ABA Tax Section Meeting
Choice of Entity and Structuring for Multinational Corporations and Partnerships After Tax Reform
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Overview

• The Tax Cuts and Jobs Act added a number of new international tax provisions (and the IRS and Treasury have issued extensive guidance relating to application of these new provisions along with some changes to existing rules) that can significantly impact multinational groups

• As a result, multinational groups will need to evaluate their organizational structures and transactions in light of these new provisions, with a particular emphasis on the implications of their choice of entities (e.g., “regular” corporations or partnerships, hybrids (including disregarded entities), reverse hybrids, and branches)

• This panel will explore some of the implications and issues relating to a multinational group’s choice of entity under selected provisions
Agenda

• Selected examples highlighting issues and implications relating to a multinational’s choice of entity in the following areas:
  • Section 267A—Anti-Hybrid Rules
  • Section 1503(d)—Dual Consolidated Loss Rules
  • Section 951A--Global Intangible Low-Taxed Income ("GILTI")
  • Section 250--Foreign Derived Intangible income ("FDII")
  • Section 59A--Base Erosion and Anti-abuse Tax ("BEAT")
  • Section 245A--Participation Exemption
Section 267A--Anti-Hybrid Rules
Section 267A – Anti-Hybrid Rules

• No deduction allowed for Disqualified related party amount (DRPA) paid or accrued if—
  • Pursuant to a hybrid transaction; or
  • By or to a hybrid entity

• DRPA includes interest or royalty paid or accrued to a related party (RP) if—
  • The amount is not included in income of the RP under the tax law of the country of which such RP is a resident for tax purposes or is subject to tax; or
  • Such RP is allowed a deduction with respect to such amount under the tax law of such country

• DRPA does not include any payment to the extent included in gross income of a US shareholder under section 951(a)

• RP is defined by reference to section 954(d)(3) with modification to substitute person referred to section 267A(a)(1) for CFC
Section 267A – Anti-Hybrid Rules

• **Hybrid transaction** means any transaction, series of transactions, agreement, or instrument one or more payments with respect to which are treated as interest or royalties and which are not so treated for purposes of the tax law of the foreign country of which the recipient of such payment is resident for tax purposes or is subject to tax.

• **Hybrid entity** means any entity—
  • treated as fiscally transparent for US tax purposes but not so treated for purposes of the tax law of the foreign country of which the entity is resident for tax purposes or is subject to tax, or
  • treated as fiscally transparent for purposes of such tax law but not so treated for US tax purposes.
Section 267A – Anti-Hybrid Rules

Statute gives Treasury authority to issue guidance as may be necessary or appropriate, including guidance addressing:

- Conduit arrangements;
- Branches or domestic entities;
- Certain structured transactions;
- Treatment of a tax preference as an exclusion from income if reduces generally applicable tax rate by 25% or more;
- Treatment of a participation exemption as an exclusion or deduction;
- The tax residence of an entity that is otherwise considered a tax resident of more than one country, or no country;
- Exceptions for cases where disqualified related party amount is taxed by country other than related party’s residence country; and
- Other cases that do not present risk of eroding US tax base
Proposed Section 267A Regulations

- Prop. Reg. § 1.267A-1 Disallowance of certain interest and royalty deductions
- Prop. Reg. § 1.267A-2 Hybrid and branch arrangements
- Prop. Reg. § 1.267A-3 Income inclusions and amounts not treated as disqualified hybrid amounts
- Prop. Reg. § 1.267A-4 Disqualified imported mismatch amounts
- Prop. Reg. § 1.267A-5 Definitions and special rules
- Prop. Reg. § 1.267A-6 Examples
- Prop. Reg. § 1.267A-7 Applicability dates
Proposed Section 267A Regulations

• Treasury issued proposed regulations in December of 2018 on section 267A (REG-104352-18) providing extensive guidance on the application of rules

• The proposed regulations include rules addressing certain structures and transactions involving several types of entities including:
  • Branches
  • Hybrids
  • Reverse hybrids as defined in the proposed regulations (an entity (US or foreign) that is fiscally transparent where it is organized but not fiscally transparent under the tax laws of an investor)

• Selected examples below illustrate some of the structures affected by section 267A
Section 267A-Foreign Corporation Operating through USB

Facts

• Under Country X tax law, $200x of gross income is attributable to USB, but is not included in FX2's income because Country X tax law exempts income attributable to a branch. Under U.S. tax law, the $200x of gross income is effectively connected income of USB.

