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BANK & CAPITAL MARKETS TAX INSTITUTE

INTERNATIONAL TAX UPDATE

December 17, 2020

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AGENDA

- GILTI HTE (High Tax Exclusion)
- FDII Final Regulations
- Foreign tax credits
- Final BEAT Regulations under section 59A
- Other News
- DAC 6

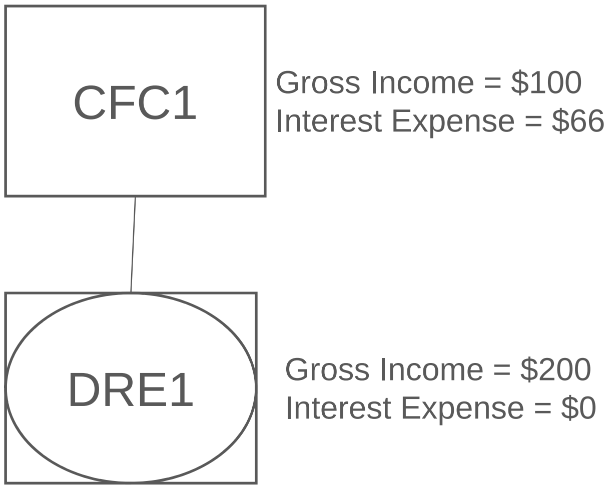
GILTI HTE

Interest Expense Apportionment and CFC Consistency Rule

Apportionment Of Expenses

- A tentative tested income item with respect to the tentative gross tested income item is determined by allocating and apportioning deductions for the CFC tax year. §1.951A-2(c)(7)(iii)(A).
- Interest expense is apportioned under the principles of §§1.861-9 and 1.861-9T.
  - Asset method
  - Modified gross income method (“MGIM”)
  - The amount of interest deduction that is allocated and apportioned to the assets or gross income of a lower tier corporation are allocated and apportioned to the residual category.

Interest Expense – HTE Test DRE



	Local Books		US Tax - MGIM	
	CFC1	DRE1	CFC1 Tested Unit	DRE1 Tested Unit
Gross Income	$100	$200	$100	$200
Interest	$(66)	–	$(22)	$(44)
Pre-Tax Income	$34	$200	$78	$156
Foreign Tax	$7	$30	$7	$30
Effective Tax Rate	20%	15%	**8.7%**	**19.2%**
HTE?	-	-	**No**	**Yes**

- Total Gross Income of $300 (CFC1 + DRE1) is considered for purposes of apportioning interest expense between CFC1 tested unit and DRE1 tested unit.
  - CFC1: ($100/$300) x $66 interest expense = $22.
  - DRE1: ($200/$300) x $66 interest expense = $44.
- The allocation of interest expense impacts the tested units' Tentative Tested Income, and ultimately the tested units' foreign effective tax rate.

Interest Expense – HTE Test CFC

CFC1

Gross Income = $100
Interest Expense = $66

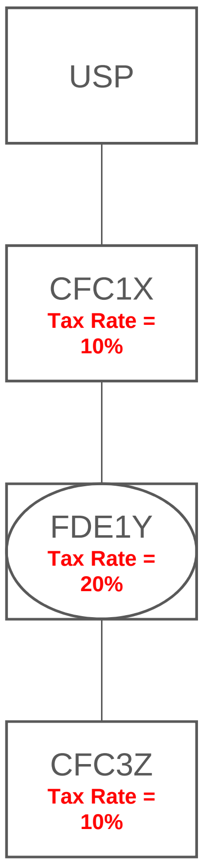
CFC2

Gross Income = $200
Interest Expense = $0

	Local Books		US Tax - MGIM		
	CFC1	CFC2	CFC1 Tested Unit	CFC1 Residual	CFC2 Tested Unit
Gross Income	$100	$200	$100	$200	$200
Interest	$(66)	_	$(22)	$(44)	-
Pre-Tax Income	$34	$200	$78	-	$200
Foreign Tax	$7	$30	$7	-	$30
Effective Tax Rate	20%	15%	**8.7%**	-	**15%**
HTE?	-	-	**No**		**No**

- Total Gross Income of $300 (CFC1 + CFC2) is considered for purposes of apportioning interest expense between CFC1 tested unit and CFC2 tested unit.
- Being CFC2 tested unit is a lower-tier corporation of CFC1, interest expense apportioned to the gross income of CFC2 will be apportioned to the residual income category of CFC1 tested unit.
  - CFC1 tested unit: ($100/$300) x $66 interest expense = $22.
  - CFC1 residual: ($200/$300) x $66 interest expense = $44.
  - CFC2 tested unit: N/A.

