TAX ALERT – JANUARY 2, 2018

U.S. Tax Reform – International Corporate Tax Provisions: *The Good, the Bad and the Extremely Complex*

On December 22, 2017, President Trump signed into law the 2017 U.S. tax reform bill "*An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018*," Public Law 115-97 (the "**Act**"), formerly known as the "*Tax Cuts & Jobs Act*." Most of the Act's provisions are effective January 1, 2018. The over 500 pages of legislation include provisions that have possibly unintended or ambiguous results that are subject to interpretation. The Department of Treasury and the Internal Revenue Service ("**IRS**") may take years to provide the necessary guidance. In the meantime, taxpayers and their tax advisors will be forced to interpret complex legislative language, creating challenges and planning opportunities.

The Act introduces the most significant changes to the U.S. tax system since 1986. This Tax Alert sets forth certain preliminary observations about the Act that may be relevant to international corporate taxpayers. What follows is not an exhaustive discussion of every international tax provision in the Act. For those clients wishing a more specific analysis, interpretation and calculation of the impact of the Act, we are available to answer your questions.

Below is a brief snapshot of the provisions analyzed in this Tax Alert (with more detail immediately below).

1. The Participation Exemption. This provision introduces a 100% dividends received deduction on the foreign-source portion of dividends received from a 10%-owned (or more) foreign corporation.

2. Foreign Branch Income and Incorporation of a Branch. Income earned by U.S. persons from foreign branches is not eligible for the participation exemption and remains subject to U.S. tax. The incorporation of a branch that has incurred losses requires such losses to be recaptured upon incorporation.

3. Tax on Repatriated Earnings. A one-time transition tax to the participation exemption system will be imposed on the earnings of foreign subsidiaries. This tax impacts taxpayers that own 10% or more of a foreign corporation. For 2017, the earnings will be taxed at corporate rates of 15.5% and 8% for earnings held as cash and cash equivalents and for all other earnings, respectively. These rules are expected to effectively "unlock" the trapped cash held offshore by U.S. multinationals.

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4. Modification of Attribution Rules. These rules broaden the "constructive ownership" rules for related parties and could impact both the tax on repatriated earnings for 2017 and the calculation of Subpart F income for subsequent years.

5. Rules for Low-Taxed "Intangible" Income and Foreign Derived "Intangible" Income. These rules could result in an additional tax for corporations with foreign subsidiaries. However, these rules also introduce a reduced tax rate, of 13.125% rate on certain income earned by U.S. corporations that sell goods or services outside the U.S.

6. Limitation on Deductions of Certain Related Party Amounts Paid or Accrued. Taxpayers that pay to foreign related parties, interest or royalties that are not taxable in the recipient's jurisdiction will be denied a corresponding deduction in the U.S.

7. Base Erosion and Anti-Abuse Tax ("BEAT"). This provision could result in an "alternative minimum tax" for corporations taking deductions for payments (other than cost of goods sold) made to foreign related parties. However, this potential tax generally applies only to corporations with gross receipts that exceed $500 million.

8. Miscellaneous Other Provisions. Miscellaneous other provisions include, amongst others, an expanded definition of "Intangible Property" for any taxpayer considering transferring intangible property outside the U.S. and a revision of the source of income from sales of inventory, impacting the computation of the foreign tax credit and the amount of U.S. income of a foreign corporation that is considered effectively connected with a U.S. trade or business.

DETAILED EXPLANATION AND INTERPRETATION

1. The "Participation Exemption"

This provision allows a domestic corporation that owns 10% or more of a foreign corporation a 100% deduction ("**DRD**") on dividends paid by the foreign corporation out of its foreign-source earnings.[1,2] A Passive Foreign Investment Company that is not also a controlled foreign corporation ("**CFC**")[3] is excluded from this definition. No foreign tax credit or deduction is allowed for any

[1] The Conference Report includes a footnote stating that "a CFC receiving a dividend from a 10% owned foreign corporation that constitutes subpart F income may be eligible for the DRD with respect to such income." However, interpretations of the Act instead believe that subpart F income is ordinary income not eligible for the DRD.
[2] The Conference Report contemplates that a "dividend received" will include a dividend paid to a partnership in which a domestic corporation is a partner. It is believed that this provision will be included in forthcoming regulations.
[3] A CFC is any foreign corporation in which more than 50 percent of the total combined voting power of all classes of stock entitled to vote is owned directly, indirectly, or constructively by U.S. shareholders on any day during the taxable year of such foreign corporation or more than 50% of the total value of the stock is owned directly, indirectly or constructively by U.S. shareholders on any day during the taxable year of the corporation.

taxes paid or accrued (including withholding taxes) with respect to a dividend that qualifies for the DRD.

