# Overview of the Major International Tax Provisions Of the Tax Cuts and Jobs Act

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On December 20, 2017, Congress passed H.R.1, known as the "Tax Cuts and Jobs Act" (referred to in this letter as the "Act"), which was signed into law by President Donald Trump on December 22, 2017. The Act makes widespread changes to the Internal Revenue Code. This overview discusses the major international tax provisions contained in the Act. One purpose of the international tax provisions in the Act is to introduce a quasi-territorial system to the taxation of multinational corporate income. This includes the introduction of a participation exemption, transition rules for deferred income, and the expansion of the base erosion rules, among other provisions. Nearly all of the Act's provisions will take effect on January 1, 2018. Further, many of the Act's provisions affecting individual taxes are not permanent and are scheduled to sunset after December 31, 2025, unless Congress acts to extend those provisions.

Overview of Major International Tax Provisions in the Tax Cuts & Jobs Act:

1. Move to a Quasi-Territorial System Through a 100 Percent Dividend Deduction
2. Transitional Rule
3. Global Intangible Low-Taxed Income
4. Effective 13.125% Tax Rate on Foreign-Derived Intangible Income of a Domestic Corporation
5. Expansion of Definition of U.S. Shareholder
6. Elimination of 30-Day Requirement for Subpart F Inclusions
7. Expansion of Stock Attribution Rules for Determining CFC Status
8. Base Erosion Rules
9. Repeal of Active Trade or Business Exception Under Section 367(a)
10. Loss Recapture on Transfer of a Foreign Branch to a Foreign Corporation
11. Shareholders Not Eligible for Preferential Tax Rate on Dividends from Inverted Companies
12. Sale of a Partnership Interest by a Foreign Person
13. Changes to Foreign Tax Credit System
14. Source of Income from Sales of Inventory Produced by the Taxpayer

A summary of the most salient international tax provisions of the Act is as follows:

1. Move to a Quasi-Territorial System Through a 100 Percent Dividend Deduction:
   a. The Act provides for a 100% dividends received deduction ("DRD") applicable to the foreign-source portion of dividends paid by certain foreign corporations (excluding a passive foreign investment companies (or "PFICs") that is not also a controlled foreign corporation ("CFC")) to U.S. corporate shareholders owning at least 10% of such foreign corporation. Under this provision, the U.S. corporate tax system moves away from a "worldwide" tax system and towards a "territorial" tax system.
   b. Under the Act, individual U.S. shareholders continue to be subject to tax on dividends from foreign corporations.
   c. The DRD is available only if the U.S. corporate shareholder satisfies a one-year holding period for the stock in the 10% owned foreign subsidiary. Gain on the sale of stock of certain 10%-owned foreign subsidiaries, which would under current law be taxed under Section 1248 (sale of stock of a CFC), is also eligible for DRD treatment as long as the stock was held for at least one year.
   d. There is no DRD allowed for "hybrid dividends," or dividends paid to a foreign corporation that received a deduction (or other tax benefit) with respect to taxes imposed by a foreign country.
   e. Further, foreign tax credits are not allowed for any taxes paid with respect to the portion of a dividend qualifying for the DRD.

2. Transitional Rule:
   a. As part of the quasi-territorial system, the Act provides for a transitional rule which imposes a one-time tax on U.S. shareholders of certain foreign corporations. This tax is imposed on such U.S. shareholders through a deemed repatriation of foreign earnings and profits and is assessed on the U.S. shareholder's share of such foreign corporation's accumulated foreign earnings not previously subject to tax (post-1986).
   b. The transitional rule applies to U.S. shareholders, and is not just limited to U.S. corporate shareholders.
   c. Earnings attributable to cash and cash equivalents under applicable rules will effectively be taxed at a rate of 15.5%, while all other earnings will be taxed at a rate of 8%. Cash and cash equivalents are defined to include net accounts receivable, foreign currency and the fair market value of similarly liquid assets. The effective tax rates are clear for U.S. corporate shareholders, and while such tax rates may also apply for U.S. individual shareholders, certain computational and other uncertainties exist.
   d. Modified foreign tax credit rules apply.
   e. The tax may be paid in installments over an 8 year period, with 8% of the net tax liability payable for each of the first five years, 15% of the net tax liability payable in year 6, 20% of the net tax liability payable in year 7, and 25% of the net tax liability payable in year 8. Special rules, however, apply to S corporations.