• Under an income tax treaty between the United States and Country X, USB is a US permanent establishment and, for taxable year 1, $25x of royalties is allowable as a deduction in computing the business profits of USB and is deemed paid to FX2

Analysis

• Under Country X tax law, the $25x is not regarded

• Accordingly, the $25x is a specified payment that is a deemed branch payment. See Prop. Reg. §§1.267A-2(c)(2) and 1.267A-5(b)(3)(i)(B)

• The entire $25x is a disqualified hybrid amount for which a deduction is disallowed because the tax law of Country X provides an exclusion or exemption for income attributable to a branch. See Prop. Reg. §1.267A-2(c)(1)

• For additional details, see Prop. Reg. §1.267A-6(c)(4), Ex.4 (Alternative facts)
Section 267A-Domestic Reverse Hybrid

**Facts**

- FX holds all the interests of US1
- For Country X tax purposes, US1 is a disregarded entity of FX
- During taxable year 1, US1 pays $100x to FX pursuant to a debt instrument
- The amount is treated as interest for US tax purposes but is disregarded for Country X tax purposes as a transaction involving a single taxpayer
- During taxable year 1, US1's only other items of income, gain, deduction, or loss are $125x of gross income and a $60x item of deductible expense
- The $125x item of gross income is included in FX's income, and the $60x item of deductible expense is allowable for Country X tax purposes
Analysis

• US1 is a specified party and thus a deduction for its $100x specified payment is subject to disallowance under section 267A. As described in Prop. Reg. § 1.267A-6(c)(3)(ii)(A) and (B), $35x of the payment is a disqualified hybrid amount under the disregarded payment rule of Prop. Reg. § 1.267A-2(b) and, as a result, $35x of the deduction is disallowed under Prop. Reg. § 1.267A-1(b)(1)

• (A) US1's $100x payment is not regarded under the tax law of Country X (the tax law of FX, a related tax resident to which the payment is made) because under such tax law the payment is a disregarded transaction involving a single taxpayer. See Prop. Reg. § 1.267A-2(b)(2) and (f)
  • In addition, were the tax law of Country X to regard the payment (and treat it as interest), FX would include it in income
  • Therefore, the payment is a disregarded payment to which Prop. Reg. §1.267A-2(b) applies. See Prop. Reg. §1.267A-2(b)(2)
Analysis

• (B) Under Prop. Reg. §1.267A-2(b)(1), the excess (if any) of US1's disregarded payments for taxable year 1 ($100x) over its dual inclusion income for the taxable year is a disqualified hybrid amount.
  
  • US1's dual inclusion income for taxable year 1 is $65x, calculated as $125x (the amount of US1's gross income that is included in FX's income) less $60x (the amount of US1's deductible expenses, other than deductions for disregarded payments, that are allowable for Country X tax purposes). See Prop. Reg. §1.267A-2(b)(3).
  
  • Therefore, $35x is a disqualified hybrid amount ($100x less $65x). See Prop. Reg. §1.267A-2(b)(1).
  
  • For additional details, see Prop. Reg. §1.267A-6(c)(3), Ex. 3 (Basic Fact Pattern).
Section 1503(d)--Dual Consolidated Loss Rules
Section 1503(d)-Domestic Reverse Hybrids

- The current DCL regulations do not treat a DRH as a dual resident corporation (DRC)—thus, current DCL rules do not have rules addressing DRH.

- The new proposed DCL regulations (REG--104352-18) include rules under sections 1503(d) and 7701 to prevent the use of these structures to obtain a double-deduction outcome.

- The proposed regulations require, as a condition to a domestic entity electing to be treated as a corporation under Reg. §301.7701-3(c), that the domestic entity consent to be treated as a DRC for purposes of section 1503(d) (such an entity, a “domestic consenting corporation”) for taxable years in which two requirements are satisfied. See Prop. Reg. §301.7701-3(c)(3).

- The requirements are satisfied if (i) a “specified foreign tax resident” (generally, a body corporate that is a tax resident of a foreign country) under its tax law derives or incurs items of income, gain, deduction, or loss of the domestic consenting corporation, and (ii) the specified foreign tax resident is related to the domestic consenting corporation (as determined under section 267(b) or 707(b)). See Prop. Reg. §1.1503(d)-1(c).
If a domestic entity filed an election to be treated as a corporation before December 20, 2018 such that the entity was not required to consent to be treated as a DRC, then the entity is deemed to consent to being treated as a DRC as of its first taxable year beginning on or after the end of a 12-month transition period. This deemed consent can be avoided if the entity elects, effective before its first taxable year beginning on or after the end of the transition period, to be treated as a partnership or disregarded entity such that it ceases to be a corporation for US tax purposes. For purposes of such an election, the 60 month limitation under Reg. §301.7701-3(c)(1)(iv) is waived.