Note that this is not by any means a full participation exemption, as several exceptions apply. For example, dividends received by non-corporate taxpayers as well as dividends from subsidiaries in which the U.S. taxpayer does not own 10% of the equity (by vote or by value) will be fully taxable (with potential for foreign tax credit relief).

A U.S. corporation receiving the deduction must reduce its basis in the foreign corporation's stock by the amount of such dividend for purposes of determining its loss (but not gain), if any, on a subsequent disposition of such stock. This provision intends to prevent a U.S. shareholder from taking the additional benefit of selling the stock of a foreign corporation at a loss (because the distribution reduced the value of the foreign corporation) after it takes advantage of the participation exemption.

Furthermore, the DRD is not available for any dividend received by a U.S. shareholder from a CFC if the dividend is a hybrid dividend. A hybrid dividend is an amount received from a CFC for which the foreign corporation received a deduction (or other tax benefit) from taxes imposed by a foreign country.

Also, to the extent a domestic corporation is a U.S. shareholder with respect to tiered CFCs, a hybrid dividend paid from a lower-tier CFC to an upper-tier CFC is treated as subpart F income to the upper-tier CFC, and the U.S. shareholder is required to include in gross income an amount equal to the shareholder's pro-rata share of subpart F income.

The DRD is subject to a holding period requirement pursuant to which the U.S. corporation is eligible for the deduction only if it has held the stock of the foreign corporation for more than 365 days during the 731-day period beginning on the date that is 365 days before the date on which the share becomes ex-dividend with respect to the dividend.

Despite the exemption for actual dividends from foreign subsidiaries, the Act retains the existing rules requiring U.S. shareholders of a CFC to currently include in taxable income the earnings of the CFC reinvested in US property, loans from CFCs to U.S. corporate shareholders and other similar provisions.

Effective date – This provision is effective for distributions made after December 31, 2017.

Action Steps – For those corporations that previously included dividend income from their CFCs in their taxable income, the participation exemption regime will reduce their taxable income in the future to the extent that the foreign tax credit did not entirely offset the dividend income in prior years. However, to ensure the 100% deduction can be used, it is necessary to confirm that the income the foreign corporation earned did not benefit from any special deduction or tax regime in the foreign country.

2. Foreign Branch Income and Incorporation of a Branch

A taxpayer can deduct losses from a foreign branch operation against U.S. taxable income and then incorporate the branch once it becomes profitable. If a domestic corporation transfers substantially all of the assets of a foreign branch to a 10%-owned foreign corporation with respect to which it is a U.S. shareholder after the transfer, the domestic corporation must include in gross income an amount equal to the net losses incurred by the branch after December 31, 2017.

Effective Date – This provision is effective for transfers after December 31, 2017.

Action Steps – Any corporation considering the incorporation of a branch should also consider the resulting income it must recognize as part of the transfer.

3. Tax on Repatriated Earnings

To transition to the new participation exemption system, the Act imposes a "toll charge" that treats deferred foreign income of a "specified foreign corporation" ("**SFC**") as income, taxed at a special rate, for the year ended December 31, 2017.

An SFC is a CFC or a foreign corporation in which a U.S. person owns a 10% or more voting interest. However, in the case of a foreign corporation that is not a CFC ("**non-CFC**"), in order for it to be considered an SFC, it must have at least one U.S. shareholder that is a domestic corporation.

Deferred foreign income is based on the aggregate post-1986 accumulated foreign earnings and profits ("**E&P**"), an amount that is roughly equivalent to a financial statements retained earnings, as of November 2, 2017 or December 31, 2017, whichever is greater. Deferred earnings of a U.S. shareholder are reduced (but not below zero) by the shareholder's share of deficits for the same dates. The toll charge inclusion amount is treated as additional Subpart F income.

The income inclusion is reduced by a deduction to the extent necessary for the net deferred foreign earnings attributable to cash and other liquid assets (defined below) to be taxed at an effective rate of 15.5%, and of 8%, on all other earnings. Foreign tax credits are available for the portion of the earnings subject to tax.

Cash or cash equivalents is the sum of cash, net accounts receivable (i.e., accounts receivable in excess of accounts payable), plus the fair market value of marketable securities (i.e., commercial paper, foreign currency, any obligation with a term of less than a year, etc.).

