Has TCJA Changed the Geometry of International Tax Planning: A Riff on Circles, Squares, and Triangles

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National Tax Association 49th Annual Spring Symposium
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We Ride Again!

Lucky Dusty Ned

El Guapo and His Gang!

§163(j) BEAT GILTI BEPS/ATAD

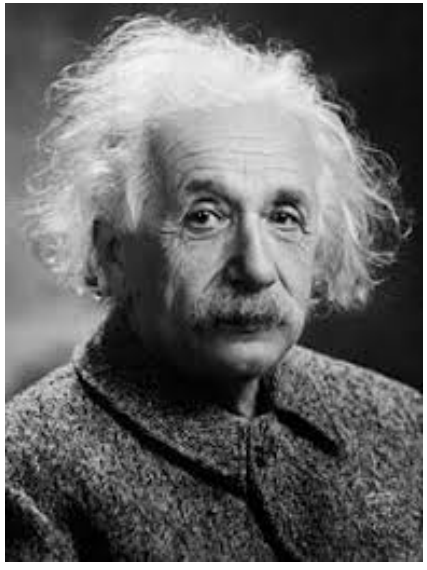
Thoughts About International Tax Planning

The laws of nature are but the mathematical thoughts of God.

Thoughts About International Tax Planning

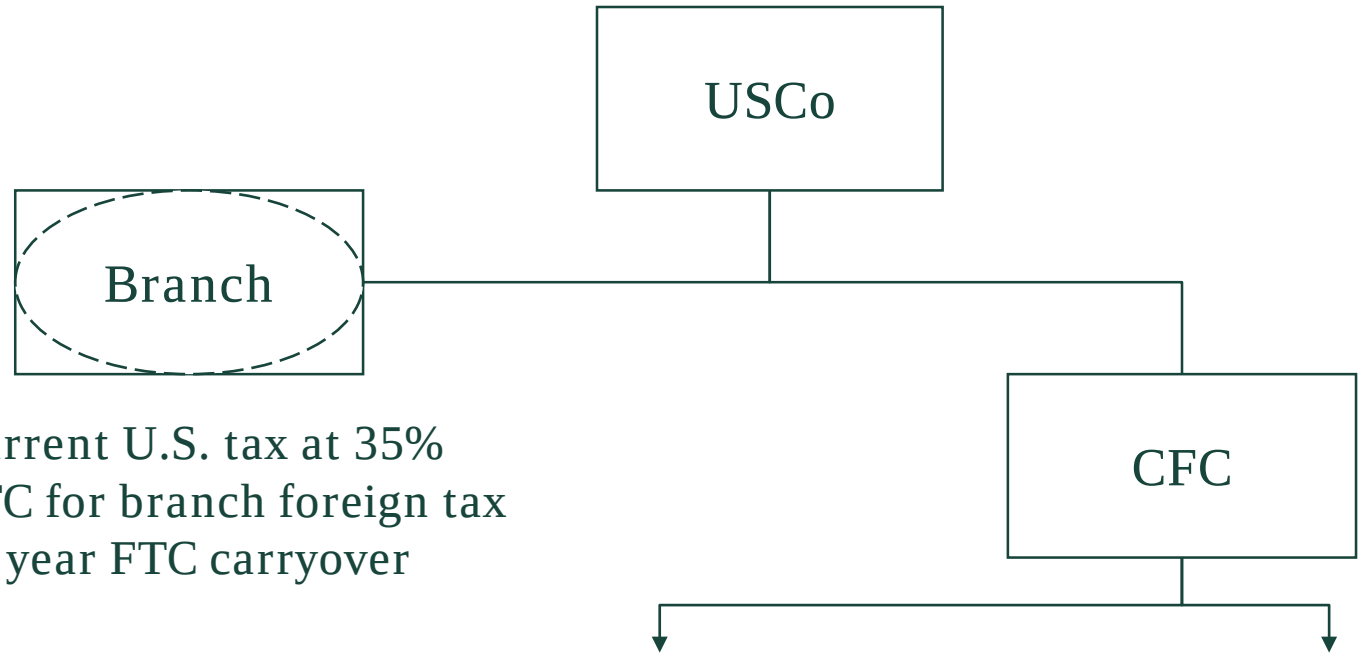
This is a question too difficult for a mathematician.

It should be asked of a philosopher (when asked about completing his income tax form)



Our Polestar

The U.S. MNE Tax Regime Pre-2018



Current U.S. tax at 35%
FTC for branch foreign tax
10 year FTC carryover

Subpart F income
- Current U.S. tax at 35%
- FTC for deemed-paid FT
- 10 year FTC carryover

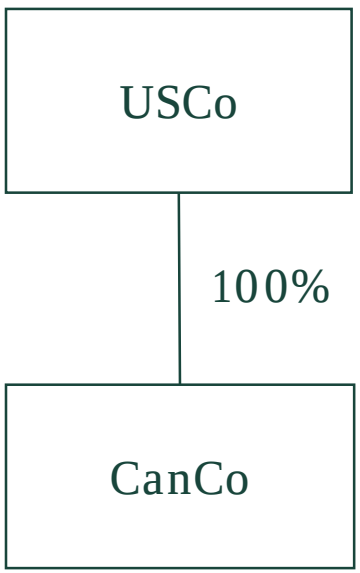
Deferred income
- No U.S. tax until repatriated
- FTC for deemed-paid FT
- 10 year FTC carryover

The U.S. MNE Tax Regime Pre-2018

- Deferral of U.S. tax on income earned outside the U.S. through a foreign corporation
  - U.S. tax on such income was deferred until the earnings were repatriated to the U.S.
  - Withholding taxes paid on the remittance were creditable against precredit U.S. tax
  - Corporate shareholders owning 10% or more of the FC were entitled to a “deemed paid” foreign tax credit for income taxes paid by the foreign corporation on the earnings remitted
  - The U.S. corporate tax rate was 35% (if TI > $18,333,333)

The U.S. MNE Tax Regime Pre-2018

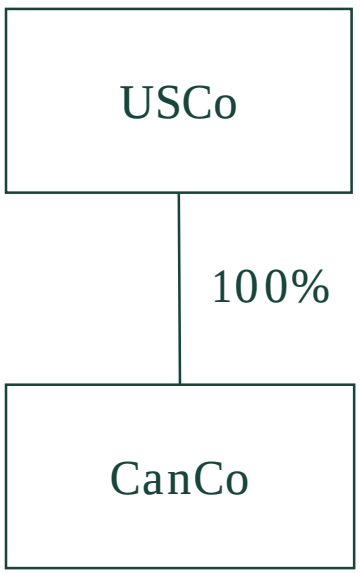
Taxation of a U.S. MNE



Pretax income	$400
Foreign tax (25%)	100
E&P	$300

The U.S. MNE Tax Regime Pre-2018

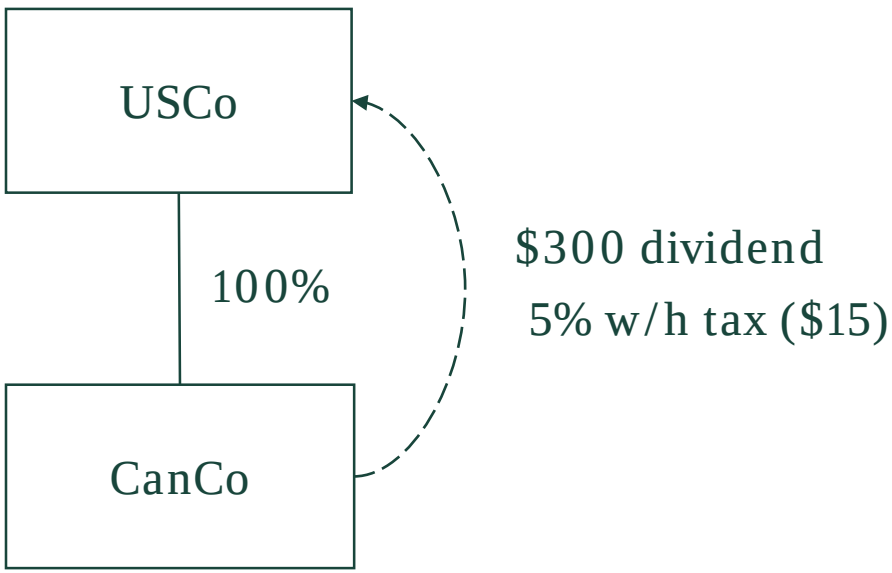
Taxation of a U.S. MNE - $300 not distributed to USCo



Worldwide ETR = $100/$400 = 25%

The U.S. MNE Tax Regime Pre-2018

Taxation of a U.S. MNE - $300 distributed to USCo



The U.S. MNE Tax Regime Pre-2018

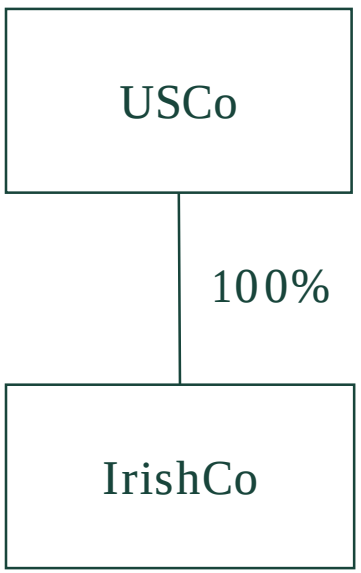
Taxation of a U.S. MNE - $300 distributed to USCo

	1120
Dividend	$300
§78 gross-up	100
Total income	$400
× U.S. tax rate	× .35
Precredit tax	$140
– DPC (§902)	–100
– FTC (§903)	– 15
Net U.S. tax	$ 25

Worldwide ETR = $140/$400 = 35%

The U.S. MNE Tax Regime Pre-2018

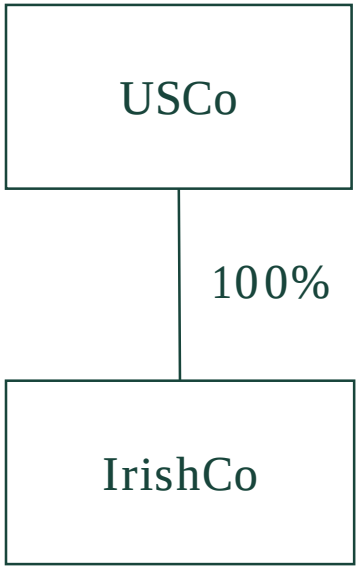
Taxation of a U.S. MNE



Pretax income	$400
Foreign tax (12.5%)	50
E&P	$350

The U.S. MNE Tax Regime Pre-2018

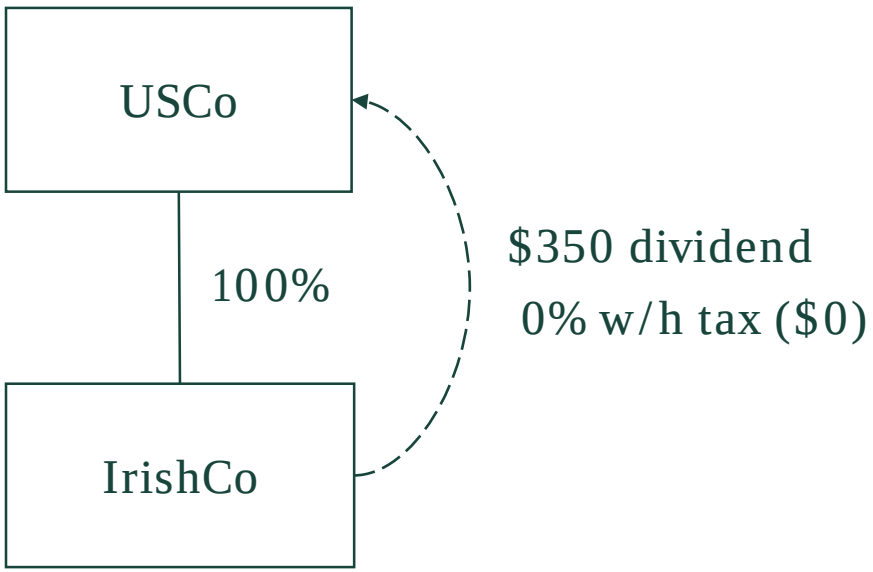
Taxation of a U.S. MNE - $350 not distributed to USCo



Worldwide ETR = $50/$400 = 12.5%

The U.S. MNE Tax Regime Pre-2018

Taxation of a U.S. MNE - $350 distributed to USCo



The U.S. MNE Tax Regime Pre-2018

Taxation of a U.S. MNE - $350 distributed to USCo

1120

	Dividend	$350
	§78 gross-up	50
	Total income	$400
×	U.S. tax rate	× .35
	Precredit tax	$140
–	DPC (§902)	– 50
–	FTC (§903)	– 0
	Net U.S. tax	$ 90

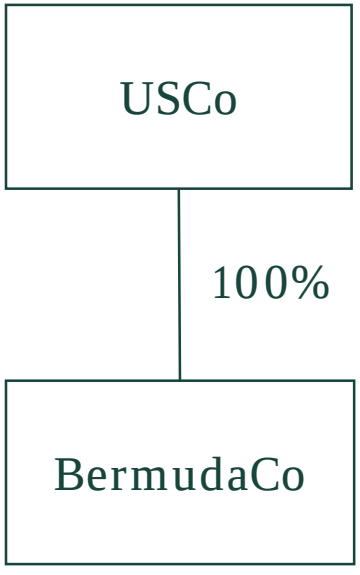
Worldwide ETR = $140/$400 = 35%

The U.S. MNE Tax Regime Pre-2018

- No deferral of U.S. tax on income earned outside the U.S.
  - Income was earned through a “controlled foreign corporation” (>50% owned by “U.S. shareholders”)
  - Income met the definition of “subpart F income”
    - Low-taxed (<90% of U.S. tax rate = 31.5%)
    - Income is passive (dividends, interest, rents, royalties)
    - Income is siphoned through a “foreign base company”
  - Such “tainted” income was treated as a “deemed dividend” to the U.S. shareholders and taxed by the U.S. currently