Example 3: §1.951A-2(c)(8)(iii)(C)



Gross Income: €4,000
- *CFC1 books: €3,000*
- *FDE1Y books: €1,000*

Interest Expense: €1,000
CFC1X Tax Liability: €200

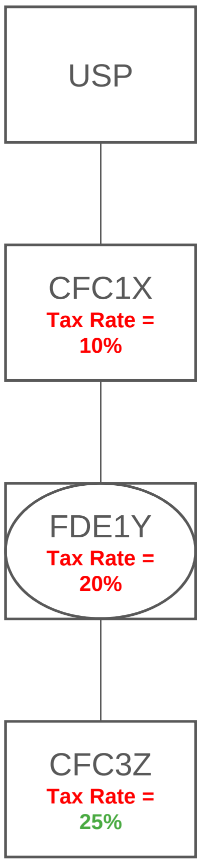
FDE1Y Tax Liability: €200

Gross Income: €1,000
CFC1X Tax Liability: €100

	CFC1X	CFC1X – Residual (MGIM)	FDE1Y	CFC3Z
Tentative Gross Tested Income	3,000	1,000	1,000	1,000
Interest Expense	(600)	(200)	(200)	-
Foreign Tax Deduction	(200)	-	(200)	(100)
Tentative Tested Income	2,200	-	600	900
ETR	**8.33%**	-	**25%**	**10%**
HTE?	**No**	-	**Yes**	**No**

- Gross Income of CFC3Z tiers to CFC1X and treated as residual for purposes of the HTE
  - Applies regardless of the characterization of CFC3Z's gross income.
- Total Gross Income for CFC1X interest expense apportionment purposes = €5,000.
  - CFC1X Tested Unit = (3,000 / 5,000) x 1,000 interest = 600 interest expense
  - CFC1X Residual = (1,000 / 5,000) x 1,000 interest = 200 interest expense
  - FDE1Y Tested Unit = (1,000 / 5,000) x 1,000 interest = 200 interest expense
- CFC1X Tested Unit Tentative Tested Income, 2,200, less 200 of CFC1X Residual Interest Expense = 2,000 of Net Tested Income of CFC1X. 200 of Interest Expense deductible in computation of CFC1X tested income, as it relates to CFC3Z 1,000 of Tested Gross Income.
  - Assuming HTE election made, FDE1Y Gross Income of 1,000 is exempt.
  - Apportioned Taxes of 200 is excluded from CFC1X net tested income
  - Apportioned Interest Expense of 200 is excluded from CFC1X net tested income

Example 3: §1.951A-2(c)(8)(iii)(C)