The aggregate foreign cash position is the greater of:

- The aggregate of the U.S. shareholder's pro rata share of the cash position of each SFC determined at December 31, 2017; or

- One half of the sum of the aggregate described above for the years end December 31, 2015 and 2016.

A U.S. shareholder can elect to pay the net tax liability in eight installments.[4] The payments for each of the first 5 years equals 8% of the net tax liability, the 6th installment equals 15%, increasing to 20% for the 7th installment and the remaining balance of 25% is paid in the 8th year.

What is unknown is how state and local jurisdictions will tax this income and whether the entire amount will be taxed in 2017 or taxed over a period of years.

Effective date – This provision is effective for the last taxable year of a foreign corporation that begins before January 1, 2018 (i.e., this tax is assessed as part of the taxpayer's 2017 tax return).

Action Steps – Those corporations or individuals with SFCs will need to analyze the undistributed E&P (net of any deficits) of their foreign corporations to determine the extent of the potential tax liability. The law requires the analysis be prepared for both November 2, 2017 and December 31, 2017. The use of the November 2nd date is likely to avoid an issue where certain foreign corporations might have taken steps to reduce E&P prior to year-end in advance of legislation. Since the tax rate is dependent on the foreign corporation's "cash" positions as of December 31, 2017, 2016 and 2015, it will be necessary to collect this information for a complete analysis.

4. Modification of Attribution Rules

4.A. Downward Attribution

Certain stock of a foreign corporation owned by a foreign person is attributed to a U.S. entity that is owned by the foreign person (so-called "downward attribution") for purposes of determining whether the related U.S. person is a U.S. shareholder of the foreign corporation, and, therefore, whether the foreign corporation is a CFC.

This is mainly intended to impact inverted groups. However, many non-inverted groups may be affected. For example, a foreign subsidiary of a foreign parent that also owns a U.S. subsidiary could be treated as a CFC as a result of the downward attribution to the U.S. subsidiary, even if the foreign subsidiary was never directly or indirectly controlled by domestic shareholders. In that case, a U.S. group member that directly or indirectly owns an interest in the foreign subsidiary could be subject to current U.S. tax on the subpart F income of the foreign subsidiary.

[4] If an S Corporation is a US shareholder of an SFC, each shareholder of the S Corporation can elect to defer paying its net tax liability on its mandatory inclusion until a "triggering event" occurs (i.e., the corporation ceases to be an S Corporation, liquidation, etc.).

Effective Date – This provision is effective for the last taxable year of foreign corporations beginning before January 1, 2018. This means that it must be considered for purposes of the tax on repatriated earnings assessed as part of the taxpayer's 2017 return.

Action Steps – Corporations must immediately consider whether they have any downward attribution since it would impact the computation of the amount of tax on repatriated earnings and reporting requirements.

4.B. Definition of US Shareholder

Prior to the enactment of the Act, a U.S. shareholder was defined as a U.S. person who owns directly, indirectly, or constructively 10% or more of the total combined voting power of all classes of stock entitled to vote in a foreign corporation. The Act expands the definition of U.S. shareholder for purposes of subpart F to include a U.S. person who owns directly, indirectly or constructively, 10% or more of the voting power *or* total value of shares of all classes of stock of a foreign corporation.

Effective Date – This change is effective for tax years of foreign corporations beginning after December 31, 2017, and, therefore, does not apply for purposes of the tax on repatriated earnings.

Action Steps – Those corporations that own more than 10% of the value of foreign corporations will need to consider the impact of any subpart F income they might earn starting in 2018.

5. Rules for Low-Taxed Intangible Income and Foreign Derived Income

The Act includes two complementary provisions to tax "intangible" type income. The first, the tax on global intangible low-taxed income (or "**GILTI**") is meant to impose a minimum tax on foreign earnings deemed received by corporations from intangibles. The second allows a deduction for Foreign Derived Intangible Income (or "**FDII**"), *i.e.*, income earned directly by corporate U.S. taxpayers from selling property or providing services outside the U.S.

5.A. Global Intangible Low-Taxed Income ("GILTI")

The Act introduces a current tax on U.S. shareholders of CFCs with "global intangible low-taxed income" ("**GILTI**"). The tax on GILTI is designed to reduce the incentive to relocate CFCs to tax haven jurisdictions (*i.e.*, jurisdictions with an effective income tax rate of less than 18.9%), considering that any foreign tax savings by the CFC would be offset by an increase in U.S. taxes to U.S. shareholders.