The U.S. MNE Tax Regime Pre-2018

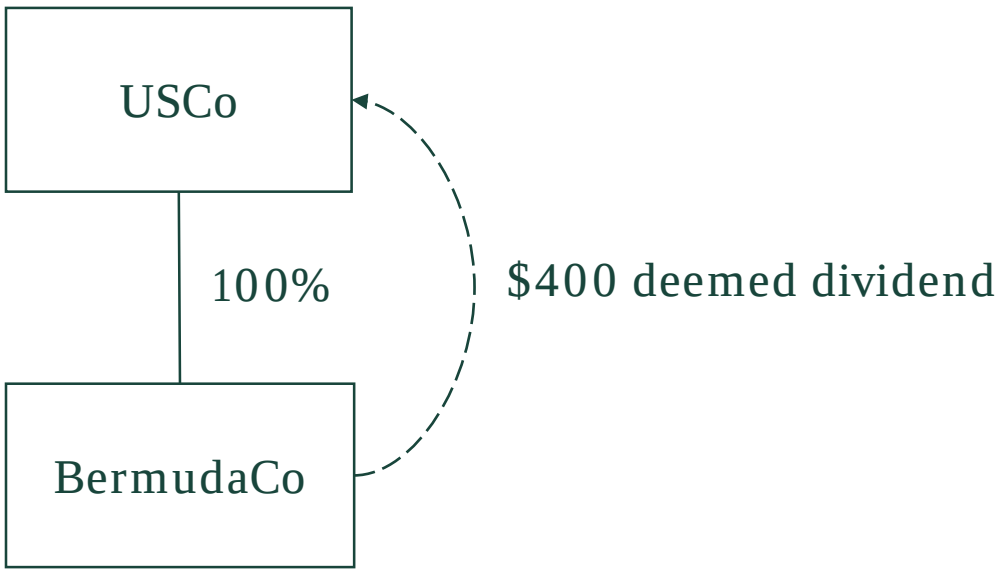
Taxation of a U.S. MNE



Pretax passive income	$400
Foreign tax (0%)	0
E&P	$400

The U.S. MNE Tax Regime Pre-2018

Taxation of a U.S. MNE - $400 deemed distributed to USCo



The U.S. MNE Tax Regime Pre-2018

Taxation of a U.S. MNE - $400 deemed distributed to USCo

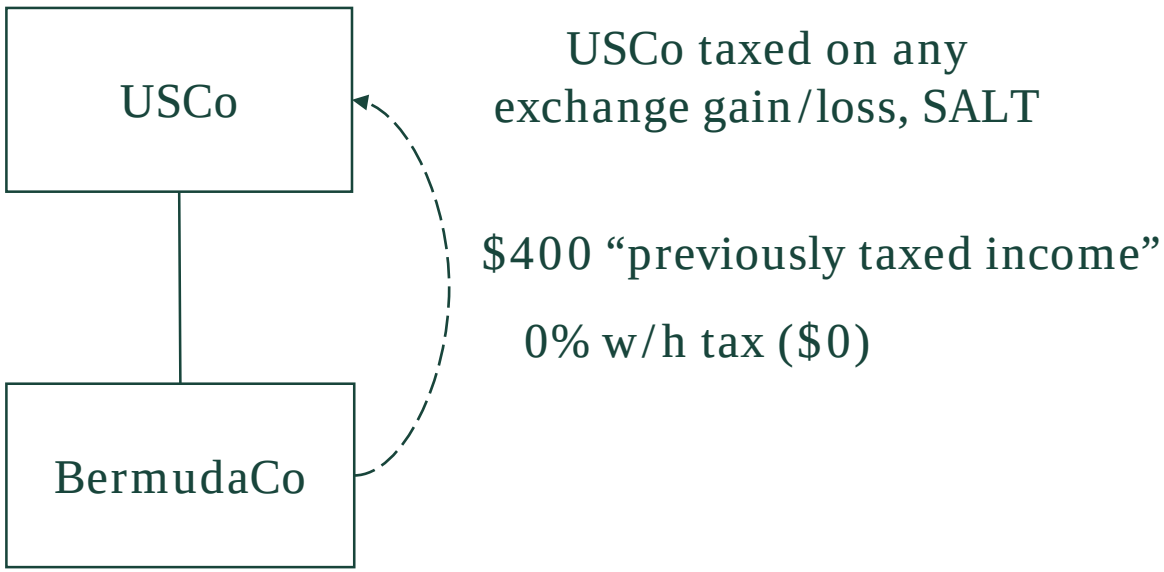
1120

	Sub F Dividend	$400
×	U.S. tax rate	× .35
	Precredit tax	$140
–	DPC (§960)	– 0
	Net U.S. tax	$140

Worldwide ETR = $140/$400 = 35%

The U.S. MNE Tax Regime Pre-2018

Taxation of a U.S. MNE - $400 distributed to USCo



The U.S. MNE Tax Regime Pre-2018

- Predictable outcomes of this “worldwide” tax system
  - U.S. corporations maximized (“optimized”) their worldwide earnings “sheltered” in low-tax countries through transfer pricing
  - U.S. corporations retained those earnings outside the U.S. to avoid the U.S. repatriation tax
  - U.S. corporations devised “Rube Goldberg” arrangements by which to repatriate cash to the U.S. without paying the repatriation tax (Killer B, Deadly D, Shanghai Lady, outbound F)
  - U.S. corporations created structures that would avoid the U.S. anti-deferral (subpart F) rules through “check the box” arrangements

The U.S. MNE Tax Regime Pre-2018

*Cash, cash equivalents, and short-term investments totaled **$138.5 billion** and $133.0 billion as of September 30, 2017 and June 30, 2017.*

*Of the cash, cash equivalents, and short-term investments as of September 30, 2017, **$132.1 billion was held by our foreign subsidiaries** and would be **subject to material repatriation tax effects**. The amount of cash, cash equivalents, and short-term investments held by foreign subsidiaries subject to other restrictions on the free flow of funds (primarily currency and other local regulatory) was $2.4 billion. As of September 30, 2017, approximately **88%** of the cash equivalents and short-term investments held by our foreign subsidiaries were invested in U.S. government and agency securities, approximately **3%** were invested in U.S. mortgage- and asset-backed securities, and approximately **2%** were invested in corporate notes and bonds of U.S. companies, all of which are denominated in U.S. dollars.*

Microsoft Corporation
Form 10-Q, September 30, 2017

$132.1 / $138.5 = 95.4%

The U.S. MNE Tax Regime Pre-2018

We earn a significant amount of our operating income outside the U.S., which is deemed to be permanently reinvested in foreign jurisdictions. As a result, as discussed above under Cash, Cash Equivalents, and Investments, the majority of our cash, cash equivalents, and short-term investments are held by foreign subsidiaries. ***We currently do not intend nor foresee a need to repatriate these funds****. We expect existing domestic cash, cash equivalents, short-term investments, cash flows from operations, and access to capital markets to continue to be sufficient to fund our domestic operating activities and cash commitments for investing and financing activities, such as regular quarterly dividends, debt maturities, and material capital expenditures, for at least the next 12 months and thereafter for the foreseeable future.*

Microsoft Corporation
Form 10-Q, September 30, 2017

The U.S. MNE Tax Regime Pre-2018

The amount of money held overseas by Russell 1000 companies as indefinitely reinvested earnings has reached an all-time high of ***2.6 trillion dollars****.* As shown in the graph on the left, this number has steadily climbed over the last nine years,* ***an increase of almost 140% since 2008****. Evidently, the decrease in number of companies with reinvested earnings in recent years (as mentioned above) did not translate into a drop in total amount of IRFE.*

... the total amount of IRFE held by the 526 Russell 1000 companies with such earnings ... ***averaged 9.95% of their total assets in 2016****. This number has increased by over 70% since 2008, when those IRFE averaged around 5.8% of total assets.*

Indefinitely Reinvested Foreign Earnings: Balances Held by the Russell 1000—A 9-Year Snapshot

Audit Analytics, July 2017

The U.S. MNE Tax Regime Pre-2018

As of June 30, 2017, we have not provided deferred U.S. income taxes or foreign withholding taxes on temporary differences of approximately ***$142 billion resulting from earnings for certain non-U.S. subsidiaries which are permanently reinvested outside the U.S.*** *The unrecognized deferred tax liability associated with these temporary differences was approximately* ***$45 billion*** *as of June 30, 2017.*

Microsoft Corporation
Form 10-K, June 30, 2017

($142 + x).35 – x = $45 residual U.S. tax

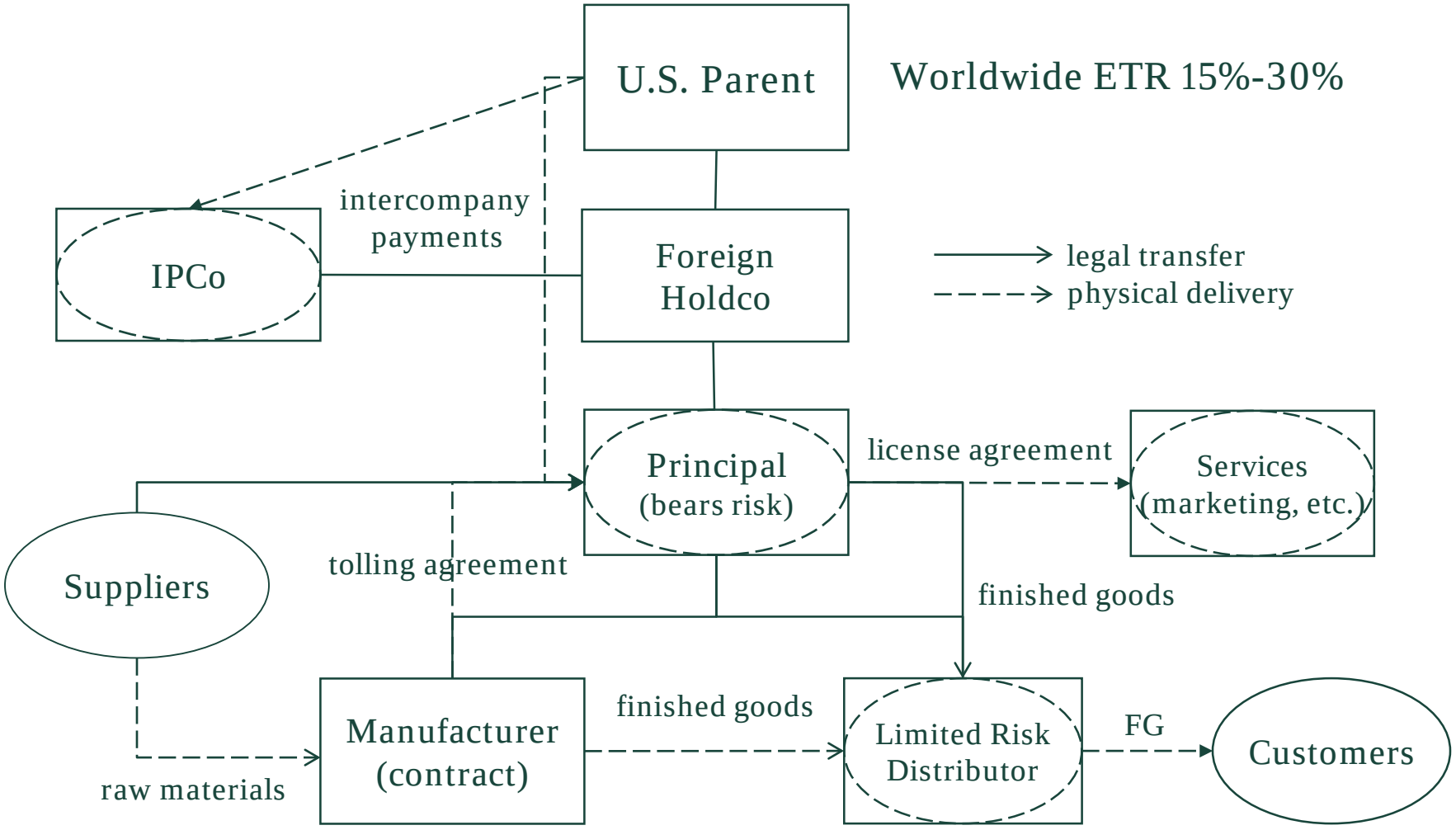
x = foreign tax paid

.65x = $5 billion

x = 7.7 billion of foreign tax paid

FETR = $8 / ($142 + $8) = ***5% !!!***

The U.S. MNE Tax Regime Pre-2018



Global Reaction to TESCM

- Predictable responses to these actions
  - More aggressive transfer pricing audits by the U.S. and other high-tax countries – increased global tax controversy!
  - OECD BEPS (base erosion and profit shifting) project – country-by-country reporting
  - European Commission Anti-Tax Abuse Directive (ATAD I & II)
  - Congressional hearings!
    - Apple
    - Caterpillar
    - Hewlett Packard

The U.S. MNE Tax Regime Post-2017

FDII
- ***13.125%*** U.S. tax
- Separate FTC basket
- 80% FTC, no carryover

t = 21%

BEAT
- ***10%*** U.S. "excise" tax
- >3% base-erosion payments
- Exception for COGS, SCM
- No carryover

USCo

§163(j)
- interest limitation
- 30% tax EBITDA

Current U.S. tax at ***21%***
FTC for branch foreign tax (separate basket)
10 year FTC carryover

CFC

Exempt income
- ≤10% QBAI
- high-tax subF income
- No FTC

Subpart F income
- ***21%*** U.S. tax
- FTC for deemed-paid FT
- 10 year FTC carryover

GILTI
- ***10.5%*** U.S. tax
- Separate FTC basket
- 80% FTC, no carryover

The U.S. MNE Tax Regime Post-2017

- Limited "territorial taxation"
  - Section 245A generally provides a 100% DRD for the foreign-source portion of dividends received by a U.S. corporation from foreign corporations with respect to which it is a 10% U.S. shareholder ("***participation exemption***").
  - To qualify for the 100% DRD, the E&P from which the dividend is paid must not be in excess of a "normal return" on the tax basis of the foreign corporation's assets (≤10% of QBAI).
  - Withholding taxes paid on the remittance ***are not*** creditable against the precredit U.S. tax.
  - The §902 deemed paid credit is repealed.