Gross Income: €4,000
- *CFC1 books: €3,000*
- *FDE1Y books: €1,000*

Interest Expense: €1,000
CFC1X Tax Liability: €200

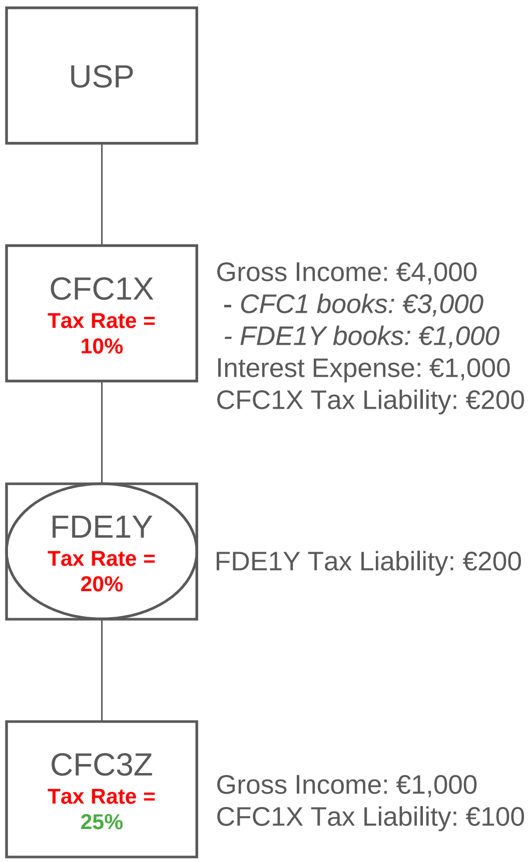
FDE1Y Tax Liability: €200

Gross Income: €1,000
CFC1X Tax Liability: €100

	CFC1X	CFC1X – Residual (MGIM)	FDE1Y	CFC3Z
Tentative Gross Tested Income	3,000	1,000	1,000	1,000
Interest Expense	(600)	(200)	(200)	-
Foreign Tax Deduction	(200)	-	(200)	(250)
Tentative Tested Income	2,200	-	600	750
ETR	**8.33%**	-	**25%**	**25%**
HTE?	**No**	-	**Yes**	**Yes**

- Assume same facts as in prior example, except that CFC3Z now is taxed at 25% and meets the HTE.
- Because CFC3Z meets the HTE, CFC1X's interest expense of 200 which was allocated to residual (under the MGIM; based upon CFC3Z's tested gross income of 1,000), will be treated as apportioned away from CFC1's tested income for purposes of CFC1's total tested income.

Example 3: §1.951A-2(c)(8)(iii)(C)



Comparison of Two Examples – Tested Income of CFC1X

	CFC1X (CFC3Z **Fails** HTE)	CFC1X (CFC3Z **Passes** HTE)
Gross Tested Income	3,000	3,000
Interest Expense	(800)	(600)
Foreign Tax	(200)	(200)
Tested Income	2,000	2,200

Consistency Requirement for HTE

- The final GILTI regulations also contain a consistency requirement, that an election must be made for all of the CFCs in a "CFC Group", or for none of the CFCs in a CFC Group (see Reg. §1.951A-2(c)(7)(viii)(E)(1)). A CFC Group generally means an affiliated group as defined in §1504(a), which is generally ownership through a common parent corporation. However, certain modifications to §1504 are made for this test:
  1. Excluding the definitions provided in §1504(b), regarding includible corporations. By excluding, e.g. a foreign corporation, S-Corps, tax exempts, etc., are also treated as includible corporations.
  2. Changing the 80% vote **and** value test, to **more than 50%** vote **or** value.
  3. Section 318 attribution rules are considered.
- Giving consideration to the first two points, consider a non-US parented company that owns e.g. two separate US consolidated groups (Group A, and Group B), each owning their own respective CFCs. Group A US parent and Group B US parent are each a controlling domestic shareholder of their respective CFCs. Each US consolidated group would compute its own GILTI inclusion. However, Group A and Group B must jointly decide whether to elect the GILTI high tax election, as they are considered a CFC Group through a common parent corporation.
- Expanding upon point 3, the attribution rules of §318(a) are generally considered, but for:
  1. §318(a)(3)(A) – attribution to partnerships
  2. §318(a)(3)(B) – attribution to trusts
  3. Rules regarding options (§318(a)(4)), and
  4. Substituting in §318(a)(2)(C), "5 percent" for "50 percent"

FDII FINAL REGULATIONS

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Final FDII Regulations – Key Takeaways

- Final rules apply to tax years beginning on or after 1/1/2021
- Documentation Rules eliminated or Relaxed
  - Any reasonable method extended through 2020
- Sale is presumed to foreign person if
  1. Foreign retail sales;
  2. Sales of general property that are delivered to an address outside the United States;
  3. Other sales of general property (i.e., sales not described in categories 1 or 2) with a billing address outside the United States; or
  4. Sales of intangible property with a billing address outside the United States.

