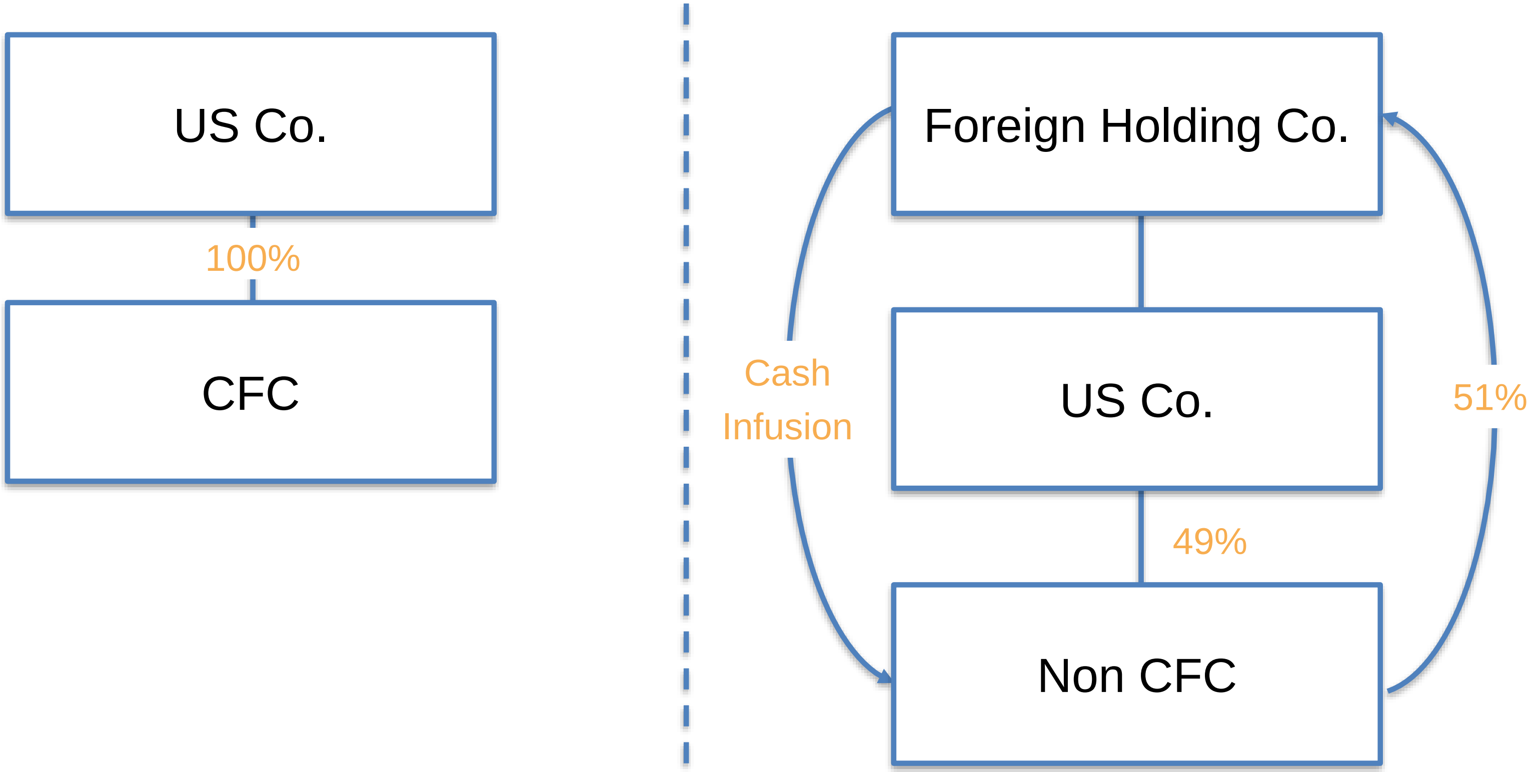
1. Attribution from children, grandchildren, parents. Attribution between spouses No sibling attribution.
2. No attribution to US family members from non-US family members
3. Attribution from an entity to its owners or beneficiaries