3. Global Intangible Low-Taxed Income:
   a. Similar to the "subpart F" regime, the Act provides that a U.S. shareholder of a CFC will be required to include in income, as a deemed dividend, the CFC's "global intangible low-taxed income" ("GILTI").
   b. GILTI is defined as the excess of the U.S. shareholder's net CFC tested income over a net deemed tangible income return. "Net CFC tested income" generally means a CFC's gross income, other than income that is subject to U.S. tax as effectively connected income, Subpart F income (including income that would be Subpart F income but for the application of certain exceptions), and foreign oil and gas extraction income, less allocable deductions. The "net deemed tangible income return" generally is an amount equal to (i) 10% of the aggregate of the United States shareholder's pro rata share of a CFC's qualified business asset investment (generally, a quarterly average of the CFC's tax basis in depreciable property used in its trade or business) over (ii) the amount of interest expense taken into account to determine such U.S. shareholder's net CFC tested income.
   c. For U.S. corporate shareholders, GILTI results in an effective US tax rate of 10.5% (based on the new U.S. 21% corporate tax rate after applying a 50% deduction). This is increased to 13.125% beginning in 2026.
   d. U.S. individual shareholders of a CFC will be subject to tax on GILTI at regular individual marginal rates.
   e. A C corporation can offset the U.S. tax liability with a foreign tax credit equal to 80% for foreign income taxes paid by the CFC.
   f. The GILTI rules effectively only apply for U.S. shareholders if the GILTI income is below a certain effective foreign tax rate.

4. Effective 13.125% Tax Rate on Foreign-Derived Intangible Income of a Domestic Corporation:
   a. The Act also adopts the foreign-derived intangible income ("FDII") rules, which provide for a special reduced effective tax rate on income from U.S.-held intangibles to the extent such income is derived from exports of property and services.
   b. The FDII rules provide that a domestic corporation is allowed to claim a deduction for an amount equal to 37.5% of its foreign-derived intangible income ("FDII") (reduced to 21.875% for tax years in 2026). Thus, based on the new 21% corporate tax rate, a domestic corporation is subject to U.S. tax on foreign-derived intangible income at a rate of 13.125% (increased to 16.406% in 2026).

5. Expansion of Definition of U.S. Shareholder: Under current law, a U.S. shareholder is defined as any U.S. person that owns 10% of the voting stock in a foreign corporation. The Act expands this definition to also include any U.S. person that owns 10% of the value of

the stock in a foreign corporation. As such, this change expands the circumstances in which a foreign corporation will be treated as a CFC.

6. Elimination of 30-Day Requirement for Subpart F Inclusions: Under current law, a U.S. shareholder of a foreign corporation is required to include subpart F income for a particular tax year only if such foreign corporation has been a CFC for at least 30 consecutive days for such year. The Act eliminates such 30-day requirement.

7. Expansion of Stock Attribution Rules for Determining CFC Status: The Act provides that stock in a foreign corporation is now attributed "downward" from a foreign person to a related U.S. person for purposes of determining whether such U.S. person is a U.S. shareholder of such foreign corporation, and, thus, whether such foreign corporation is a CFC. It appears this provision is intended to render ineffective transactions in which a foreign parent acquires a greater than 50% interest in a CFC of its U.S. subsidiary and, thus, causes the CFC to be a non-CFC.