Final FDII Regulations – Key Changes

- Sale of property is presumed foreign use of general property if
  1. Sales to end users receiving delivery outside the US (from a freight carrier)
  2. Sales of general property already located outside the US (foreign retail sales)
  3. General property sold to a distributor or reseller for ultimate sale to an end-user outside the US
  4. Electronic Transfers of digital content that is downloaded, installed, received or accessed by an end-user outside the US
  5. Sales of international transportation property that is registered outside the US, and, if not used for compensation or hire, is primarily stored outside the US.
- General Services income is presumed for foreign use
  1. If consumer's billing address is outside the U.S., if renderer does not have consumer's location (Section 1.250(b)-5(d)(1))
  2. For business customers, the render may make reasonable assumption based on available information (Section 1.250(b)-5(e)(i))
- Proximate service definition expanded (Section 1.250(b)-5(f))
- Property services includes limited cases where services performed in the U.S. (Section 1.250(b)-5(g)(2))
- Transportation services – no significant changes from Proposed Regs.

Final FDII Regulations – Key Changes

- Interplay of Section 163(j) and 172
  - Ordering rule removed. IRS/Treasury considering separate guidance
  - Any reasonable method is ok as long as its consistent
- Ignore carryover deductions
  - Charitable
  - NOL
  - 163(j)
- New provision/definitions for Digital content
- Related party sales
  - Treat the original sale to the related party as the FDII sale year. Eliminates complications of the unrelated party sale occurring after the FDII filing date

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Final FDII Regulations – Key Changes

- Military Sales
  - Final regulations eliminate the following requirements
    - The US governments military sale to the foreign government must be on commercial terms
    - The contract terms between the taxpayer and the US government must specify that the purchase is for resale to a foreign government.
- Hedging transactions
  - Special rule if associated with sale of general property

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Final FDII Regulations – Key Confirmations

- Taxable income is still after NOLs
- No Carryover or Carryback for excess FDII
- No Transaction by Transaction calculations
- Partnerships still need to have K-1 footnote

FOREIGN TAX CREDITS

Final Regulations on Various Foreign Tax Credit Issues

- Final Regulations
  - Allocation of foreign income taxes to section 904(d) categories (General, Passive, Branch, etc) in special circumstances
    - Most common on distributions where dividends have disparate treatment between the U.S. and foreign tax law
    - Sale of foreign disregarded entity
  - R&E Expenditures
    - Confirm no R&E allocation to GILTI, Subpart F, or Dividends
    - Allocation 50% geographically based on source, and remaining based on Gross Receipts
  - Stewardship Expenses
    - Defined as expenses related to duplicative or shareholder activities
    - Direct allocation to specific entities if possible. Remainder is apportioned similar to the interest expense apportionment rules based on relative tax book value
  - Foreign Tax Redeterminations expanded
    - Now includes a change in foreign income tax liability that affects taxpayer's US tax liability by changing the amount of Subpart F income, GILTI income, or changes the affect of the GILTI high-tax exception

Proposed Regulations on Various Foreign Tax Credit Issues

- Proposed Regulations
  - Sec 901 Creditable Foreign Taxes
    - Fundamentally alters the definition of what constitutes a creditable foreign income tax by requiring that the foreign income tax must have a jurisdictional nexus in order to be creditable
    - Response to foreign countries adopting Digital Services Taxes and similar extraterritorial taxes
  - Shortened availability of changing from crediting to deducting foreign taxes from 10-year statute down to 3-year statute
  - No credit or deduction allowed for foreign income taxes attributable to distributions on which section 245A deductions would be allowed
  - Taxpayers can make an election to capitalize and amortize advertising and R&E expenditures made in connection with apportioning interest expense
  - Direct allocation of banking branch's interest expense (section 1.861-10(g))

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FINAL BEAT REGULATIONS SECTION 59A

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Final BEAT Regulations – No Surprises here!