B. **After 2017 Tax Act**

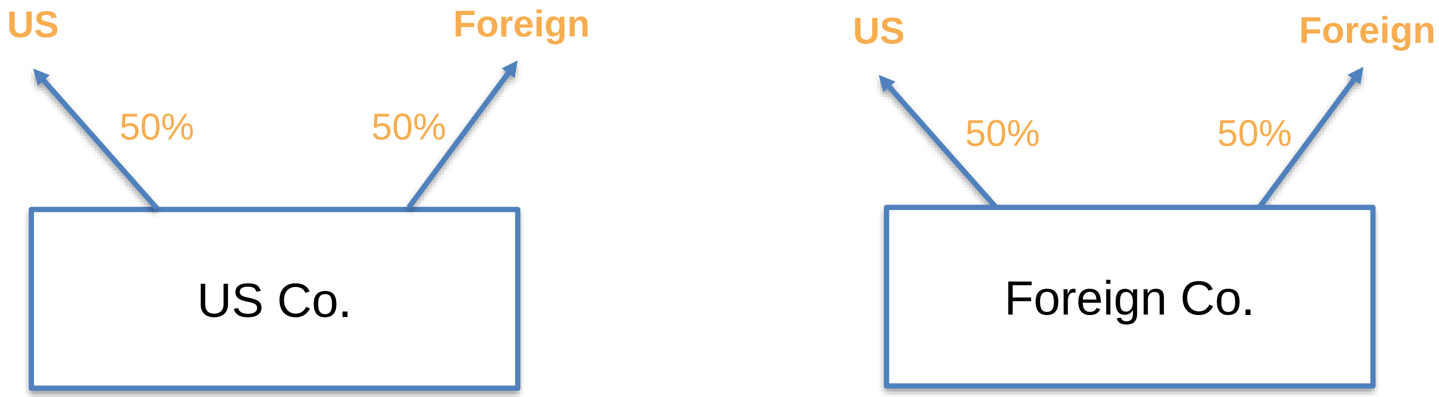
1. Downward attribution is added so that stock owned by a person can be attributed to a subsidiary
2. This rule was effective retroactive to January 1, 2017
3. Foreign companies may have inadvertently become CFC's effective January 1, 2017, thereby triggering the Section 965 transition tax.
4. Taxpayers who were not aware of this rule on a timely basis lost the ability to defer the transition tax
5. Comments have been receive by at least one of the Big Four accounting firms, asking for leniency in late elections.

V. Downward Attribution (cont'd)

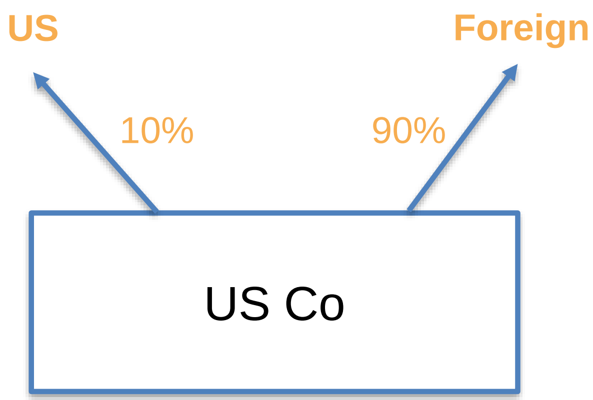
According to legislative history, the no downward attribution rule was repealed in order to limit the ability of multinational corporations to "deconsolidate"