The U.S. MNE Tax Regime Post-2017

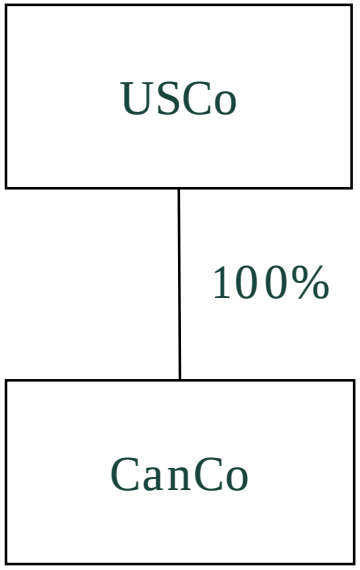
- Pre-TCJA post-1986 AE&P deemed repatriated (§965)
  - Effective tax of 15.5% imposed on cash component
  - Effective tax of 8% imposed on non-cash component
  - Tax is payable over an 8-year period, interest free

*As a result of the TCJA, we are required to pay a one-time transition tax of **$17.9 billion** on deferred foreign income not previously subject to U.S. income tax. In fiscal year 2018, we paid transition tax of **$**228 million. Under the TCJA, the remaining transition tax of $17.6 billion is payable interest-free over eight years, with 8% due in each of the first five years, 15% in year six, 20% in year seven, and 25% in year eight.*

Microsoft, Inc. Form 10-K, 9/30/2018

The U.S. MNE Tax Regime Post-2017

Taxation of a U.S. MNE post-TCJA

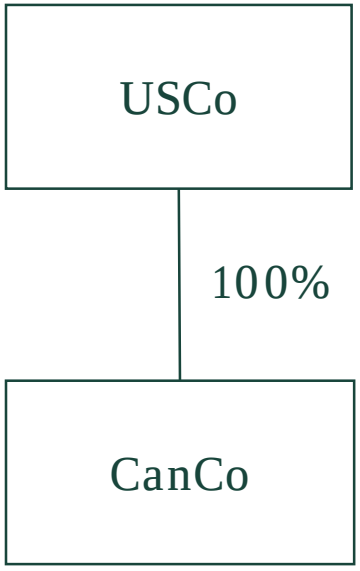


Pretax income	$400
Foreign tax (25%)	100
E&P	$300

QBAI > $3,000

The U.S. MNE Tax Regime Post-2017

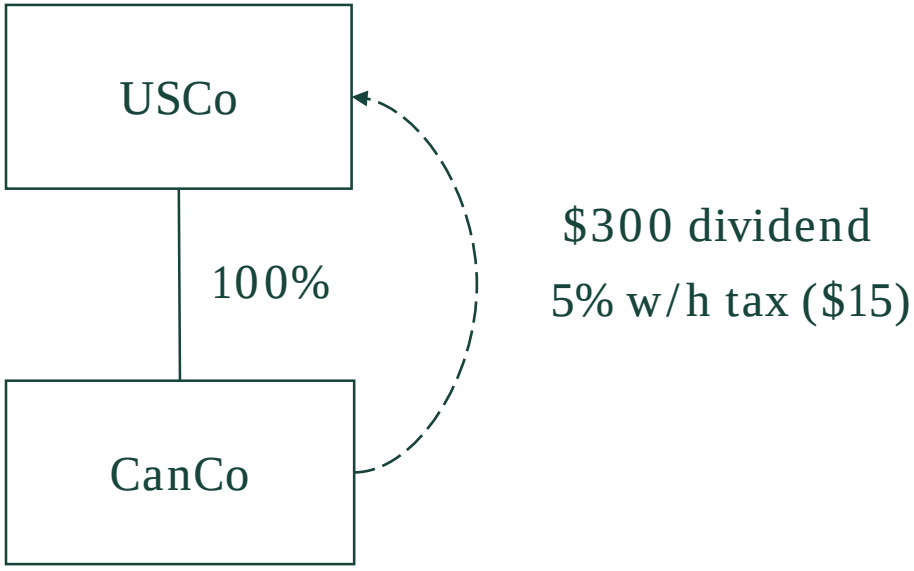
Taxation of a U.S. MNE - $300 E&P not distributed to USCo



Worldwide ETR = $100/$400 = 25%

The U.S. MNE Tax Regime Post-2017

Taxation of a U.S. MNE - $300 E&P distributed to USCo



The U.S. MNE Tax Regime Post-2017

Taxation of a U.S. MNE - $300 E&P distributed to USCo

1120

Dividend	$300
100% DRD	300
Taxable income	$ 0
× U.S. tax rate	× .21
Precredit tax	$ 0
Stranded FTC	$ 15

Worldwide ETR = $115/$400 = 28.75%

The U.S. MNE Tax Regime Post-2017

- Subpart F remains – no deferral of U.S. tax on subpart F income earned outside the U.S. through a CFC
  - Low-taxed = 19.8% (90% x 21%)
  - Full deemed-paid FTC allowed
  - FTC carryover = 10 years
  - Subpart F deemed dividends are subject to a ***look-through*** rule for FTC basket purposes
    - The deemed dividend is placed in the FTC basket for the income out of which the dividend is deemed paid (general, passive, or branch, but not GILTI).

The U.S. MNE Tax Regime Post-2017

- New anti-deferral rules are applied to "***global intangible low-taxed income***" (GILTI) - §951A
  - Income is earned through a "controlled foreign corporation" (>50% owned by "U.S. shareholders")
  - Income meets the definition of "CFC tested income"
    - Not ECI, subpart F income, income excluded from subpart F under the high-tax exception, related-person dividends
    - Tested income exceeds a normal return (10% x QBAI)
  - Such "tainted" income is treated as an income inclusion to the U.S. shareholders and taxed by the U.S. currently.
  - GILTI is eligible for a 50% deduction (§250)

The U.S. MNE Tax Regime Post-2017

- Foreign taxes associated with GILTI are included in the income inclusion computation (gross-up)
- A FTC is allowed equal to 80% of the gross-up
- The GILTI inclusion and the gross-up are put in a separate GILTI FTC limitation basket
- Any excess FTC associated with the GILTI inclusion is not eligible for carryback or carryforward
- The tax is imposed on the U.S. shareholders of the CFC (an individual or corporation owning ≥10% of voting stock or value).

The U.S. MNE Tax Regime Post-2017

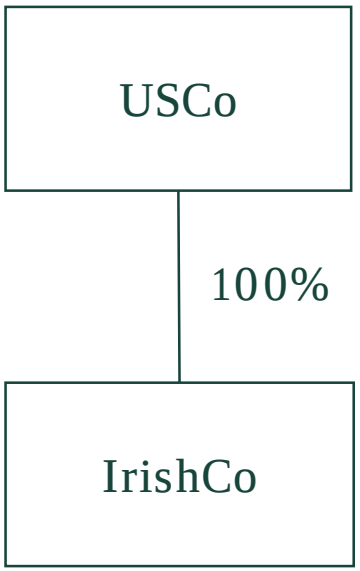
- Although GILTI is computed in a manner similar to subpart F income, it is not considered subpart F income.
  - Subpart F income is computed at a CFC-level basis.
  - The GILTI inclusion is computed at a U.S. shareholder-level basis (aggregate ownership in CFCs).
- ***Theoretically*** (***assuming no deduction apportionment***), no residual U.S. tax is owed on GILTI if the effective ***foreign*** tax rate imposed on GILTI is 13.125% or higher.

($0.86875 + .13125 - .50(1.00) x .21 - .80(.13125) = $0

(GILTI inclusion + foreign tax – §250 deduction) x 21% - 80% FTC

The U.S. MNE Tax Regime Post-2017

GILTI example



Pretax income	$400
Foreign tax (12.5%)	50
E&P	$350

QBAI = $0 (all self-created intangibles)

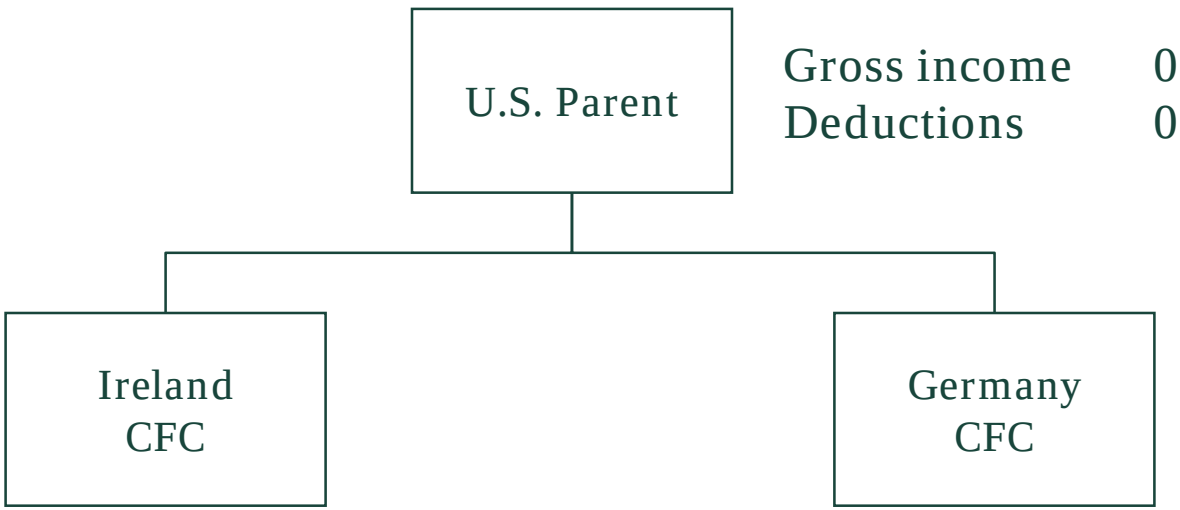
The U.S. MNE Tax Regime Post-2017

"Straight-forward" GILTI computation

CFC tested income	$350	
GILTI	$350	$350 – 10%($0)
§78 gross-up	50	
§951A inclusion	$400	
50% GILTI deduction	200	
Taxable income	$200	
x 21%	0.21	
Precredit U.S. tax	$ 42	$400 x 50%
§960 FTC (80%)	40	$50 x 80%
Net U.S. tax	$ 2	

The U.S. MNE Tax Regime Post-2017

"Less straight-forward" example



Gross income	0
Deductions	0

Sales income	20,000
IRE tax (12.5%)	2,500
Tested income	17,500
QBAI	0

Sales income	5,000
GER tax (30%)	1,500
Tested income	3,500
QBAI	30,000

The U.S. MNE Tax Regime Post-2017

GILTI computation – no expenses allocated to GILTI

Σ CFC tested income	$21,000	17,500 + 3,500
GILTI	18,000	21,000 – (10% x 30,000)
§78 gross-up	3,400	4,000 x 18,000/21,000
§951A inclusion	$21,400	
50% GILTI deduction	5,700	
Taxable income	10,700	$21,400 x 50%
x 21%	0.21	
Precredit U.S. tax	$2,247	
§960 FTC	2,720	($3,400 x 80%)
Net U.S. tax	$ 0	

F ETR = $4,000/$25,000 = 16%

"Lost FTC" = $4,000 - $2,720 = $1,280

$3,000 eligible for 100% DRD

The U.S. MNE Tax Regime Post-2017

New Tax on Overseas Earnings Hits Unintended Targets

By Richard Rubin, March 26, 2018, WSJ

WASHINGTON—A new tax aimed at overseas income earned by U.S. technology and pharmaceutical firms is hitting unexpected places, including Kansas City Southern , a U.S. railroad company.

The new minimum tax on foreign earnings will cost Kansas City Southern $25 million a year, according to the company, ***which warns the measure also encourages it to borrow money outside the U.S.***

Kansas City Southern's predicament is an example of the shifts in international taxation emanating from last year's rewrite of the U.S. tax code, and of the potential unintended consequences that companies are starting to see. Congress lowered the corporate tax rate to 21% from 35% and tried to change the way the U.S. taxes profits abroad, in an effort to boost domestic investment and help U.S. firms compete globally.