- Background - The base erosion and anti-abuse tax (BEAT) (section 59A) enacted by the Tax Cuts and Jobs Act (TCJA) - applies to a U.S. corporation that
- Average annual gross receipts of at least $500,000,000 for the prior three years, **AND**
- Base erosion percentage of 3% (2% in certain instances).
- In addition to the federal income tax, a U.S. corporation subject to these rules must pay the additional base erosion and anti-abuse tax.
- Final BEAT regulations - Issued September 1st
- Application Date - Taxpayers may apply the final regulations to tax years beginning after Dec. 31, 2017 provided the taxpayer applies the final regulations in their entirety and in subsequent years. Taxpayers may also choose to apply the final regulations from tax years beginning after Dec. 31, 2017 only with respect to certain waived deduction provisions provided the taxpayer applies those provisions in future years.

- Largely finalize the proposed regulations issued on Dec. 6, 2019.
- Final regulations - contain refinements to the 2019 proposed regulations which include:
- BEAT attributes of aggregate group members
- Waived deductions
- Application of BEAT to partnerships
- ECI exception
- RSM Tax Alert can be found on the internet site
- https://rsmus.com/what-we-do/services/tax/international-tax-planning/international-tax-structuring/us-treasury-releases-final-beat-regulations.html

IN OTHER NEWS – NEW REG PACKAGES

987 Regulations, 958(b), Sale of Partnership interests 864(c)(8), 954(c)(6), 367, 956 / 245A interplay

Sale of Partnership Interests – 864(c)(8)

- IRS issued rules on Monday (Sept 21st)
- Proposed rules - issued December 2018
- Applies to foreign investors upon sale, disposition, or exchange of US partnership interests
- Applies to transactions after Nov 26, 2017
- US Partnership must be engaged in a US trade or business
- Governs when sale, disposition, or exchange is treated as ECI
- Proposed rules were general

- Final rules – provide details on how to determine what would be considered ECI
- Limits amount of ECI – determines what portion of the gain is treated as ECI
- If the partnership were to sell sold all its assets, what portion would be ECI and what is the foreign persons portion of that.
- Added rules for sourcing gain or loss from specific assets that may be particularly difficult to source in a deemed sale
- There is a 10 year look-back rule – limits how far back the IRS will look to determine ECI
- The IRS plans to also issue final rules under Section 1446(f)
- Section 1446(f) imposes a 10% withholding tax on gains from the transfer of the partnership intere

Section 1446(f)

- On October 7, 2020, the IRS and Treasury released final regulations under section 1446(f) that will be effective 60 days from the date they are formally published
- Section 1446(f) generally requires a transferee, in connection with the disposition of a partnership interest by a non-U.S. person, to withhold and remit 10% of the "amount realized" by the transferor, if any portion of the gain realized by the transferor on the disposition would be treated as ECI under Section 864(c)(8)
- The final regulations essentially follow the framework of the proposed regulations with some modifications and enhancements, the most significant of which is new guidance and requirements for sales of publicly traded partnership (PTP) interests, which weren't previously subject to section 1446(f) withholding as guidance was pending.
- Under the final regulations, effective January 1, 2022, section 1446(f) withholding at a rate of 10% is required on amounts realized from sales of PTP interests by non-U.S. transferors. Brokers are responsible for the withholding, so their systems and processes must be updated to identify withholdable trades, potential exceptions, and reportable data.

Section 1446(f) cont.

- The final section 1446(f) regulations also:
  - Clarify that secondary withholding liability for partnerships will only apply to transfers that occur on or after January 1, 2022
  - Clarify that partnerships can rely on a valid Form W-9 for the transferor to determine that an applicable exception to Section 1446(f) Withholding is satisfied;
  - Require new certifications to confirm the applicability of certain exceptions to Section 1446(f) Withholding
  - Confirm which exceptions look to gross income and which exceptions look to net income
  - Allow transferees to directly claim refunds for excess secondary withholding by a partnership (rather than requiring the partnership itself to apply for such refunds); and
  - Allow tax treaty benefits to be taken into account in limited circumstances to reduce or eliminate Section 1446(f) Withholding.

