2017 Federal Tax Act – International Tax Provisions

Tax Alert | **December 21, 2017**
By: John Eagan

The most salient provisions of the 2017 Federal Tax Act relating to the taxation of international business activities are as follows:

- The US is establishing a Participation Exemption System for the taxation of foreign income. US C corporations can now repatriate foreign-sourced income from certain 10% owned foreign subsidiaries on a tax exempt basis by claiming a 100% dividend received deduction (DRD). The DRD applies to distributions made beginning after December 31, 2017. Regulated Investment Companies (RIC) and Real Estate Investment Trusts (REIT) are not eligible for the DRD and the new DRD rules will also not apply to a foreign corporation that is a Passive Foreign Investment Company (PFIC) as long as the PFIC is not also a controlled foreign corporation (CFC).
- The DRD is available only if the US C corporation satisfies a one-year holding period for the stock in the 10% owned foreign subsidiary, although the DRD is not available for a “hybrid dividend” from a foreign corporation that is a CFC. A hybrid dividend is a dividend for which the CFC received a deduction or other tax benefit with respect to any income, war profits or excess profits tax imposed by a foreign country.
- Gain on the sale of stock of certain 10% owned foreign subsidiaries, which would under current law be taxed under Code 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.
- A foreign tax credit or a foreign tax deduction is not allowed for any taxes paid or accrued with respect to a dividend distribution that qualifies for the DRD.
- As part of the establishment of the Participation Exemption System, there is a mandatory deemed repatriation of the accumulated post-1986 deferred foreign income of a 10-percent owned foreign corporation to US shareholder who owns a 10% voting interest. The US shareholder will report as income its pro rata share of such deferred foreign income.
- The mandatory repatriation applies to CFCs and non-CFCs (other than a PFIC that is not also a CFC) where the ownership test is met, but if the foreign corporation is not a CFC, there must be at least one US shareholder that is a US corporation in order for the mandatory repatriation rules to apply.
- The mandatory repatriation occurs for the last taxable year beginning before January 1, 2018, which will be the tax year ending December 31, 2017 for many taxpayers.
- The income inclusion resulting from the mandatory repatriation is taxed at the rate of 15.5% on accumulated post-1986 deferred foreign earnings held in the form of cash or cash equivalents and 8% on all other post-1986 deferred foreign earnings.

- There are complicated rules on the calculation of the amount of the accumulated post-1986 deferred foreign earnings, but the intent is to apply the mandatory repatriation rules only to foreign income that was not previously subject to US income tax at the foreign corporation level or the US shareholder level.
- The tax liability resulting from the mandatory repatriation is generally payable over a period of eight years, 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. In the case of S Corporations, the shareholders have the ability to defer the payment of the net tax liability until a triggering event (*i.e.*, the cessation of S corporation status, a liquidation or sale of substantially all of the S corporation assets, a cessation of business, and a sale of the stock, although the triggering event only applies to the portion of the S corporation stock sold). Special rules apply for a shareholder that is a REIT.
- The US is also establishing new rules for taxable years beginning after December 31, 2017 to address the taxation of passive income and to target activities that involve base erosion.
- A US shareholder of a CFC must now include in income its global intangible low-taxed income (GILTI) in a manner that is similar to the income inclusion rules for Subpart F income. However, C corporation shareholders (other than a RIC or REIT) are able to claim a deduction equal to 50% of its GILTI and 35% of its foreign-derived intangible income (FDII), which is intangible income derived from serving foreign markets. Based on the 21% C corporation tax rate, GILTI income will be taxed at an effective rate of 10.5% and FDII income will be taxed at an effective rate of 13.125%. To the extent a US corporation includes GILTI in income, there is a deemed-paid foreign tax credit generally equal to 80% of the foreign taxes paid with respect to such income.
- A new base erosion minimum tax would apply to certain payments made in taxable years beginning after December 31, 2017 by a US person to a foreign person that is a related party. Payments for cost of goods sold and payments for services that comply with the transfer pricing rules are not subject to the minimum tax. The tax is generally the excess of 10% of modified taxable income over the regular tax liability.
- The indirect foreign tax credit (Code Section 902) would be repealed for taxable years of foreign corporations beginning after December 31, 2017.
- The sourcing rules for sales of inventory have changed effective for taxable years beginning after December 31, 2017. Under prior law, title passage determined the source of income for the sale of inventory. The proposal would change the sourcing rule so that title passage no longer controls sourcing and instead income from the sale of inventory is sourced to the country where the inventory was produced. If inventory was produced entirely outside of the US, then income from the sale of the inventory is not US source income.
- Under an active trade or business exception, outbound transfers by a US shareholder to a foreign corporation of assets used in the active conduct of a trade or business were non-taxable under Code Section 367. This exception allowed such transfers when most outbound transfers were considered taxable. This active trade or business exception is repealed for transfers after December 31, 2017.
- The requirement that a foreign corporation be controlled for 30 days before income inclusion under Subpart F is eliminated and the 10% test to determine if there is a US shareholder of a CFC is expanded to include not only voting power (current law), but also total value of the shares of stock in the foreign corporation. These changes are effective for the taxable year of foreign corporations beginning after December 31, 2017.

For questions, information, or guidance, please feel free to contact Bill Hussey (husseyw@whiteandwilliams.com; 215.864.6257), John Eagan (eaganj@whitenandwilliams.com; 212.868.4835), Kevin Koscil (koscilk@whiteandwilliams.com; 215.864.6827) or another member of our Tax and Estates Group.

This correspondence should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general informational purposes only, and you are urged to consult a lawyer concerning your own situation and legal questions.