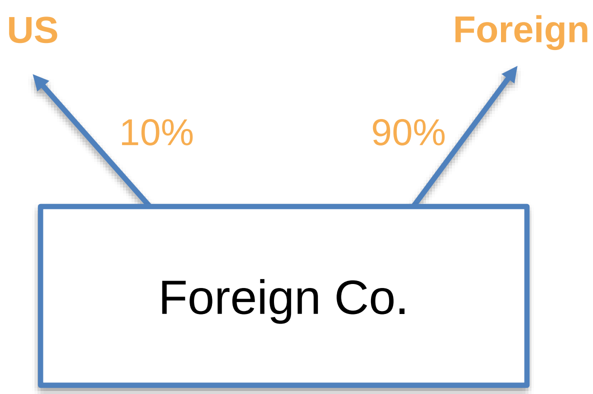


V. Downward Attribution – Example 1



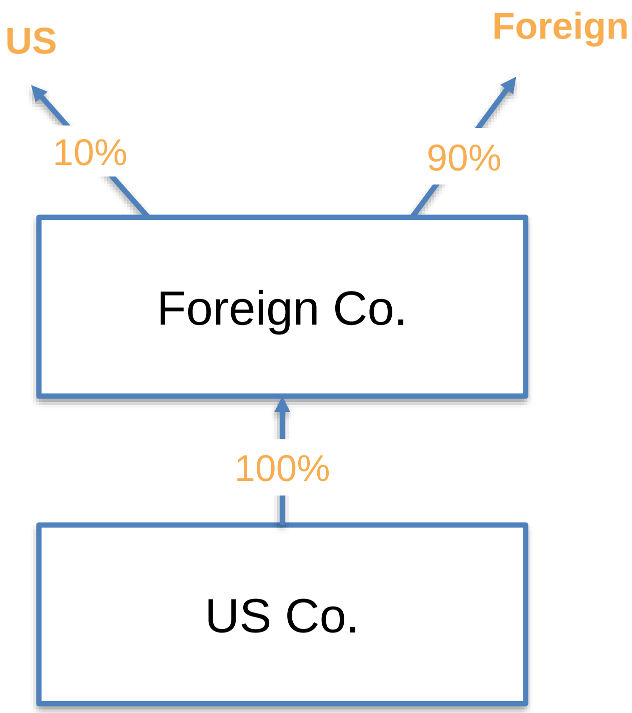
V. Downward Attribution – Example 1 (cont'd)