- As a result of these changes, partnerships should anticipate additional diligence and certification requests and should enhance their processes accordingly

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Ownership Attribution Rules

- Attribution Rules –
  - Used to determine whether FC is a CFC.
  - Used to determine whether FC shareholders are "US Shareholders"
- Background - previously Sec. 958(b)(4) excluded U.S. persons from constructively owning stock in a CFC by application of Sec. 318(a)(3)(A), (B), or (C)
- Mechanics of Repeal – Downward attribution - stock of a foreign corporation is now attributed to a U.S. person under Sec. 318(a)(3)
- Result
  - U.S. person could be treated as a U.S. shareholder of a CFC who was not formerly a US shareholder
  - foreign corporations that were not previously treated as a CFC now treated as CFC
- Final regulations generally follow favorable proposed regulations
- Application - the last tax year of foreign corporations beginning before Jan. 1, 2018, and later.
- Sec. 267(a)(3)(A) - Watch CFC payee rule limitations

Sections 367(a) and 954(c)(6)

- Proposed regulations involving Section 958(b)(4) issued
- Background
  - Section 367(a): Outbound transfer of domestic corporation stock
  - Section 954(c)(6): Dividends, interest, rents, and royalties received by a CFC from a related CFC
- Some outbound transfers considers repeal of Section 954(b)(4) but not others
- Limits application of section 958(b)(4) repeal for purposes of 954(c)(6) related payments

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Section 987 Regulations

- Defer the applicability by one additional year.

Sections 956 and 245A – Effects on Guarantees

- Typically lenders would like guarantees or pledges of subsidiary shares for loans or lines of credit
- Pre-TCJA – Borrowers pledged c.65% to stay under deemed inclusion rule under Section 956
- Post-TCJA – 100% pledged since Section 245A generally neutralized Section 956 inclusion.
- For acquisitions of new foreign targets, old terms (e.g., 65% pledge) may still be desirable due to holding period requirement to qualify for Section 245A deduction.

MANDATORY DISCLOSURE DIRECTIVE (DAC 6)

DAC 6 Background

- The Directive on Administration Cooperation 2018/822/EU (commonly referred to as DAC 6) is a mandatory disclosure regime designed to increase transparency and curtail tax evasion by ensuring that European Union (EU) taxing authorities of member states have early access to information on potentially abusive tax schemes.
- Building on BEPS Action 12, DAC 6 reporting requirements are intended to deter those who promote aggressive tax planning schemes, as well as users of such schemes.
- Penalties for noncompliance can include significant monetary sanctions under local law as well as reputational risks for businesses, individuals and intermediaries.
- While reporting is generally required by intermediaries (discussed below), taxpayers who carry on any activity in the EU or that derive any income or profits in the EU are potentially subject to and may be affected by these rules, even if they are not residents and do not have a permanent establishment in the EU.

DAC6 - How does it work?

- Similar to the Foreign Account Tax Compliance Act (FATCA) and Common Reporting Standard (CRS), DAC 6 reports will be filed via the automatic exchange of information (AEOI) portal for the taxing authority of each EU member state and the information reported will be automatically exchanged between EU member states through a centralized database.
  - Transactions that involve one EU country and another EU country or an EU country with a non-EU country are all in scope and the rules mandate reporting these arrangements irrespective of whether they are justified or recognized under national or local laws.
- Unlike FATCA and CRS, however, DAC 6 reporting is not limited to financial institutions and has much broader application and a wider scope of transactions to which it can apply.
  - Specifically, DAC 6 reporting applies to any intermediary (including lawyers, accountants, banks, brokers, asset managers, tax advisors, corporate service providers and other professionals) that advises taxpayers on cross-border transactions or is involved in the implementation of transactions that have the characteristics or hallmarks.
  - The rules may, therefore, be particularly challenging for nonfinancial institutions and other corporate service providers who may not have been subject to FATCA or other information reporting regimes and therefore, do not likely have sufficiently robust systems, processes and governance structures already in place that can be leveraged for the purpose of complying with DAC 6.

DAC 6 - What is the timing?