8. Base Erosion Rules: The Act includes a 5% minimum tax (increased to 10% in 2019 and to 12.5% in 2026) which would be imposed on U.S. C corporations calculated on a modified tax base that excludes certain deductions, such as deductions for certain payments made to a foreign person. The minimum tax would only apply to corporations with average annual gross receipts of at least $500 million, and with at least 3% of deductions derived from payments made to a related foreign party. Special rules apply to banks and security dealers.

9. Repeal of Active Trade or Business Exception Under Section 367(a): The Act provides that, if a U.S. person transfers to a foreign corporation property that is used in the active conduct of a foreign trade or business, then such foreign corporation shall not be treated as a corporation for purposes of determining the extent to which gain is recognized on such transfer.

10. Loss Recapture on Transfer of a Foreign Branch to a Foreign Corporation: The Act provides that, if a domestic corporation transfers substantially all of the assets of a foreign branch to a specified 10%-owned foreign corporation with respect to which it is a U.S. shareholder after the transfer, then such domestic corporation must recapture, as U.S. source income, any net branch losses incurred after December 31, 2017, and before the transfer and with respect to which the domestic corporation was allowed a deduction.

11. Shareholders Not Eligible for Preferential Tax Rate on Dividends from Inverted Companies: Certain dividends from "qualified foreign corporations" are subject to a reduced rate of tax. Such qualified foreign corporations include corporations incorporated in a U.S. possession and certain corporations that are eligible for benefits of an income tax

treaty with the United States and that are approved by Treasury as sufficiently providing for an exchange of information. Under the Act, dividends from a surrogate foreign corporation (as defined under Section 7874) are not eligible for reduced tax rates unless such corporation is deemed to be a domestic corporation under Section 7874.

12. Sale of a Partnership Interest by a Foreign Person: Under the Act, gain or loss realized by a foreign corporation or a nonresident alien individual from the sale or exchange of an interest in a partnership engaged in a U.S. trade or business is treated as effectively connected with a U.S. trade or business to the extent the sale of the partnership assets would have produced effectively connected gain or loss. This provision applies to sales, exchanges, and dispositions occurring on or after November 27, 2017. The Act also amends Section 1446 to require the transferee of a partnership interest to withhold 10% of the amount realized on the sale or exchange of a partnership interest unless the transferor provides certification that it is not a nonresident alien individual or foreign corporation.

13. Changes to Foreign Tax Credit System:
    a. Changes to Indirect Foreign Tax Credit Rules:
        i. The Act repeals Section 902, which allows a domestic corporation to claim an indirect foreign tax credit with respect to dividends it receives from a foreign corporation in which it owns 10% of the voting stock.
        ii. The Act modifies Section 960, which allows a domestic corporation to claim an indirect foreign tax credit with respect to Subpart F inclusions. Under the Act, the foreign tax credit is determined based on current-year foreign taxes paid (rather than a cumulative foreign tax pool) with respect to the relevant item of Subpart F income.
    b. Separate Foreign Tax Credit Limitation Basket for Foreign Branch Income:
        i. In general, under Section 904, a taxpayer is allowed to claim a foreign tax credit only in an amount equal to the U.S. tax imposed on the taxpayer's foreign source income. Such limitation applies separately to the taxpayer's "general basket" and "passive basket" income.
        ii. The Act adds as a new basket called "foreign branch income," which is defined as the business profits of a U.S. person that are attributable to one or more qualified business units in one or more foreign countries. Foreign branch income, however, does not include any income that is otherwise treated as passive basket income.

14. Source of Income from Sales of Inventory Produced by the Taxpayer: Under current law, the source of a taxpayer's income from the sale or exchange of inventory property produced, in whole or in part, by the taxpayer in the United States and sold outside the United States (or vice versa) is generally sourced 50% to the place of production and 50%

to the place of sale (based on title passage rule). The Act modifies these rules and provides that, with respect to such inventory property, the source of such income is determined solely based on the location of production.