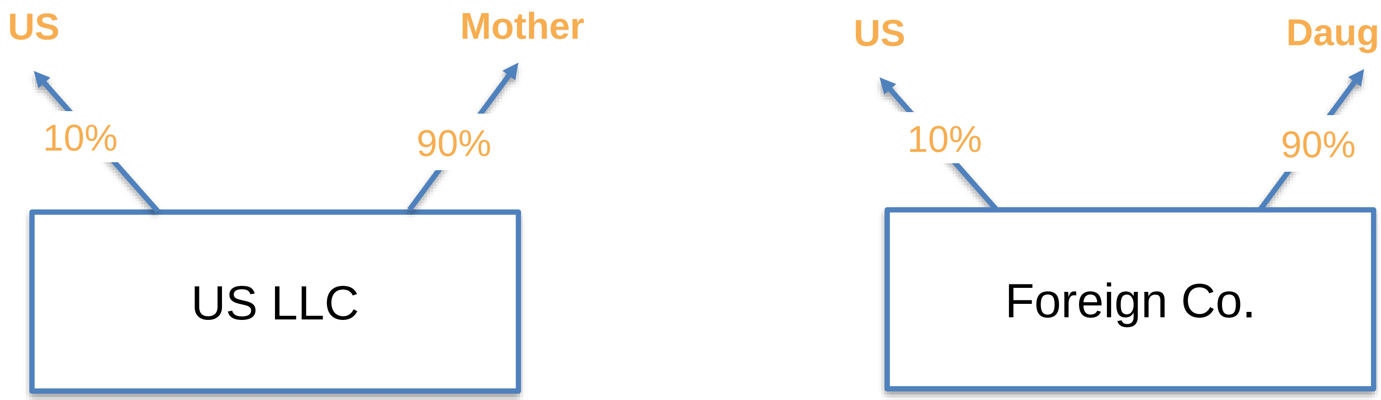


V. Downward Attribution – Example 1 (cont'd)

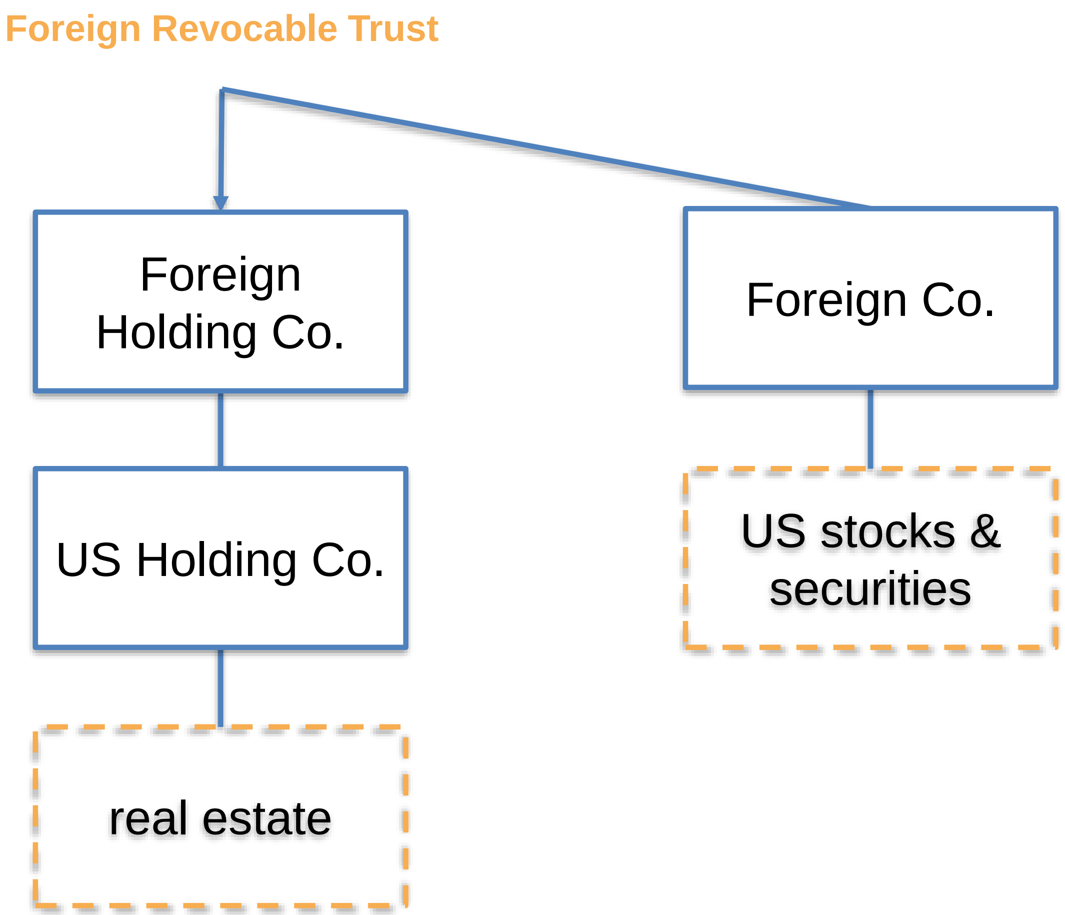
Possible Solution



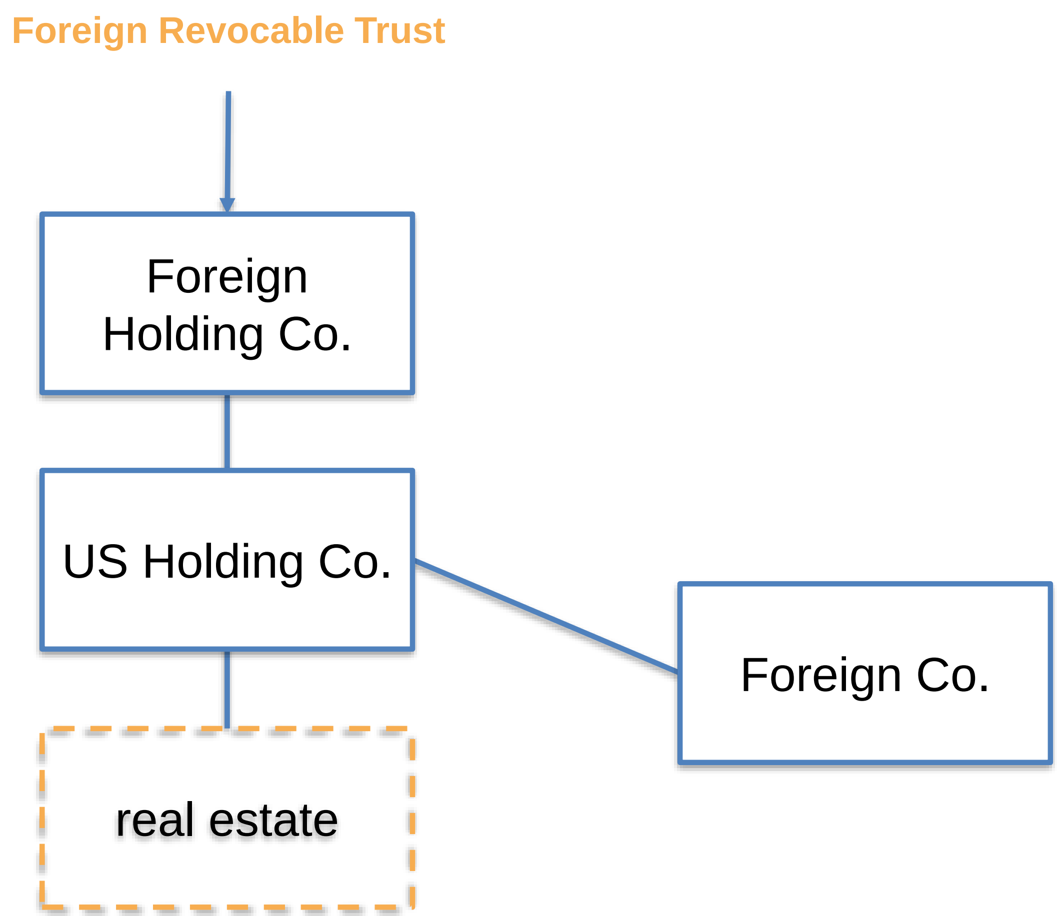
V. Downward Attribution – Example 2 (cont'd)