The GILTI inclusion is equal to the U.S. shareholder's share of:

- The CFC's gross income (subject to certain exclusions, such as exclusions for highly-taxed foreign income); reduced by

- The excess of (i) 10 percent of the CFC's aggregate adjusted bases in depreciable tangible property used in its trade or business, over (ii) the CFC's net interest expense.

While the full amount of the U.S. shareholder's share of the GILTI is included in income, U.S. corporations are provided a 50 percent deduction.

Corporate U.S. shareholders are eligible for a foreign tax credit of up to 80 percent of the amount of foreign taxes deemed paid and are required to include 100 percent of the foreign taxes deemed paid in income under the Internal Revenue Code ("**IRC**") §78 gross-up.

The Act also modifies the existing foreign tax credit rules by creating a new basket of foreign tax credits paid or accrued with respect to GILTI. Such foreign tax credits can only be used to offset tax on GILTI inclusions, and not tax on other types of income, and cannot be carried back or forward.

U.S. shareholders of CFCs with relatively high interest expense and CFC corporate shareholders with little basis in depreciable property, such as service providers and corporations with high value intangibles, could find that most of the CFC's income is treated as GILTI.

For example, assume that a corporate U.S. shareholder owns 100% of a CFC, and all of the CFC's $1,000 of taxable income is treated as GILTI. If the CFC pays local income taxes of $140 (14% tax rate on $1,000 of taxable income), the US shareholder would be eligible for a foreign tax credit of $112 (80% of $140 foreign taxes). After taxes, the CFC would have $860 ($1,000 of income less $140 of taxes) treated as GILTI. However, the IRC §78 gross-up would require the U.S. shareholder to increase its GILTI by the entire $140.

The US shareholder would have $1,000 of GILTI income inclusion and a 50% deduction of $500. Thus, its net income would be $500. Based on the new 21% US corporate rate, the US shareholder's total US tax on the $500 would be $105. After taking into account the foreign tax credit, the US shareholder would have no current income tax liability on the foreign corporation's earnings (because the foreign tax credit of $112 exceeds its tax liability of $105). Generally, foreign tax rates under 13.125% will result in a GILTI inclusion to a US corporate shareholder.

Effective Date – The provision is effective for taxable years beginning after December 31, 2017.

Action Steps – Corporations should review and document the tax rate they pay for each CFC. To the extent they are subject to a low tax rate for any entity (less than 18.9%), they should consider estimating a GILTI calculation to see if the minimum tax might apply.

5.B. Foreign Derived Intangible Income (“FDII”)

In order to incentivize U.S. corporations to retain operations within the U.S., the Act allows a deduction that reduces to 13.125% the effective tax rate on “foreign derived intangible income” (“**FDII**”).

This provision could be viewed as the U.S. version of a “patent box system,” (*i.e.*, a system that allows companies to benefit from a reduced rate of tax on income derived from intangible property). However, in order to benefit from the U.S. system, none of the tests typical of patent box regimes apply (*e.g.*, R&D expenses, royalty payments, or intangible assets). In fact, taxpayers may be able to benefit from these provisions merely from the sale of tangible property outside the U.S.

FDII is generally the portion of the U.S. corporation’s net income that exceeds a deemed rate of return of the U.S. corporation’s tangible depreciable business assets and is attributable to certain sales of property to foreign persons or to the provision of certain services to any person, or with respect to any property, located outside the U.S.

Once again, the calculation of FDII (which is formula driven) is rather complex. Simplifying, FDII can be expressed as the following formula:

FDII = Deemed Intangible Income (“**DII**”) * [Foreign Derived Deduction Eligible Income (“**DEI**”)/DEI]

Therefore, the calculation of FDII includes three steps:

Step 1 – **Calculate DEI** – DEI is generally the gross income of the U.S. corporation without regard to:

- Subpart F income of the corporation;
- Any GILTI income the corporation might have;
- Any dividend received from 10%-owned CFCs;
- Foreign branch income;

less deductions (including taxes) properly allocable to such income.

Step 2 – **Calculate Deemed Intangible Income (“DII”)** – DII is DEI minus 10% of the tax basis of the corporation’s Qualified Business Asset Investment (“**QBAI**”). QBAI is the quarterly average tax bases in depreciable tangible property used in the corporation’s trade or business to produce the relevant income or loss. For these purposes, the taxpayer is generally required to use straight-line depreciation.