The U.S. MNE Tax Regime Post-2017

GILTI is hitting Kansas City Southern and other companies like it because of the way the new tax interacts with other provisions in the tax code, specifically the treatment of foreign tax credits that are supposed to prevent two countries from taxing the same income. When companies calculate the credits they receive for paying taxes overseas, the law typically requires them to assign some of their domestic expenses to foreign jurisdictions. The result for some companies is that, for U.S. tax purposes, their foreign income and foreign taxes look smaller than they actually are, shrinking their credits*. That, in turn, could force them to pay the new minimum tax on top of their foreign tax bills.*

The U.S. MNE Tax Regime Post-2017

13.125% tax rate with $100 expenses allocated to GILTI

§951A inclusion	1,000
50% GILTI deduction	500
Taxable GILTI	500
x 21%	x .21
Precredit U.S. tax	105
§960 FTC (*)	84
Net U.S. tax	21

FTC limitation = (500 – 100) x 21% = $84

The U.S. MNE Tax Regime Post-2017

While the Tax Reform Act provides for a territorial tax system, beginning in 2018, it includes the global intangible low-taxed income ("GILTI") provision. The Company elected to account for GILTI tax in the period in which it is incurred. The GILTI provisions require the Company to include in its U.S. income tax return foreign subsidiary earnings in excess of an allowable return on the foreign subsidiary's tangible assets. ***The GILTI tax expense is primarily caused by a U.S. foreign tax credit limitation which requires an allocation of interest expense to the GILTI income, effectively rendering the allocated interest expense non-deductible. As a result of the GILTI provisions, the Company's effective tax rate increased by 1.3% for 2018.***

Kansas City Southern, Form 10-K, December 31, 2018

The U.S. MNE Tax Regime Post-2017

	2018		2017		2016	
	Dollars	Percent	Dollars	Percent	Dollars	Percent
Income tax expense using the statutory rate in effect	$ 186.2	21.0%	$ 306.0	35.0%	$ 231.9	35.0%
Tax effect of:						
Difference between U.S. and foreign tax rate	46.1	5.2%	(26.6)	(3.0%)	(19.2)	(2.9%)
Foreign exchange (i)	21.8	2.5%	31.6	3.6%	(45.0)	(6.8%)
Tax credits	(14.2)	(1.6%)	(8.4)	(1.0%)	(14.3)	(2.2%)
Global intangible low-taxed income ("GILTI") tax, net	11.8	1.3%	—	—	—	—
Withholding tax	11.2	1.3%	8.1	0.9%	9.6	1.4%
State and local income tax provision, net	7.5	0.8%	8.3	1.0%	8.1	1.2%
Change in U.S. tax rate	(2.2)	(0.3%)	(487.6)	(55.8%)	—	—
Deemed mandatory repatriation	(18.7)	(2.1%)	74.6	8.6%	—	—
Other, net	8.0	0.9%	4.4	0.5%	11.7	1.9%
Income tax expense (benefit)	$ 257.5	29.0%	$ (89.6)	(10.2%)	$ 182.8	27.6%

Kansas City Southern Form 10-K, 2018

History of GILTI

- Reasons given for the enactment of GILTI in TCJA

  The Committee [Congress] recognizes that, without any base protection measures, the participation exemption system established by the bill creates an incentive for U.S. corporations to allocate income that would otherwise be subject to the full U.S. corporate tax rate to foreign affiliates operating in low- or zero-tax jurisdictions*, where the income could potentially be distributed back to the U.S. corporation with no U.S. tax imposed. As a result, U****.S. corporations may have an incentive to serve the U.S. market and foreign markets through their foreign affiliates rather than U.S. affiliates****.*

History of GILTI

To address this possible source of erosion of the U.S. tax base, and the potential migration of economic activity from the United States to other countries, the provision ***subjects certain income earned by CFCs to current U.S. tax****. Subjecting that income to current U.S. tax reduces the tax benefit of allocating that income to low- or zero-tax jurisdictions. However, the Committee recognizes that* ***taxing that income at the full U.S. corporate tax may hurt the competitive position of U.S. corporations relative to their foreign counterparts****, and has decided to tax that income at a reduce rate (with a portion of foreign tax credits available to offset U.S. tax).*

History of GILTI

The Committee [Congress] believes the type of ***income that is most readily allocated to low- or zero-tax jurisdictions is income derived from intangible property, or intangible income****.* ***Intangible income is mobile*** *and constitutes a large portion of the foreign-source income earned by U.S. corporations, and significant erosion of the U.S. tax base could result if no base protection measure were adopted in a move to a participation exemption system. At the same time, if intangible income is located in a jurisdiction with a sufficiently high tax rate, the Committee believes there is limited base erosion concern. Consequently, the* ***Committee believes that taxing global intangible low-tax income ("GILTI") on a current basis addresses the primary source of base erosion arising from a move toward a participation exemption system****.*

History of GILTI

The Committee views the ***most difficult problem with identifying GILTI as identifying intangible income****, and believes that calculating intangible income based on facts and circumstances may be both complicated and administratively difficult. As a result, the provision* ***adopts a formulaic approach*** *to calculating intangible income to make the determination simpler and more administrable. The formula is based on the* ***premise that directly calculating tangible income is simpler than calculating intangible income****.*

History of GILTI

The provision ***approximates a U.S. corporation's tangible income earned through its CFCs as a 10-percent return on the U.S. corporation's aggregate pro rata share of the adjusted basis in tangible depreciable property across each CFC*** *with respect to which it is a U.S. shareholder.* ***Intangible income is a residual amount*** *generally determined by* ***subtracting tangible income from the total amount of certain income earned by each CFC****. The Committee believes that tangible property, and the associated tangible income, are relatively immobile and an indicator of the extent to which a DVD has active business operations and presence in any particular jurisdiction. Therefore, the* ***provision exempts tangible income from U.S. tax****. However, it generally subjects the corporation's GILTI to current U.S. tax at a reduced rate, with 80 percent of foreign tax credits available to offset U.S. tax.*

History of GILTI

GILTI is calculated at the U.S. shareholder level *after aggregating both certain income and adjusted basis in tangible depreciable property on a pro rata basis across each CFC with respect to which it is a U.S. shareholder. GILTI is treated as subpart F income, and the aggregate nature of the GILTI calculation is a departure from present law, under which subpart F income is calculated at the CFC level. The Committee believes that* ***calculating GILTI on an aggregate basis, instead of on a CFC-by-CFC basis, reflects the interconnected nature of a U.S. corporation's global operations and is a more accurate way of determining a U.S. corporation's global intangible income****.*

History of GILTI

The provision does not permit full foreign tax credits with respect to GILTI. The Committee believes that ***permitting a full foreign tax credit with respect to GILTI would make taxpayers indifferent between paying U.S. tax and foreign tax,*** *and may reduce the incentive for taxpayers to minimize the foreign tax they pay or encourage foreign countries to adopt "soak-up" taxes knowing that a taxpayer's combined U.S. and foreign tax liability may remain unchanged with the adoption of the soak-up tax if foreign tax credits were allowed in full. The Committee believes that* ***allowing for partial foreign tax credits with respect to GILTI will result in an increase in the amount of U.S. tax revenue collected and decrease the amount of foreign tax revenue collected (relative to the case where full foreign tax credits are permitted with respect to GILTI).***

History of GILTI

The Committee believes that certain items of income earned by CFCs should be excluded from the GILTI, either because they should be exempt from U.S. tax–as they are generally not the type of income that is the source of base erosion concerns–or are already taxed currently by the United States. ***Items of income excluded from GILTI because they are exempt from U.S. tax under the bill include … income subject to high levels of foreign tax****. Items of income excluded from GILTI because they are taxed currently by the United States include ECI and subpart F income earned by CFCs. CFC look-through payments are also excluded from GILTI to help implement the dividend exemption system established by the bill. [Senate Committee on the Budget, 115th Cong., Reconciliation Recommendations Pursuant to H. Con. Res. 71, at 365 (Comm. Print 2017) ("Senate Explanation"), pp. 370-371].*

Impact of GILTI on U.S. MNEs

Disclosure challenges

While existing or proposed disclosures address several of the key changes to the U.S. Federal Tax Code (for example, paragraphs 740-10-50-9(g) and 740-10-50-12 require disclosures that address a change in the corporate income tax rate), ***there are no existing or proposed disclosures that explicitly address a company's exposure to certain of the new international tax provisions in the Tax Cuts and Jobs Act*** *(for example, taxes on GILTI or BEAT).*

Board (FASB) Meeting Handout

Disclosure Framework—Disclosure Review: Income Taxes

November 14, 2018

Impact of GILTI on U.S. MNEs

Financial statement users from the IAC, FASAC, and the income tax disclosure workshop reiterated that ***one of their primary areas of focus when analyzing taxes is on the sustainability of an entity's tax rate****. Users explained that they often rely on the entity to provide them with the effective tax rate (ETR) because it is difficult to forecast. However,* ***users indicated that it would be useful to understand the specific effect of GILTI, BEAT, and FDII on the ETR and income tax expense.*** *One user commented that if the amount of GILTI or BEAT is material, investors would benefit from a required separate line item in the entity's ETR reconciliation.*

Impact of GILTI on U.S. MNEs

Preparers *indicated that it is* ***unnecessary to require a separate disclosure of the effect of GILTI****, BEAT, or FDII on income tax expense. Preparers commented that if GILTI, BEAT, or FDII had a significant effect on the ETR, then they would already be required to disclose the separate effect because of the* ***5 percent threshold for the ETR reconciliation**** *(a current SEC requirement and a proposed disclosure). Furthermore,* ***preparers stated that it would be costly and complex to differentiate the individual tax effect of GILTI, BEAT, and FDII because of the interconnectedness of those international tax provisions****. In addition, preparers indicated that separate presentation of those provisions* ***would not provide useful information to preparers because of the interconnectedness****.*

* 21% x 5% = 1.05%

Impact of GILTI on U.S. MNEs

For example, an entity's tax strategy may result in a higher amount of GILTI in a given year but a lower income tax amount in a foreign jurisdiction. In this case, the preparer would consider its overall tax burden on foreign earnings instead of the components. ***Preparers also did not support requiring disclosure of specific provisions of the Tax Cuts and Jobs Act because they are similar to other provisions of the tax law that result in U.S. taxes on foreign earnings*** *(for example, Subpart F income, which taxes income on passive investments held by foreign subsidiaries) for which no specific disclosure is required. Therefore, requiring disclosures for those specific provisions in the tax bill would be inconsistent with how other aspects of tax law are treated.*

Impact of GILTI on U.S. MNEs

The Board decided ***not to require any additional disclosures for any provisions of the Tax Cuts and Jobs Act***, ***including global intangible low-taxed income***, the base erosion anti-abuse tax, or foreign-derived intangible income.

	For Years Ended December 31,		
	2018	2017	2016
U.S. statutory income tax rate	**21.0%**	35.0%	35.0%
U.S. tax benefit for foreign derived intangible income	**(5.3)**	—	—
U.S. Tax Act transitional non-cash expense	**4.2**	—	—
U.S. Tax Act enactment-date effects and measurement period adjustments	**(0.7)**	12.7	—
U.S. tax on global intangible low-taxed income	**0.4**	—	—
U.S. tax benefit for manufacturing	**—**	(1.6)	(1.5)
U.S. excess tax benefit for stock compensation	**(2.0)**	(4.1)	(3.0)
U.S. R&D tax credit	**(1.3)**	(1.1)	(1.2)
U.S. non-deductible expenses	**0.2**	0.2	0.3
Non-U.S. effective tax rates	**0.1**	(2.5)	(3.7)
Impact of changes to uncertain tax positions	**—**	0.7	0.6
Other	**(0.1)**	0.1	0.6
Effective tax rate	**16.5%**	39.4%	27.1%

Texas Instruments, Form 10-K, 2018

Impact of GILTI on U.S. MNEs

Teasing out the impact of GILTI on the ETR of a U.S. MNE using Form 10-K information (Biogen Inc.)

17. Income Taxes

Income Tax Expense

Income before income tax provision and the income tax expense consist of the following:

(In millions)	For the Years Ended December 31, 2018	2017	2016
Income before income taxes (benefit):			
Domestic	$ 3,877.0	$ 3,540.4	$ 3,655.4
Foreign	2,022.6	1,588.4	1,277.6
Total	$ 5,899.6	$ 5,128.8	$ 4,933.0
Income tax expense (benefit):			
Current:			
Federal	$ 1,131.8	$ 2,201.4	$ 1,304.3
State	45.5	57.0	55.1
Foreign	140.0	108.6	52.9
Total	1,317.3	2,367.0	1,412.3
Deferred:			
Federal	$ (62.0)	$ 241.0	$ (125.6)
State	(7.4)	9.9	(3.8)
Foreign	177.7	(159.2)	(45.6)
Total	108.3	91.7	(175.0)
Total income tax expense	$ 1,425.6	$ 2,458.7	$ 1,237.3

F- 54

Impact of GILTI on U.S. MNEs

Tax Rate

A reconciliation between the U.S. federal statutory tax rate and our effective tax rate is summarized as follows:

	For the Years Ended December 31,		
	2018	2017	2016
Statutory rate	21.0%	35.0%	35.0%
State taxes	0.6	0.8	0.9
Taxes on foreign earnings	(1.9)	(11.1)	(9.6)
Credits and net operating loss utilization	(0.9)	(0.8)	(1.4)
Purchased intangible assets	1.2	1.4	1.2
Manufacturing deduction	—	(1.9)	(1.9)
Other permanent items	0.3	0.7	0.5
2017 Tax Act	2.1	22.9	—
GILTI	1.6	—	—
Impairment of ZINBRYTA related tax assets	—	0.9	—
Other	0.2	—	0.4
Effective tax rate	24.2%	47.9%	25.1%

GILTI = $5,900 x .016 = $94

Impact of GILTI on U.S. MNEs

Geographic Information

The following tables contain certain financial information by geographic area:

December 31, 2018 (In millions)	U.S.	Europe	Asia	Other	Total
Product revenues from external customers	$ 6,800.5	$ 3,370.3	$ 281.2	$ 434.8	$10,886.8
Revenues from anti-CD20 therapeutic programs	$ 1,903.4	$ 0.2	$ —	$ 76.6	$ 1,980.2
Other revenues from external customers	$ 457.0	$ 32.7	$ 96.2	$ —	$ 585.9
Long-lived assets	$ 1,152.7	$ 2,442.8	$ 3.9	$ 1.8	$ 3,601.2

Impact of GILTI on U.S. MNEs

- Approach 1

Foreign PBT	2,023
Tax at 21%	425
Foreign provision	140
Difference	285
Rate reconciliation foreign differential	112
GILTI "plug in" for foreign rate differential	173

Impact of GILTI on U.S. MNEs

- Approach 2

Foreign PBT	2,023
Deemed tangible return	123
GILTI	1,900
§250 deduction	950
Taxable GILTI income	950
Pre credit U.S. tax	200
FTC (current provision x 80%)	105
GILTI tax	**94**