- Initial reporting was to have started Summer 2020, however due to the COVID-19 pandemic, the EU allowed an optional six-month delay to reporting deadlines. EU members other than Germany, Austria and Finland implemented this deferral.
- The rules have a retroactive effect in that they require reporting of arrangements whose first steps were implemented on or after June 25, 2018. This, in effect, means that intermediaries must have systems and processes for identifying and flagging reportable transactions back to June 25, 2018, and will need to educate key stakeholders on requirements and implement internal controls for managing risk now.
- The rules require intermediaries to file reports with their respective taxing authorities on their AEOI portals within 30 days of the earlier of:
    1. The date after the reportable cross-border arrangement is made available for implementation.
    2. The date after the reportable cross-border arrangement is ready for implementation.
    3. The date when the first step in the implementation of the reportable cross-border arrangement has been made.
    4. The date when the intermediary provided aid, assistance or advice (only when an intermediary is involved).
    5. Tracking all four dates identified above is critical for ensuring timely reporting/disclosure of transactions and arrangements.

Deferral of reporting obligations

- Member states can opt to defer until February 28, 2021
- Member states that are not deferring
  - Germany
  - Finland
  - Austria (although reports can be filed by October 31, 2020)
- Not clear if Italy and Portugal will opt out
- 30-day rule: arrangements entered into between July 1, 2020 and December 31, 2020 must be reported within the period of 30 days beginning on January 1, 2021, if member state opted for deferral
- UK is currently treated as an EU member state for DAC 6
  - Brexit transition period due to end December 31, 2020
  - Changes to UK regulations may be needed to make clear exchange of information mechanism

Timeline

DAC6 comes into force	Deadline to implement DAC6 in all EU countries	DAC6 becomes applicable	First deadline to disclose information	First exchange of information between EU countries
June 25, 2018	December 31, 2019	July 1, 2020	August 31, 2020	October 31, 2020

Transition period (June 25, 2018- June 30, 2020)

- A retrospective "catch-up" provision exists for reportable cross-border arrangements entered into between June 25, 2018, and July 1, 2020. Information on these arrangements must be disclosed to the tax authority by August 31, 2020

After transition period (July 1 onwards)

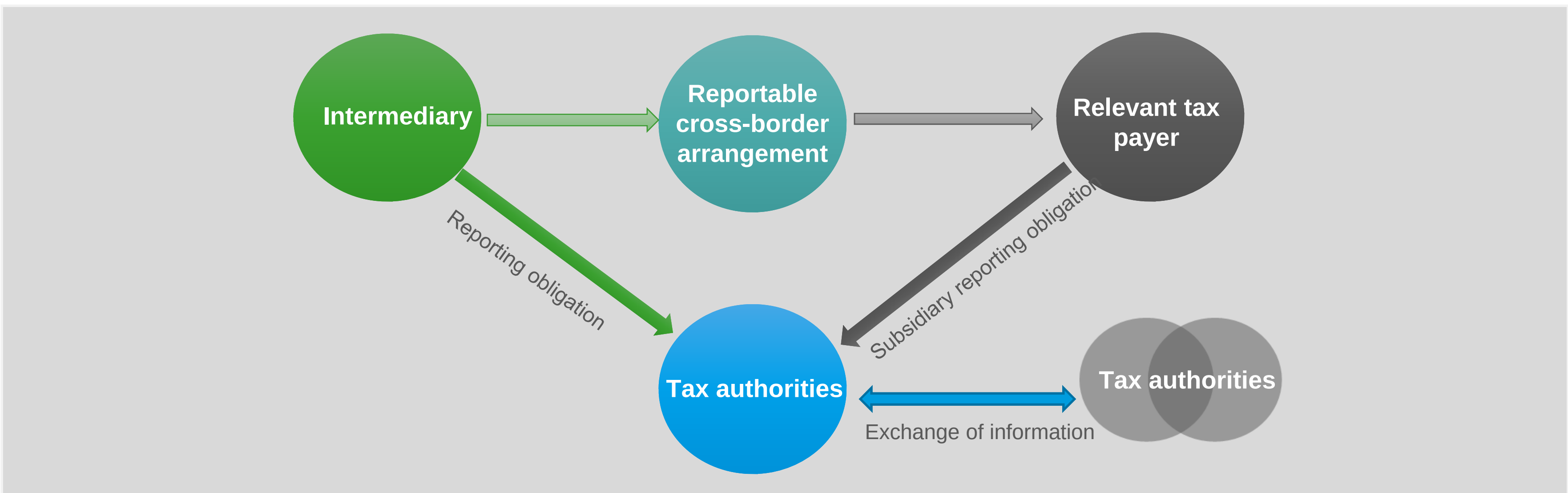
- Reporting deadline is within 30 days of the day after:
  - o The arrangement was made available for implementation
  - o The arrangement was made ready for implementation
  - o The first step of implementation was undertaken, whichever occurs first