Step 3 – **Calculate the Foreign Derived DEI** – DEI is considered “foreign derived” DEI if it is derived in connection with:

- Property sold to a non-U.S. person for a foreign use; or
- Services provided to any person (or with respect to property) outside of the U.S.

Sales to Related Parties – A sale of property to a foreign related person is not treated as sold for a foreign use and therefore will not qualify for FDII benefits unless the property is ultimately sold by a related person, or used by a related person in connection with sales of property or the provision of services to an unrelated foreign person for use outside the U.S. Services provided to a foreign related person will not qualify for FDII benefits if the services are substantially similar to the services provided by the foreign related person to persons located in the U.S.

For taxable years 2018 through 2025, eligible C corporations are allowed a deduction equal to 37.5% of FDII. Accordingly, at the new 21% tax rate, this results in an effective tax rate of 13.125% on FDII. In other words, a domestic corporation would be subject to the standard 21% tax rate on its fixed 10% return on its U.S. depreciable assets and to a reduced 13.125% tax rate on any excess return that is attributable to exports of goods or services. An example of this calculation is as follows:

FACTS		
U.S. Corporation's Deduction Eligible Income ("DEI")	$	10,000,000
U.S. Corporation's Foreign Derived DEI	$	3,000,000
Qualified Business Asset Investment ("QBAI")	$	1,000,000
10% Return on QBAI	$	100,000
COMPUTATION		
Foreign Derived DEI/DEI (in percentage)		30%
Deemed Intangible Income = DEI - 10% Return of QBAI	$	9,900,000
Foreign Derived Intangible Income ("FDII")	**$**	**2,970,000**
37.5% FDII Deduction	$	(1,113,750)
Net FDII Subject to Tax	**$**	**1,856,250**
Regular 21% Rate x Net FDII = Effective Tax on Net FDII	**$**	**389,813**
Effective Tax Rate Applicable to Net FDII		**13.125%**
Regular 21% Rate x FDII (Without FDII Deduction)	**$**	**623,700**
FDII Tax Savings	**$**	**233,888**

Effective Date – The provision is effective for taxable years beginning after December 31, 2017.

Action Steps – This provision could be very beneficial and corporations with income from foreign sales or services should immediately start considering an implementation strategy.

6. Limitation on Deductions of Certain Related Party Amounts Paid or Accrued in Hybrid Transactions or with Hybrid Entities

The Act would disallow a deduction for any disqualified related-party amount paid or accrued pursuant to a hybrid transaction, or by, or to, a hybrid entity. A disqualified related-party amount is any interest or royalty paid or accrued to a related party if:

- There is no corresponding income inclusion to the related party under local tax law; or
- Such related party is allowed a deduction with respect to the payment under local tax law.

This does not include any payment to the extent such payment is included in the gross income as subpart F income of a U.S. shareholder. Generally, a corporation is related if there is directly or indirectly 50% ownership by vote or value.

Effective Date – This provision is effective for tax years beginning after December 31, 2017.

Action Steps – Corporations should determine whether they have any hybrid transactions that might trigger the loss of a deduction. Although there is no additional reporting requirement as part of this provision (i.e., on Form 5471 or Form 5472) it might be necessary to confirm that none of their deductions are disallowed in accordance with this provision.

7. Base Erosion and Anti-Abuse Tax ("BEAT")

This provision is meant to level the playing field between U.S. headquartered parent companies and foreign headquartered parent companies. The BEAT is in effect an alternative minimum tax for companies making base erosion payments (as defined below). However, the BEAT only applies to corporations with:

- At least $500 million of annual domestic (including effectively connected amounts earned by foreign affiliates) gross receipts (over a three-year averaging period)[5]; and
- That have a base erosion percentage (as defined below) which is 3% or higher.

The base erosion percentage is determined by dividing the deductions the taxpayer takes with respect to its base erosion payments ("**BE Payments**" defined below) by the overall amount of deductions the taxpayer takes (including deductions with respect to BE Payments), but excluding NOL carrybacks and carryforwards (and certain other deductions).[6]

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[5] Generally, all persons who are members of a controlled group of corporations are treated as one person for purposes of aggregating gross receipts when determining whether a corporation has sufficient gross receipts for the BEAT to apply.

[6] The BE% is also calculated at the controlled group level.