Impact of GILTI on U.S. MNEs

- Impact of GILTI on the ETR using Approach 1

F PBT	2,023	
F current provision	140	6.9%
GILTI plug-in	173	8.5%
F statutory ETR (provision + GILTI)		**15.5%**

Impact of GILTI on U.S. MNEs

- Impact of GILTI on the ETR using Approach 2

F PBT	2,023	
F current provision	140	6.9%
GILTI plug-in	94	4.6%
F statutory ETR (provision + GILTI)		**11.5%**

Impact of GILTI on U.S. MNEs

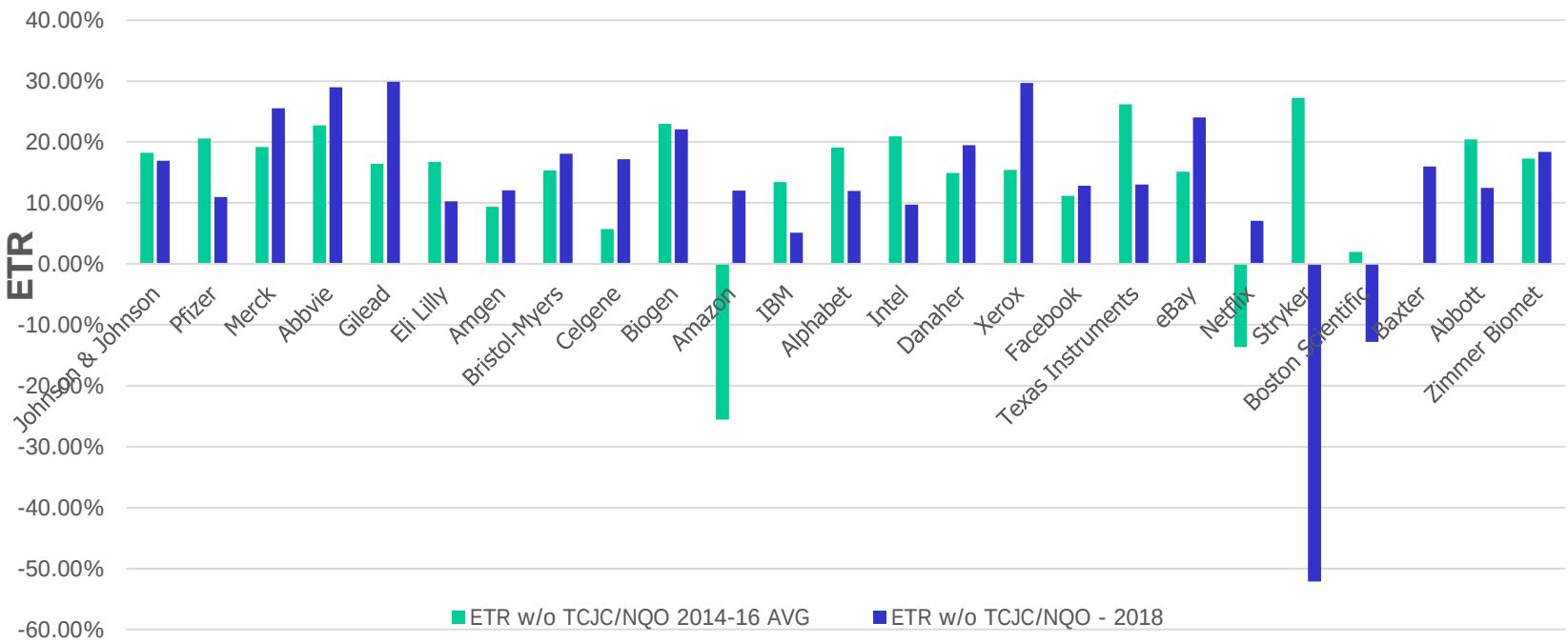
- Caveats
  - Financial accounting income ≠ taxable income
  - Not all Foreign PBT is GILTI
  - PP&E in segmental reporting may not qualify as QBAI
  - Foreign PBT in the tax footnote is based on entity location
  - Accounting ETRs can be distorted by discrete items unrelated to international tax changes
  - Tax footnote disclosures and rate reconciliations are not consistent (diversity in disclosures!)

Impact of GILTI on U.S. MNEs

- Sample (12/31/18 FYE)
  - Pharma (10 companies)
  - Tech (10 companies)
  - Medical devices (5 companies)