Past planning can be reportable. The initial report covers a two year period starting in 2018.

Intermediaries may fail to make an initial report on past planning which is still operative, but where they have no ongoing involvement.

Who must report?

- The reporting obligation falls initially on intermediaries - any person that designs, markets, organizes, makes available for implementation, or manages the implementation of a reportable cross border arrangement.
- This also includes persons who provide assistance or advice in relation to making the arrangement available.



Who must report? (Cont'd)

- Intermediaries are obliged to report if they are:
  - incorporated, constituted or resident within an EU member state;
  - have a permanent establishment in the EU; or
  - registered with an EU based professional association.
- Where there are intermediaries in different EU jurisdictions, the Directive requires that each jurisdiction must require their local intermediary to make a report, unless there is proof that the relevant information has been reported in another jurisdiction.
- Intermediaries who benefit from legal privilege or a similar right may be granted a waiver from reporting.
- Where no EU intermediary is involved, or the intermediaries are granted waivers, **<u>the taxpayer must report</u>**.

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30-day period

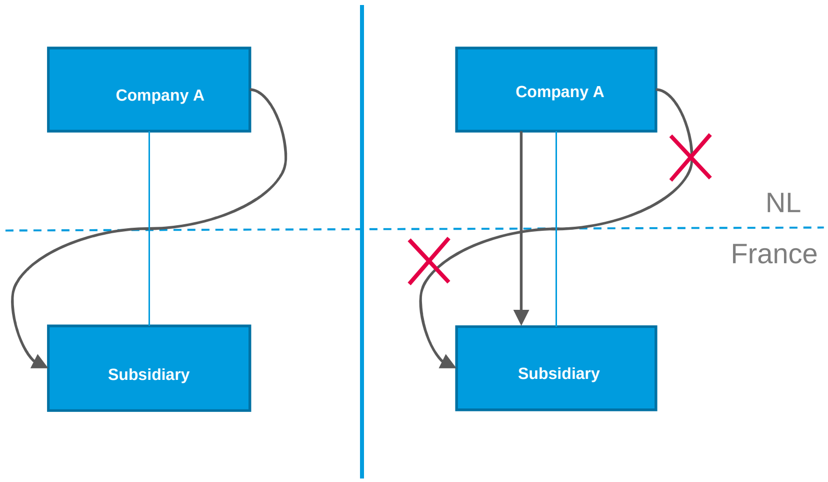
The 30-day period begins on the earliest of:

– Day after the arrangement is made available for implementation;

– Is ready for implementation, or

– The first step in implementation has been made

Example 1 – Converting loan into capital / share premium



Step 1:
Company A holds a loan receivable from its subsidiary. Subsidiary requires additional equity for local reasons.

Step 2:
The loan is converted into share capital / share premium.

Cross-border arrangements	Date of first step of implementation	Hallmarks	Benefit test	Reportable arrangement
Yes	January 1, 2019	Specific Hallmarks (B) includes as a “Hallmark” the conversion of income into a category taxed at a lower level/exempt. This Hallmark needs to pass the benefit test	The conversion of the loan does not trigger any taxation either in the Netherlands nor in France, whereas the interest income would be taxed in the Netherlands.	**Reportable** to the extent that the main benefit or one of the main benefits of the conversion of income into another category was to derive a tax advantage (having in regard all relevant facts and circumstances).

THANK YOU FOR YOUR TIME AND ATTENTION

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QUESTIONS AND ANSWERS

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