V. Downward Attribution – Example 3

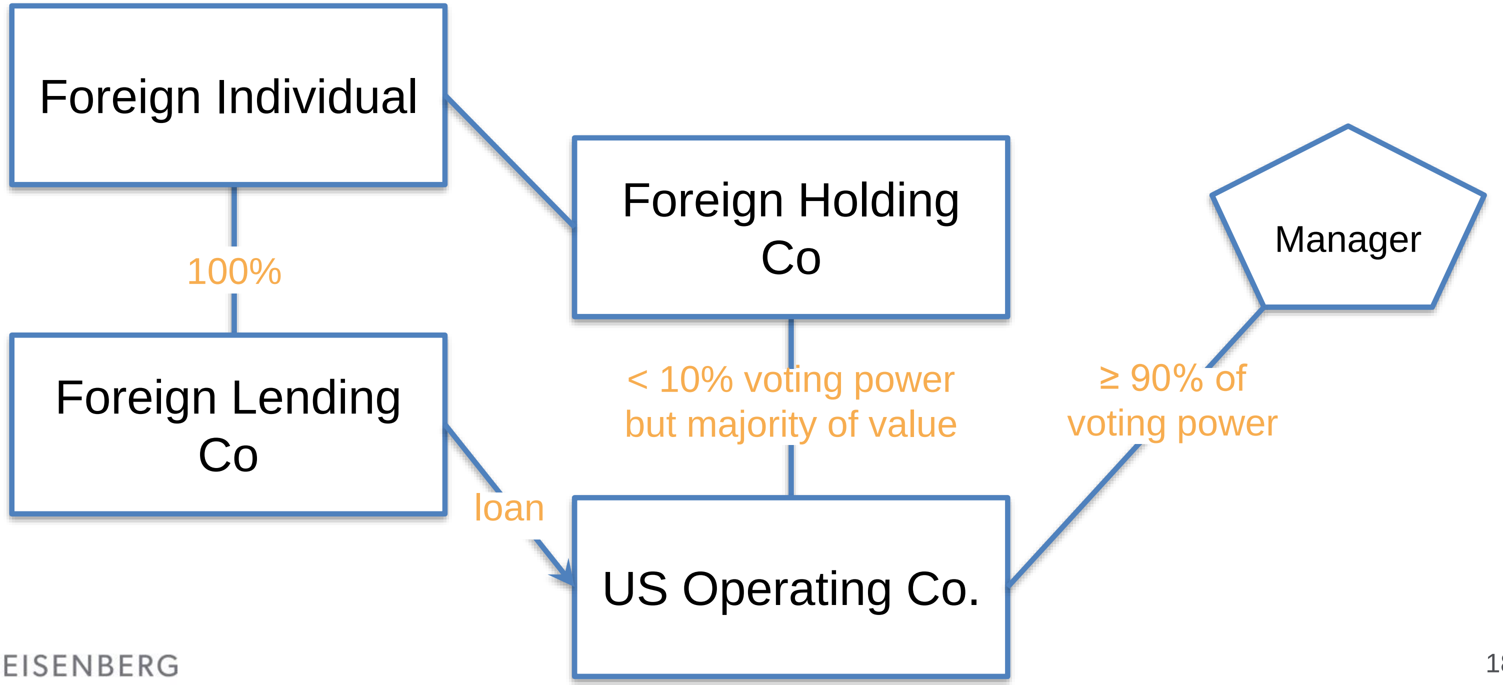


V. Downward Attribution – Example 3 (cont'd)



VI. Portfolio Interest

1. Section 881 exempts interest received by a foreign corporation from US withholding tax if:
   a. Foreign lender does not own 10% or more of the voting power of the corporate borrower
   b. Foreign lender is not a CFC