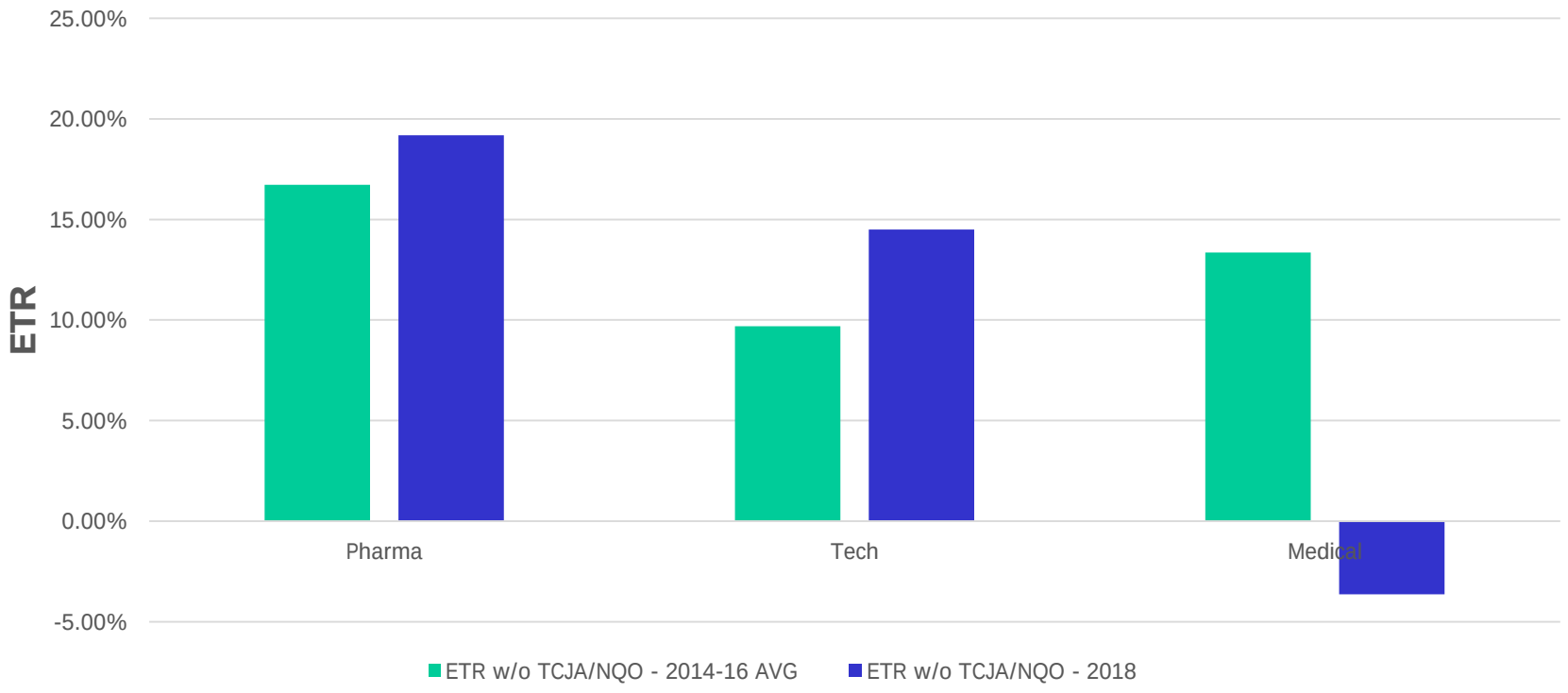
Impact of GILTI on U.S. MNEs

ETR w/o TCJA/NQO – 2014-16 Average vs. 2018



Impact of GILTI on U.S. MNEs

ETR w/o TCJA/NQO – 2014-16 Average vs. 2018 By Industry

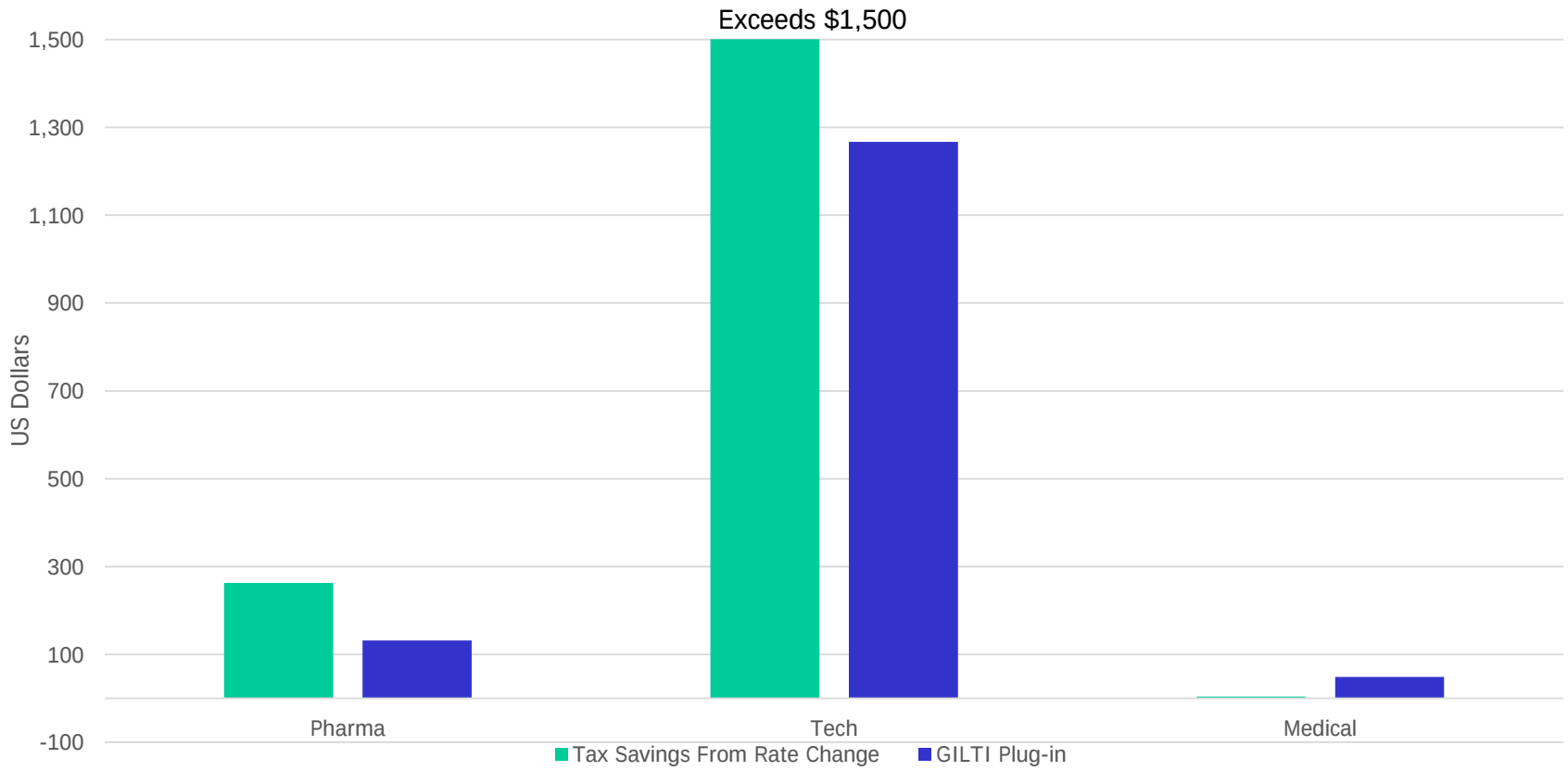


Impact of GILTI on U.S. MNEs

Tax Savings from Rate Change vs. GILTI Tax

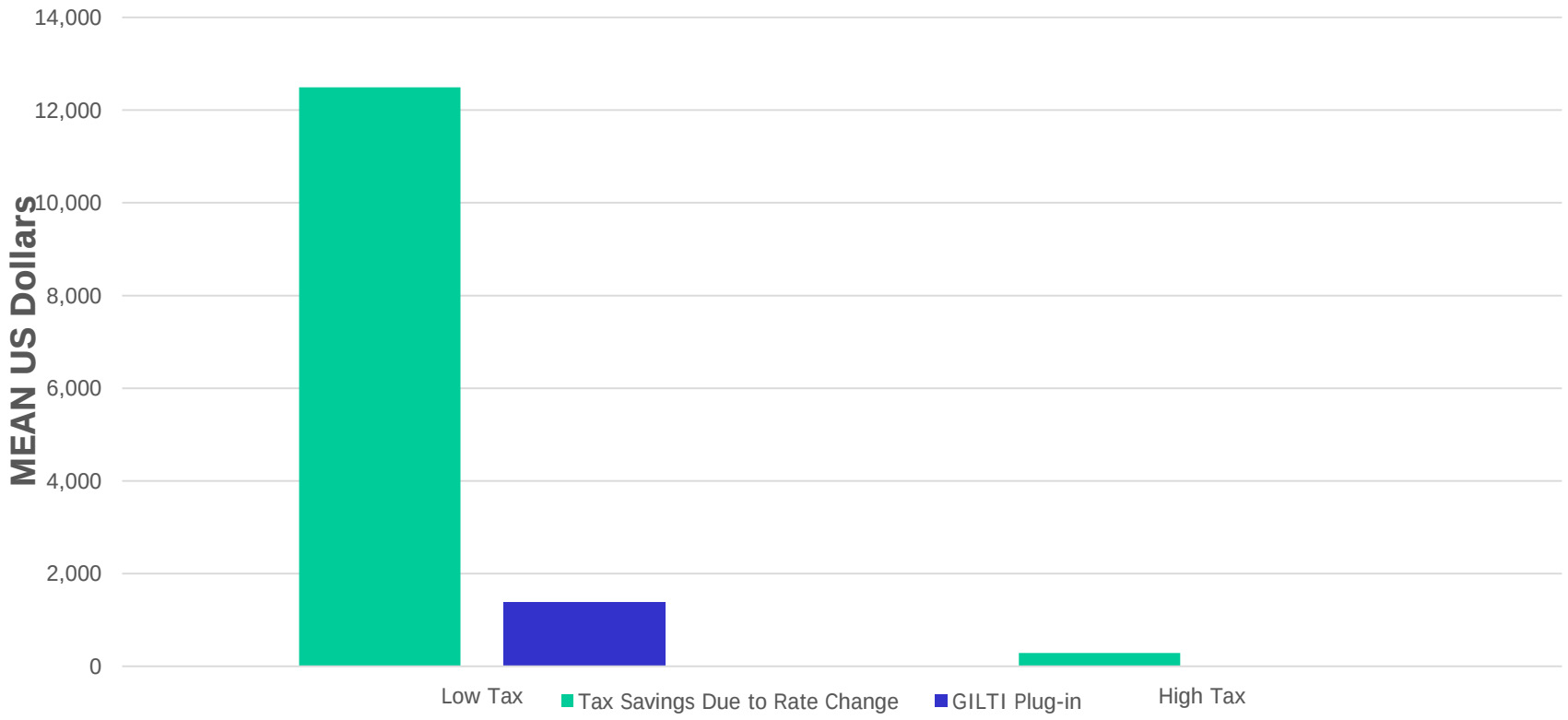
Impact of GILTI on U.S. MNEs

Tax Savings from Rate Change vs. GILTI Tax – By Industry



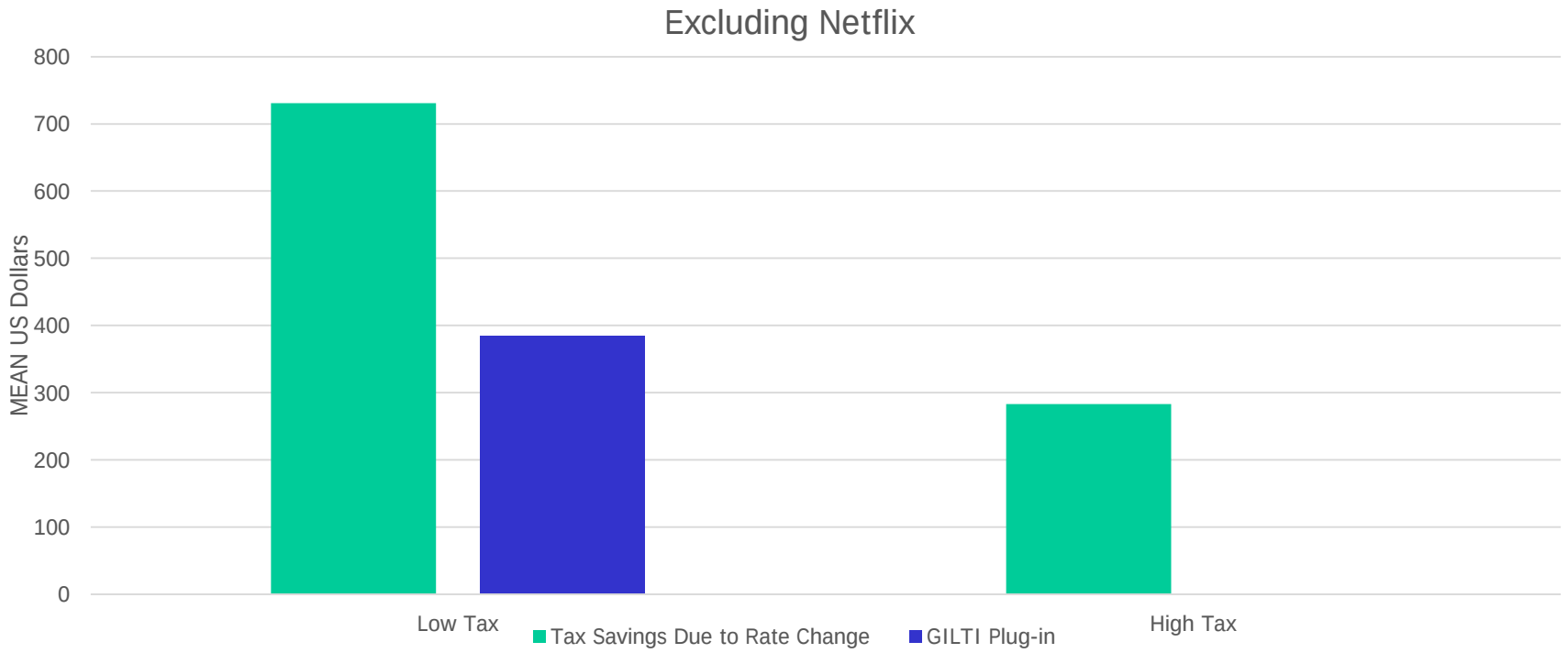
Impact of GILTI on U.S. MNEs

Tax Savings from Rate Change vs. GILTI Tax – Low Foreign Tax vs. High Foreign Tax (> 13.125%)



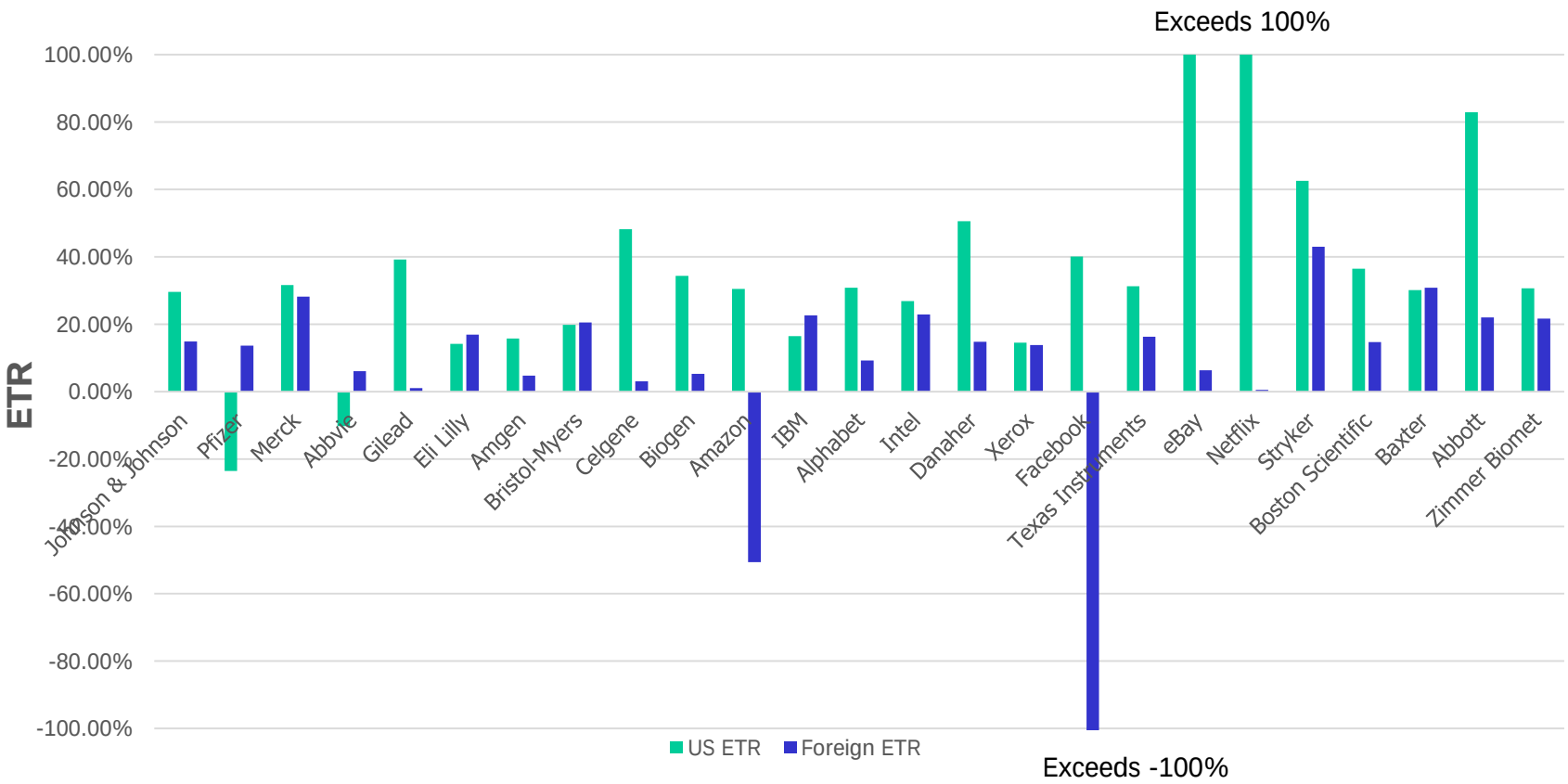
Impact of GILTI on U.S. MNEs

Tax Savings from Rate Change vs. GILTI Tax – Low Foreign Tax vs. High Foreign Tax (> 13.125%) [Excluding Netflix]



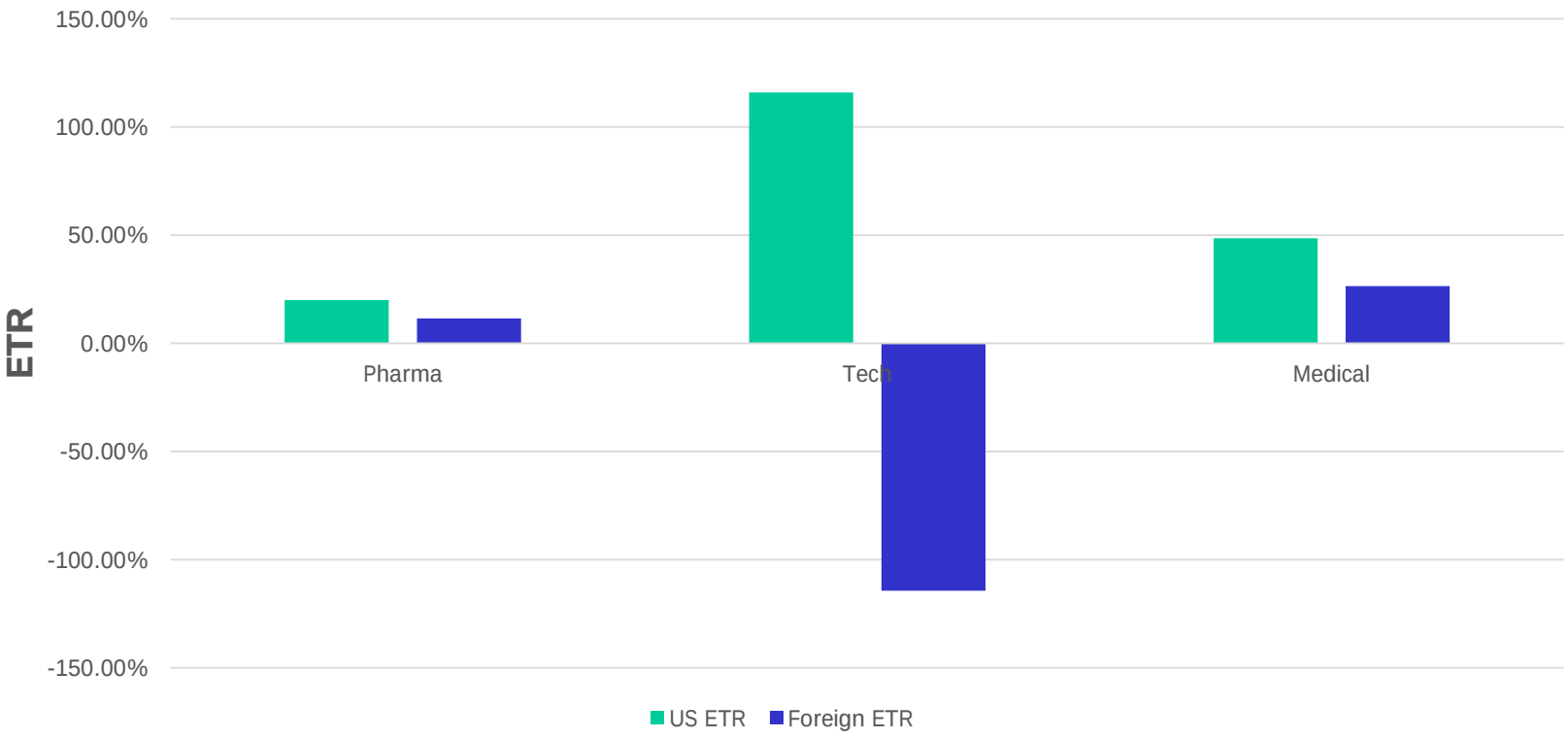
Impact of GILTI on U.S. MNEs

US vs. Foreign ETR



Impact of GILTI on U.S. MNEs

US vs. Foreign ETR – By Industry



Base Erosion and Anti-Abuse Tax

- Base Erosion and Anti-Abuse Tax
  - New §59A imposes a 10% minimum tax on "excess" "base erosion payments" made to related parties (owned 25% or more by the U.S. corporation).
  - The minimum tax is 10% of the taxpayer's "***modified taxable income***," over the shareholder's regular tax liability for the taxable year net of certain tax credits.
  - Base erosion payments are deductible amounts (interest, royalties, rent, fees) paid to a related party that "erode" the taxpayer's U.S. taxable income.
  - "Excess base erosion payments" are those payments that are collectively 3% or more of the taxpayer's total deductions.

