Changes In International Tax Law

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West Virginia Tax Institute Annual Meeting

Morgantown, WV

October 29, 2018

On December 22, 2017 President Trump signed into law the Tax Cuts and Jobs Act. This new law made many changes to domestic taxation but also made drastic changes to the system of international taxation. The taxation of multinational corporations was the biggest changes to the code since its enactment in 1913. The new law transition multinational taxation from a worldwide (credit) system to a territorial form of taxing international transactions. The changes that were made in this Act were heavily applauded by practitioners in the international community including this practitioner. These changes have been advocated by international tax practitioners for years. Many bills have been proposed over the years but few changes have been made until this Act. Under the old worldwide (credit) system a US company with a foreign subsidiary would be able to compete effectively in a foreign host country because that company would pay the same tax to the host country as other local companies similarly situated. Under the prior worldwide (credit) system of taxation the US would not tax these foreign profits unless they were repatriated to the parent company in the United States. This is an antiquated tax relic leftover from the Cold War days. We were one of the only countries using the worldwide (credit) system of taxation to tax multinational corporations. Our prior tax laws created a disincentive to repatriated foreign earnings back to the parent companies headquartered in the US. This situation resulted in the companies not repatriating their foreign profits because they did not want to pay another level of tax to the US.

THE OLD LAW:

Under the previous tax legislation multinational corporations domiciled in the US with foreign subsidiaries would pay tax to the host country on their foreign profits. If they repatriated these foreign profits the US taxed these profits at normal corporate tax rates. The US multinational corporation was then permitted to take a foreign tax credit (FTC) on those profits that they had previously paid to the foreign host country. This system was complicated and there were many tax planning and tax avoidance strategies that were used to increase the FTC on those foreign profits. There were no incentives for these multinational corporations to bring these profits back to the US because that would create another level of taxation. As long as the company kept their foreign profits offshore, the US did not have the right to tax those foreign profits. Therefore billions of dollars of foreign profits had been kept in the offshore banks.

THE NEW LAW:

Under the new law, with most provisions taking effect January 1, 2018, the United States came into the modern world of taxation by changing to a territorial system of taxing multinational transactions. One major change brought about by the new law is a reduction of the corporate tax rate from 35% down to 21%. This new law creates a system of dividend exemption in taxing US corporations that have foreign earnings of their foreign subsidiaries when the earnings are distributed to the parent. The new law created what is known as **PARTICIPATION EXEMPTION DEDUCATION FOR FOREIGN-SOURCE PORTION OF DIVIDENDS**. The new law allows 100% of these participation exemption deductions for all of foreign-source dividends received provided the US corporate parent owns at least 10% of the foreign owned subsidiary. Foreign tax credits therefore will no longer be permitted on those foreign dividends that qualify for the participation exemption deduction. In other words, the government will not allow these companies to double dip. Therefore, the Foreign Tax Credit rules and the Subpart F rules are modified with phase-ins. The look through rule for controlled foreign corporations is now permanent.

The new DRD exemption rules require a one year holding period. The participation DRD only applies to a dividend on any share of stock held by the domestic corporation for more than 365 days during the 731 day period beginning on the date that is 365 days before the shares become ex-dividend (Code section 246(c)(5)(A)). This participation DRD places US companies on a level playing field with their worldwide competition. These new participation exemption rules only apply to US C-Corporations. This law change eliminates double taxation; therefore, no foreign tax credits will be allowed on the foreign dividends that are excluded in these rules. This should create a trend of other types of entities switching to C-Corporations or the subsidiaries being merged into C-Corporations. No US corporate tax will be levied against these foreign source dividends and individuals can receive a qualifying dividend from these US corporations and in effect have the benefits of deferral.

The anti-deferral regime required US persons with certain categories of passive and more easily transferable foreign source income to be currently taxed. A controlled foreign corporation (CFC) under Subpart F rules is taxed pro-rata on their CFC Subpart F income whether they received it or not (Code section 951(a)). Any foreign corporation with a US share holder holding more than 50% of the corporation's stock is classified as a CFC. Dividends from foreign corporations that are less than 10% owned by domestic corporations do not qualify for this participation exemption. These dividends will continue to receive the same treatment as under the prior law. These dividends will be taxed upon distribution, any anti-deferral rules would apply. Foreign tax credits will still be permitted on that income.

The new law introduces a new modification to Subpart F income known as "Global Intangible Low-Taxed Income" (GILTI). These rules tax GILTI income on individuals and trusts who own CFC stock higher than if the income were to be held in a C-Corporation.

Now what do we do with all of these billions of dollars of untaxed foreign profits? The new law introduces a repatriation tax that allows the US parent to bring back these profits accumulated in foreign countries and pay a reduced corporate tax. The new repatriation tax rate is 15.5% for cash assets and 8% for illiquid assets. This lower repatriation tax coupled with the new reduced corporate flat rate tax of 21% should provide an incentive for businesses to not shift their operations to foreign countries. Now we have a system that creates an incentive to multinational corporations headquartered in the US to bring their profits back home where they will now only be taxed once and hopefully reinvest in the US.

TAXATION OF US CITIZENS WORKING ABROAD (expatriate taxation)

The new law has in effect created a Bifurcated tax system. Multinational corporations are on the new territorial system but US expatriates are still under a worldwide (credit) system. Therefore there has been no change to the system of taxing individual US citizens or permanent residence on their foreign income. However, all changes made to the domestic tax laws will impact the expatriate tax returns because these expatriates are subject to taxation in the US under current law.

GILTI RULES: GLOBAL INTANGIBLE LOW-TAXED INCOME

The new GILTI rules are a new concept of taxation that was introduced by the recent US tax legislation. The concept is possibly too complicated for a 30 minute discussion but here are the basics of the new GILTI rules in a nutshell:

When Ireland and other countries in the European Union were allowing the multi-national companies to use various tax planning techniques to minimize their taxes, The European Commission stepped in and decided that the big multi-nationals were being given an unfair tax advantage by these countries. The EC ordered Apple, for instance, to pay back to Ireland approximately $15 billion in back taxes. In an extremely unusual move, Ireland entered into an appeal with Apple and protested the EC ability to dictate Irish tax policy. So the taxing authority and the taxpayer are both appealing an EC ruling. Ireland is in effect saying "we don't want those billions of dollars, we want to control our own fiscal and tax policies" It also said "we want the jobs created by these big high tech companies." This is the only time to my knowledge that this unusual tax appeal has ever occurred. When Ireland did away with their tax preferred method of allowing Apple and other multi-nationals to minimize their worldwide tax footprint, they came up with another crowd pleaser by giving the big companies a break on the taxation of their intangibles. The prior method of tax reduction was referred to as "**THE DOUBLE IRISH WITH A DUTCH SANDWICH".** This was replaced by the new tax break on taxation of intangibles. So they took away with the one hand and gave back with the other. This helps assure that the big tech and pharmaceutical companies did not leave because now their copyrights and patents would generate royalties and other intangible income that would be taxed at a lower rate, thus reducing their worldwide tax obligation. The new GILTI legislation in effect creates a new tax on that intangible income that is Globally taxed at a lower rate, thus we now have **GLOBAL INTANGIBLE LOW-TAXED INCOME** which attempts to add an additional tax to the low-taxed income and add to the coffers of the US Treasury. The new tax is heavier on an individual than on a C corporation.