VII. Global Intangible Low Taxed Income

A. Legislative history suggests that this rule was enacted to tax the low taxed income of multinationals (such as Apple operating out of Ireland)

B. As enacted in 2017, the income base to which the GILTI applies is much broader and has included many taxpayers that never expected to be subject to the GILTI.

C. GILTI causes immediate taxation of the earnings of a 10% or greater US shareholder of a CFC (that are not Subpart F earnings) to the extent that such income exceeds a deemed 10% return on the tangible assets of a CFC.

D. Proposed regulations include a high tax exemption (18.9%). While this exemption MIGHT be highly beneficial to individuals, it does not apply yet.

VII. GILTI-Corporate Shareholders

A. A 10% or greater corporate shareholder includes in its income the share of the GILTI, BUT is:

- Entitled to a tax credit for 80% of the foreign taxes paid
- Entitled to a 50% tax deduction
- So if foreign tax rate equals or exceeds 13.125% in 2020-2025 (16.406% thereafter), no GILTI subject to current tax.

B. If the CFC is subject to a current tax rate of at least 13.125% on its taxable income (determined under US tax principles), there will be no GILTI inclusion, and any income can be brought back as a dividend to the US shareholder tax free.

VII. GILTI-Indvidual Shareholders

A. Individuals in the absence of “self help,” are not entitled to the 50% deduction or foreign tax credit, and are not entitled to the tax credit for 80% of the foreign taxes paid.

B. Thus, the GILTI inclusion of an individual is taxed at 37%, plus the 3.8% net investment income tax.

C. Under Section 962, an individual can elect to be taxed as a C corporation when receiving dividends from a foreign corporation:

- Individual would be entitled to the 80% credit on foreign taxes paid and the 50 percent deduction.
- When the CFC actually pays a dividend to the individual shareholder, the individual can exclude the federal taxes paid but no other amounts, even though previously included in income. So the GILTI income on which Federal tax may have previously been paid is NOT previously taxed earnings.
- The rececipt of a dividend will be taxed to the individual at dividend rates, which may be 37 percent or 20 percent, depending on whether the CFC is paying “qualified dividends” pursuant to an income tax treaty.
- Possibility of a late election if taxpayer was not aware of its GILTI exposure under Dougherty, 60 T.C. 917 (1973)

D. If the individual contributes the CFC shares to a US holding company, then all dividends paid by the CFC to the US corporation will be tax free and all dividends paid by the US corporation to the shareholder will be taxed at the qualififed dividend rate. But this risks being locked into a corporate structure if the tax law changes.

VIII. Section 956

Increase in investment in US assets:

A. A US shareholder of a CFC must include in income its share of a CFC’s increase in investment in US assets. The inclusion is limited to the shareholder’s pro-rata share of earnings and profits, as reduced by previous inclusions (including under the Section 965 transition tax)

B. These rules have limited the assets that a CFC can purchase, thereby reducing the ability of a CFC to invest in US stocks, bonds, etc.

C. This includes pledges of at least 2/3 of the voting power of a CFC’s stock, in conjunction with certain negative pledges

D. Rule was thought to be repealed for C corporations but not entirely, only if dividends would be exempt under the participation exemption rules. Note that high taxed subpart F income and active income not subject to GILTI would benefit from this rule.

E. New rule effectively should lower borrowing costs by allowing foreign companies to pledge assets

F. The rule does not apply to individuals. They must drop CFC stock into a US C Corporation and satisfy the 731 day rule

G. CFC’s that did not include all of their accumulated earnings in income under the Section 965 transition tax can be particularly affected by this rule.

IX. Consequences of "Missing" the fact that a foreign company is Inadvertently a CFC

1. Form 5471 Penalties ($10,000 for each form that is not filed or not substantially complete)
2. Failure to pick-up the IRC § 965 Transition tax creating six year statute of limitations?
3. Omissions from Subpart F income
4. Unlimited statute of limitations for the entire tax return under IRC § 6501(c)(8) for omitted foreign filings?