A taxpayer must first determine its regular tax liability and then compare it to the BEAT liability. If the BEAT liability is higher that the regular tax liability, the taxpayer owes both the regular tax liability plus the excess of the BEAT liability over the regular tax liability. If the BEAT liability is equal to or lower than the regular tax liability, the taxpayer owes only the regular tax liability.

The BEAT liability equals the product of 5% for 2018 (10% from 2019 through 2025) and the taxpayer's modified taxable income ("**Modified TI**") for the year.

Modified TI is the taxpayer's taxable income plus the following Base Erosion Payments:

- Any amount (including interest) paid or accrued by the taxpayer to foreign related parties for which a deduction is allowable; and
- Any amount paid or accrued in connection with the acquisition of depreciable or amortizable property from the foreign related party.

Significantly, BE Payments do not include any amount that constitutes a reduction in gross receipts, such as the cost of goods sold. BE Payments also exclude amounts paid or accrued for services that qualify for use of the services cost method, with certain modifications, if they reflect the total cost of the services without a mark-up.

For BE payments that are subject to withholding, the payment is not subject to the rule (i.e., it is not added back to Modified TI). For payments that are subject to a reduced rate of withholding in accordance with a tax treaty, the exclusion is proportionate to the statutory withholding rate.[7]

The definition of a foreign related party generally includes any 25% foreign shareholder of the taxpayer, related payments thereto, and any other person related to the taxpayer under IRC §482 (i.e., the same relationships considered for purposes of Form 5472 reporting).

The Act also calls for the issuance of regulations requiring corporations to report the details of their BE Payments. Most significantly, it increases the penalty for Form 5472 reporting from $10,000 to $25,000.

Effective Date – This provision applies to BE Payments paid or accrued in taxable years beginning after December 31, 2017.

Action Steps – Corporations will want to consider now whether they are liable for the BEAT in order to determine any potential impact. Taxpayers subject to the tax should also consider invoking the non-discrimination clause contained in the tax treaty between the US and the country of residence of the recipient of the BE payment. Non-discrimination provisions of tax treaties are

[7] To determine interest expense for which a deduction is allowed (in accordance with the new 30% limitation), the amount of interest for which a deduction is allowed is treated as allocable first to interest paid or accrued to persons who are not related parties and then to related parties.

indeed intended to prevent the denial of deductions for payments made to foreign entities where payments made to similarly-situated domestic entities are deductible.

8. Miscellaneous Other Provisions

Miscellaneous other provisions include, amongst others, an expanded definition of "Intangible Property", the method used to value intangible property, and a revision of the source of income from sales of inventory.

Expanded Definition of Intangible Property: The definition of intangibles has been a significant dispute between taxpayers and the IRS over the years. The Act amends the definition of intangible property in IRC §936(h)(3)(B) (which applies for purposes of IRC §§367 and 482) to include workforce in place, goodwill, going-concern value, and "any other item" the value or potential value of which is not attributable to tangible property or the services of an individual.

Valuation of Intangible Property: The Act gives the Commissioner the authority to specify the method used to value intangible property for purposes of both IRC §367(d) outbound transfer rules and the IRC §482 intercompany pricing rules. Specifically, when multiple intangible properties are transferred in one or more transactions, the IRS may value the intangible properties on an aggregate basis when that achieves a more reliable result. The Act would also codify the realistic alternative principle, which generally looks to the prices or profits that the controlled taxpayer could have realized by choosing a realistic alternative to the controlled transaction chosen.

Source of Income from Sales of Inventory: Currently, IRC §863(b) sources income from inventory produced in one jurisdiction and sold in another jurisdiction by allocating 50% of sales income to the place of production and 50% to the place of sale (determined based on title passage). The Act provides that income from inventory sales would be sourced entirely based on the place of production.

For federal purposes this provision impacts the computation of the foreign tax credit and the amount of U.S. effectively connected income of foreign corporations engaged in a U.S. trade or business selling inventory into the U.S. that is produced abroad. The computation of U.S. effectively connected income may also impact State and local income tax liabilities of foreign corporations that are exempt from Federal income taxes due to a Tax Treaty between the U.S. and the country where they are organized, but that are nevertheless subject to income tax at the State and local level.

Effective Date – These provisions are effective for taxable years beginning after December 31, 2017.

Action Steps – U.S. corporations considering moving their intangibles offshore should consider the tax they might pay based on the revised definition of intangibles. U.S. corporations that are subject to tax on foreign earnings and foreign corporations selling inventory to the U.S. should consider the impact of these provisions on their income tax liabilities.

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