Base Erosion and Anti-Abuse Tax

- The BEAT only applies to C corporations with average annual gross receipts of at least ***$500 million*** for the three tax-year periods ending with the preceding tax year.
- The BEAT cannot be carried forward to years when the regular tax exceeds the BEAT.
- BEAT payments can produce CFC tested income for GILTI purposes (a “boomerang effect”).

Base Erosion and Anti-Abuse Tax

- Formula to compute the BEAT liability

MTI x 10% - Adjusted Regular Tax Liability

MTI (Modified Taxable Income) =

Regular Taxable Income
+ Base Erosion Payments
+ Base Erosion Percentage of NOL deduction

Adjusted Regular Tax Liability

Regular Tax Liability
− Certain Credits (all credits except the research credit)

Base Erosion and Anti-Abuse Tax

Example (JCT)

USCo has the following income and deductions:

Gross receipts	$600
Salaries paid to U.S. employees	100
Interest paid to a related FP	50
Royalties paid to a related FP	250
Foreign tax credits	2
Research credits	3

Base Erosion and Anti-Abuse Tax

Regular taxable income

Gross receipts	$600
Salaries paid to U.S. employees	100
Interest paid to a related FP	50
Royalties paid to a related FP	250
Taxable income	$200

Regular tax liability

Taxable income	$200
x 21%	.21
Regular tax liability	42

Modified taxable income

Regular taxable income	$200
Interest paid to a related FP	50
Royalties paid to a related FP	250
Modified Taxable income	$500

Adjusted regular tax liability

Regular tax liability	$42
FTC	2
ARTL	$40

Base Erosion and Anti-Abuse Tax

Regular tax liability

Taxable income	$200
x 21%	.21
Regular tax liability	42

Adjusted regular tax liability

Regular tax liability	$42
FTC	2
ARTL	$40

BEAT

MTI x 10%	$50
ARTL	40
BEAT	$10

History of BEAT

- Reasons given for the enactment of BEAT in TCJA

  Foreign-owned U.S. subsidiaries are able to reduce their U.S. tax liability by making deductible payments to a foreign parent or foreign affiliates. This can erode the U.S. tax base if the payments are subject to little or no U.S. withholding tax. ***Foreign corporations often take advantage of deductions from taxable liability in their U.S. affiliates with payments of interest, royalties, management fees, or reinsurance programs****. This provision aims to tax payments of this kind.* ***This type of base erosion has corroded taxpayer confidence in the U.S. tax system****.*

History of BEAT

Moreover, the ***current U.S. international tax system makes foreign ownership of almost any asset or business more attractive than U.S. ownership****. This unfairly favors foreign-headquartered companies over U.S. headquartered companies, creating a tax-driven incentive for foreign takeovers of U.S. firms. Furthermore, it has created significant financial pressures for U.S. headquartered companies to re-domicile abroad and shift income to low-tax jurisdictions. Since 2000, the number of U.S.-headquartered multinationals among the 500 largest public companies has decreased by over 25 percent.*

History of BEAT

This provision aims to ***level the playing field*** *between U.S. and foreign-owned multinational corporations in an administrable way. To the extent that corporations with significant gross receipts are able to utilize deductible related party payments to foreign affiliates to reduce their U.S. corporate tax liability below 10-percent, the Committee intends that the* ***base erosion and anti-abuse tax function as a minimum tax*** *to preclude such companies from significantly reducing their corporate tax liability by virtue of these payments. Significant gross receipts is defined as a corporation with $500 million or more in annual gross receipts.*

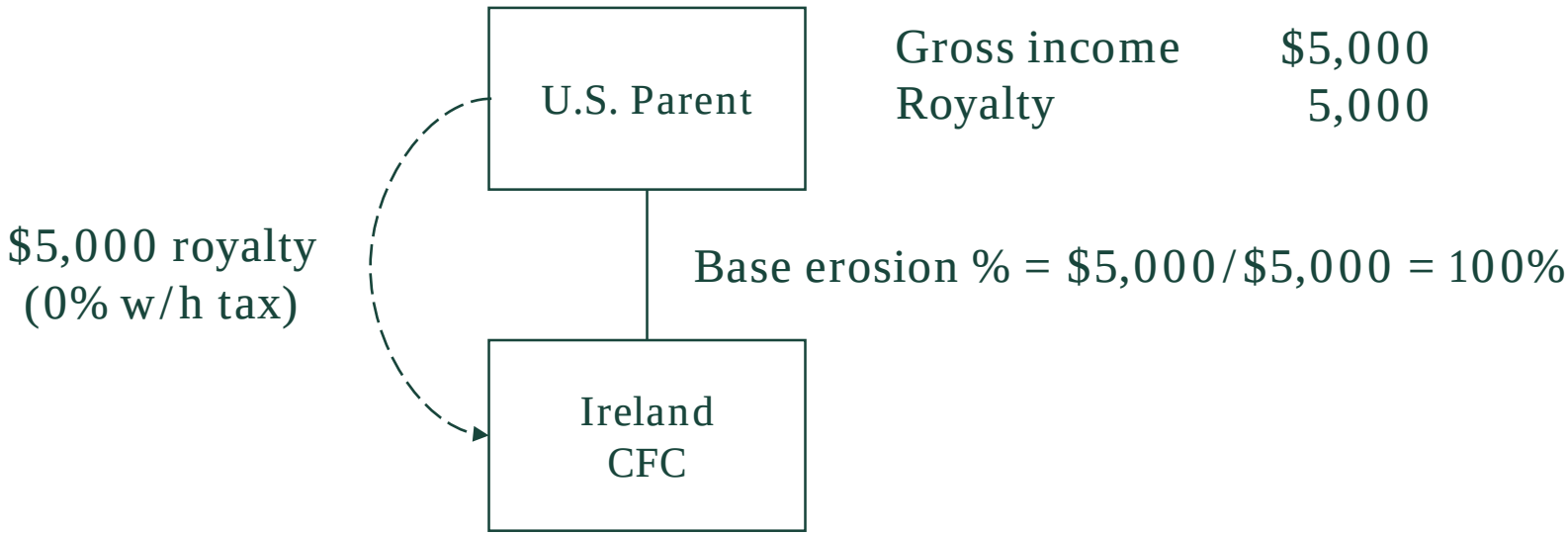
History of BEAT

The Committee also concluded that ***this minimum tax should limit the extent to which tax credits permit large, profitable corporations with significant base erosion payments to avoid virtually all tax liability in the reformed corporate tax system****. This is to ensure that those corporations with significant gross receipts and deductible foreign related party payments pay an appropriate amount of U.S. income tax on an annual basis.*

The provision applies to a corporation irrespective of whether it is owned, directly or indirectly, by a parent corporation that is U.S. or foreign-headquartered. ***The Committee believes that this level playing field, along with a globally competitive corporate rate, will encourage economically efficient foreign direct investment****. Such investment, whether foreign or domestic, is in the national interest of the United States and its workers.*

Interaction of BEAT and GILTI

"Straight-forward" example



Gross income	5,000
IRE tax	625
E&P	4,375
QBAI	0

Interaction of BEAT and GILTI

BEAT/GILTI computation

GILTI	4,375
§78 gross-up	625
§951A inclusion	5,000
U.S. source gross income	5,000
§951A inclusion	5,000
Gross income	10,000
U.S. deductions	5,000
50% GILTI deduction	2,500
Taxable income	2,500
x 21%	0.21
Precredit U.S. tax	525
FTC (*)	0
Net U.S. tax	525

FTC limitation = 2,500 (GILTI) – 2,500 (50% deductions) x 21% = $0

Interaction of BEAT and GILTI

BEAT/GILTI computation

Taxable income	$2,500
Base erosion benefits	5,000
Modified taxable income	$7,500
x 10%	750
Net regular tax	25
Excess over regular tax	725
BEAT^	725

^ no carryover of the BEAT (unlike the MTC)

Net U.S. tax = $525 + $725 = $1,250

Planning Post-2017

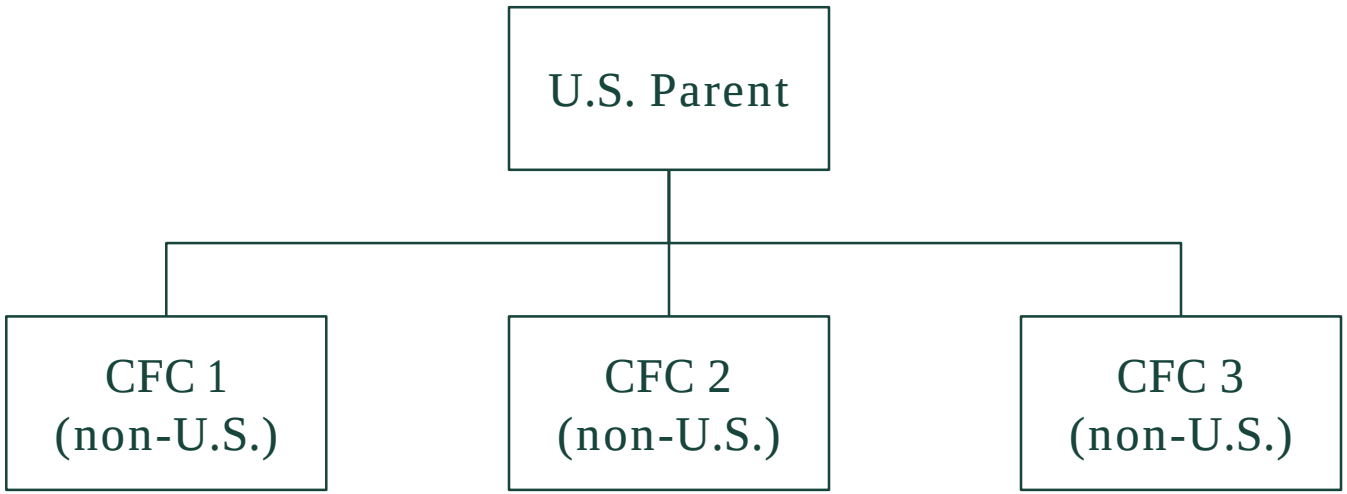
- Tax Department Activities in 2018
  - Model tax reform legislation
  - Compute the transition tax – document earnings and profits
  - Evaluate the anti-deferral and anti-base erosion provisions
  - Identify and implement planning strategies and prospective favorable filing positions, as applicable
  - Refine the intellectual property alignment plan
  - Identify costs or complications in distributions to the United States (e.g., local withholding taxes, state tax implications)
  - Analyze and compute the international tax accounting implications!

Planning Post-2017

- How will U.S. MNEs respond to these tax law changes?
  - *"[A] dramatic redesign of international tax architecture*?" (International Fiscal Association newsletter)
  - Allocate costs differently?
    - Capitalize more costs into inventory to avoid BEAT
    - Realign TESCM
    - Return intangibles to the U.S. (maximize FDII, lessen GILTI)

Planning Post-2017

Should I reorganize my international structure?



Where do I want my income?

EY Tax Webinar slide

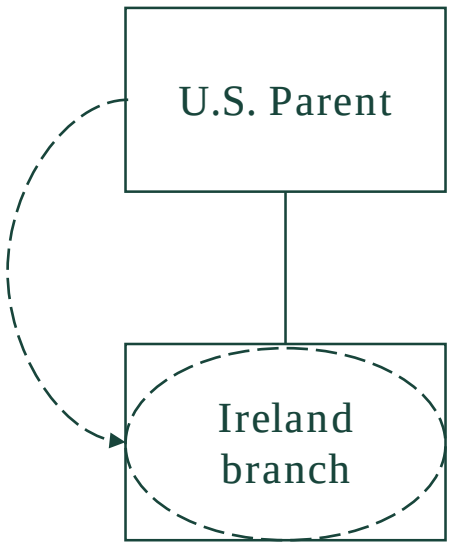
Planning Post-2017

As a result of the Tax Legislation, in fiscal 2019, several of our foreign subsidiaries made tax elections to be treated as U.S. branches for federal income tax purposes (commonly referred to as "check-the-box" elections) effective beginning in fiscal 2018 and 2019. We believe that by treating these foreign subsidiaries as U.S. branches for federal income taxes, rather than controlled foreign corporations, we will significantly reduce the risk of being subject to GILTI and BEAT taxes.

Qualcomm, Form 10-Q, 3/31/19

Planning Post-2017

"Straight-forward" example



$5,000 royalty
(0% w/h tax)

Gross income	$5,000
Royalty	5,000

Gross income	5,000
IRE tax	625
E&P	4,375
QBAI	0

Planning Post-2017

Branch computation

Branch income	0
U.S. source gross income	5,000
U.S. deductions	0
Taxable income	5,000
x 21%	0.21
Precredit U.S. tax	1,050
FTC	0
Net U.S. tax	1,050

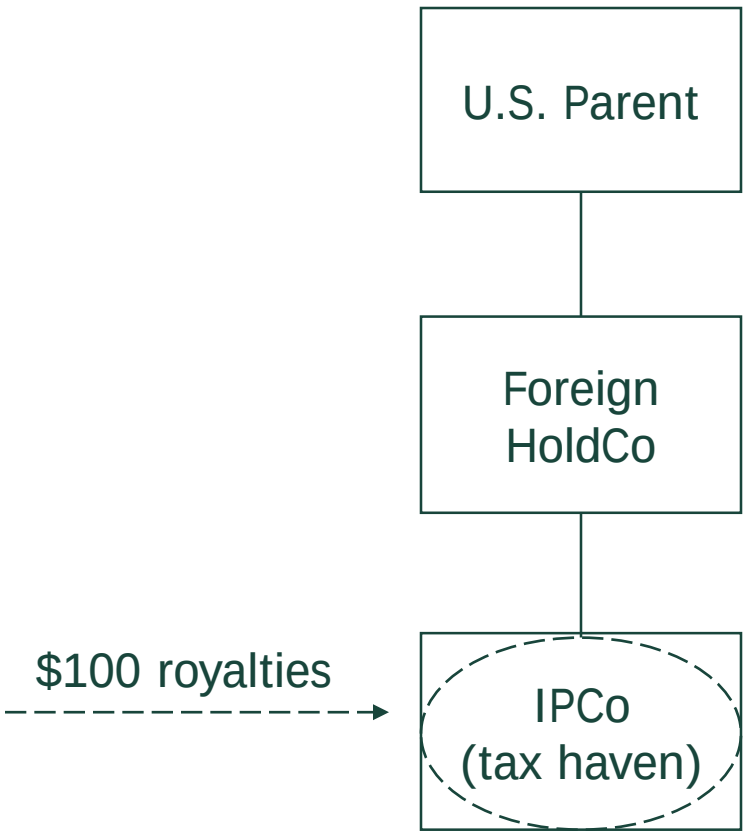
Net U.S. tax under GILTI/BEAT = $525 + $725 = $1,250

Planning Post-2017

Additionally, during fiscal 2018, one of our foreign subsidiaries distributed certain intellectual property to a U.S. subsidiary resulting in a difference between the GAAP basis and the U.S. federal tax basis of the distributed intellectual property. Upon adoption of new accounting guidance in the first quarter of fiscal 2019, we recorded a deferred tax asset of approximately $2.6 billion, primarily related to the distributed intellectual property, with an adjustment to opening retained earnings.

Qualcomm, Form 10-Q, 2/28/19

Planning Post-2017



IP FV	1,000
IP BV	0
IP TB	0

Planning Post-2017

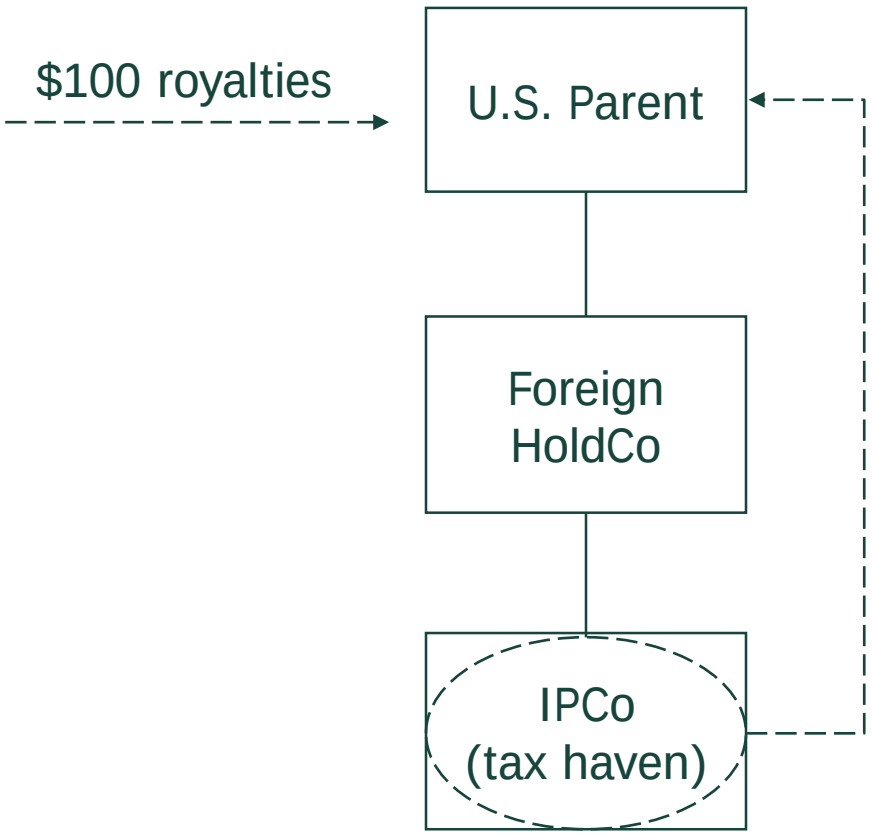
2017 tax law

No U.S. tax
No haven tax

TCJA

§951A inclusion	100
50% GILTI deduction	50
Taxable GILTI	50
x 21%	.21
Precredit U.S. tax	10.5
FTC	0
Net U.S. tax	10.5

Planning Post-2017



IP FV	1,000
IP BV	0
IP TB	1,000

Planning Post-2017

TCJA

Royalty inclusion	100.0
FDII deduction (.375)	37.5
Taxable income	62.5
x 21%	.21
Precredit U.S. tax	13.125
FTC	0
Net U.S. tax	13.125

NOLs?

Planning Post-2017

Under ASU 2016-16, IPCo records a current tax expense for the income taxes paid on the transfer.

Current tax expense	0	
Taxes payable		0

U.S. parent records a DTA for the book-tax difference and credits a deferred tax benefit for an equal amount.

Deferred tax asset ($1,000 x 21%)	21	
Deferred tax benefit		21

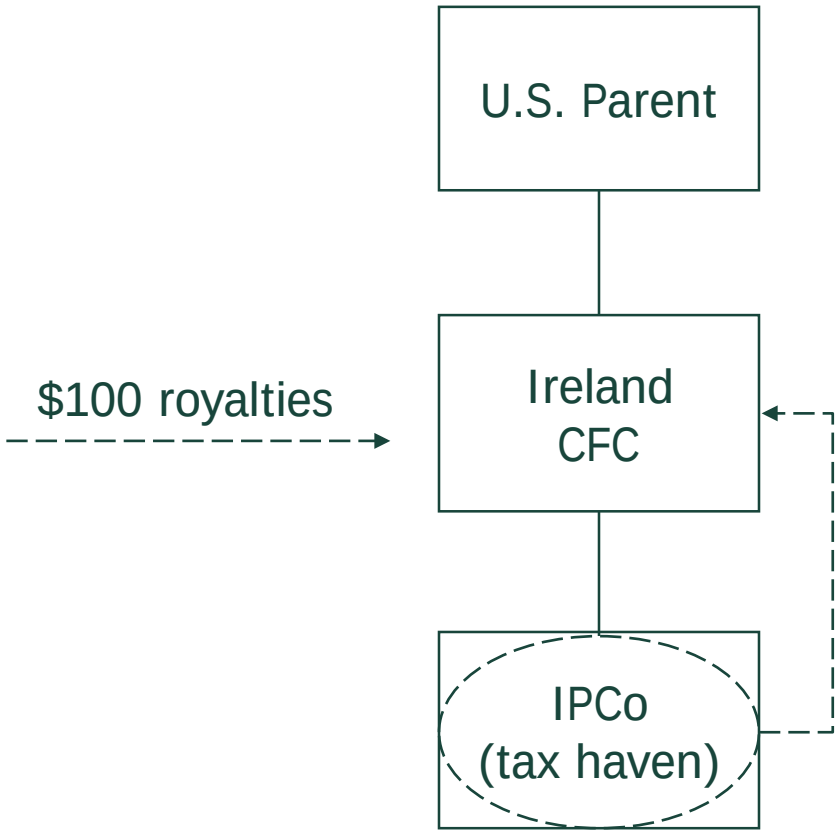
No intercompany gain is recognized in the income statement, but a *net tax benefit of $25 is recorded* (*ETR volatility*)!

Planning Post-2017

In December 2018 the transfer of certain intellectual properties between tax jurisdictions resulted in a $1.5 billion non-cash tax benefit and a corresponding $1.5 billion deferred tax asset. The benefit of the transaction will be realized as a reduction of cash paid for taxes over a period of nine years and a corresponding charge to tax expense, which consistent with the benefit recognized in 2018, will also be adjusted out of reported net earnings going forward in our non-GAAP financial measure.

Stryker Corporation, Form 10-K, 2018

Planning Post-2017



IP FV	1,000
IP BV	0
IP TB	1,000

Planning Post-2017

TCJA

GILTI inclusion	100
GILTI deduction	50
Taxable income	50
x 21%	.21
Precredit U.S. tax	10.5
FTC	10.0
Net U.S. tax	0.5

Planning Post-2017

Under ASU 2016-16, IPCo records a current tax expense for the income taxes paid on the transfer.

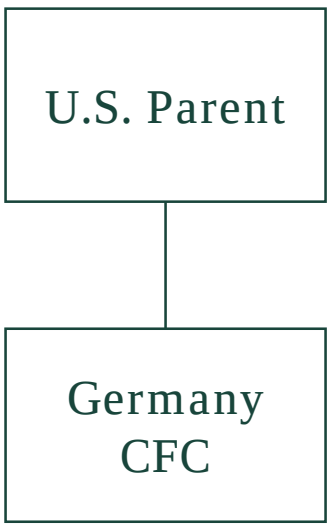
Current tax expense	0	
Taxes payable		0

Irish CFC records a DTA for the book-tax difference and credits a deferred tax benefit for an equal amount.

Deferred tax asset ($1,000 x 12.5%)	12.50	
Deferred tax benefit		12.50

Planning Post-2017

Converting GILTI income into high-tax Subpart F income



Gross income	0
Deductions	0

Sales income	2,000
GER tax (30%)	600
E&P	1,400

Planning Post-2017

GILTI computation (assume $0 QBAI)

GILTI inclusion	1,400
§78 gross-up	600
Gross income	2,000
§250 deduction	1,000
Taxable income	1,000
x 21%	0.21
Precredit U.S. tax	210
§960 FTC (80%)	480
Net U.S. tax	0

Accounting ETR = $600/$2,000 = 30%
Tax ETR $600/$2,000 = 30%

FTC foregone = $390 ($600 - $210)

Planning Post-2017

Subpart F computation

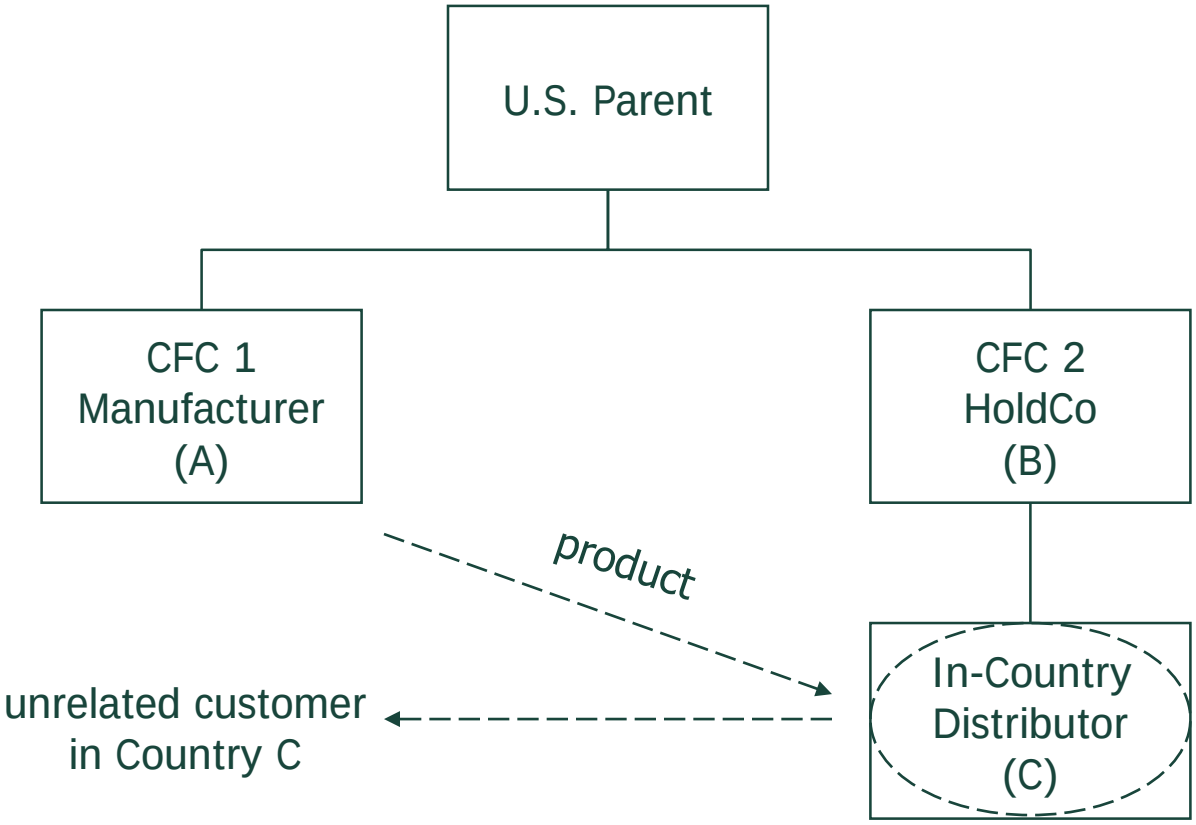
FBCS income	1,400	
Less: high-tax exception	1,400	Eligible for §245A 100% DRD
Adjusted FBCS income	0	
Taxable income	0	
x 21%	0.21	
Precredit U.S. tax	0	
§960 FTC	0	
Net U.S. tax	0	

Accounting ETR = 600 - 180/2,000 = 21%
Tax ETR 600/2,000 = 30%

FTC foregone = 0

Planning Post-2017

How does a U.S. corporation manage this income characterization?



Take-Aways

- International tax planning is not for the faint of heart
- Trust – but model
- The tax code works in mysterious ways
- GILTI for an MNE with a “low” F ETR and positive domestic and foreign income, increases the F structural ETR to ≈ 12%
  - Where is the incentive to return IP to the U.S. and pay 21%?
- International tax geometry is likely to focus first on avoiding the BEAT (deadweight tax cost) and then maximizing FTCs (avoid the lost GILTI taxes).