- The proposed regulations provide that the mirror legislation rule does not apply to dual consolidated losses of a domestic consenting corporation.
- See REG-104352-18 (Section VII under Explanation of Provisions) for proposed applicability dates relating to DCL rules.
Section 1503(d)-Domestic Reverse Hybrids

**Description:**
- Under Country Z tax law, DCC is fiscally transparent, but elects to be treated as an association for US federal tax purposes.

**Analysis:**
- DCC is a domestic consenting corporation and is treated as a dual resident corporation for DCL purposes.
- FSZ1 derives or incurs items of income, gain, deduction, or loss of DCC because, under Country Z tax law, DCC is fiscally transparent.
- DCC has a $100x DCL for taxable year 1.
- Because the loss is available to, and in fact does, offset income of FSZ1 under Country Z tax law, there is a foreign use of the DCL in year 1.
- Accordingly, the dual consolidated loss is subject to the domestic use limitation rule of Reg. §1.1503(d)-4(b).
- The result would be the same if FSZ1 were to indirectly own its DCC stock through an intermediate entity that is fiscally transparent under Country Z tax law, or if an individual were to wholly own FSZ1 and FSZ1 were a disregarded entity. In addition, the result would be the same if FSZ1 had no items of income, gain, deduction, or loss, other than the $100x loss attributable to DCC.
- See Prop. Reg. §1.1503(d)-7, Ex. 41.
Section 1503(d)-Hybrid Entity/Disregarded Item

- USP and USS are consolidated
- USP is eligible for interest deduction
- USS/FDE loan is disregarded
- FDE is eligible for interest deduction in its jurisdiction
- Under the current DCL regulations, the disregarded loan does not result in a DCL. See e.g., Reg. 1.1503(d) – 7(c), Ex. 23
- Future Guidance?

In REG 104352-18 Treasury stated the following:

“The Treasury Department and the IRS have determined that these transactions raise significant policy concerns that are similar to those relating to the D/NI outcomes addressed by sections 245A(e) and 267A, and the double-deduction outcomes addressed by section 1503(d). The Treasury Department and the IRS are studying these transactions and request comments.”
Section 951A--Global Intangible Low-Taxed Income ("GILTI")
GILTI

General Rules

• In general, section 951A provides that a US Shareholder of a CFC includes its pro rata share of GILTI in its gross income
  – A US Shareholder’s GILTI is generally equal to the US Shareholder’s net CFC tested income for such taxable year, less its net deemed tangible income return (“DTIR”) for such taxable year
  – A US Shareholder’s DTIR is generally equal to 10% of the aggregate of such US Shareholder’s pro rata share of the qualified business asset investment (“QBAI”) of each of its CFCs, less interest expense taken into account in determining net CFC tested income
  – Tested income/loss generally includes all items of a CFC’s income, deduction, gain, or loss other than certain specified types of income, such as items included in subpart F or dividends received from a related person
• With regard to pass-through entities, the proposed regulations under sections 951 and 951A provide, in part, that:
  – A domestic partnership that is a US Shareholder of a CFC generally has a GILTI inclusion (under the general rules for US Shareholders of CFCs);
  – A partner of a US Shareholder partnership that is itself a US Shareholder of a CFC owned by the partnership does not take into account its distributive share of GILTI from the partnership and instead takes into account its pro rata share of the CFC’s tested items and determines GILTI at the partner level;
  – Non-US Shareholder partners of a US Shareholder partnership take into account their distributive share of the partnership’s GILTI;
  – Certain domestic partnerships are treated as foreign partnerships for purposes of sections 951-964; and
  – The adjusted basis of specified tangible property of a partnership is included in the QBAI of a partner that is a tested income CFC (and rules are provided to determine the partner’s share of such basis)
**Facts**
- US1 and US2 each own 5% and 95%, respectively, of a foreign partnership, FP
- FP owns 100% of the single class of stock of FC1, a CFC
- US2 owns 100% of the single class of stock of FC2, a CFC
- In Year 1, FC1 has $100 of tested income, and FC2 has $25 of tested loss

**Analysis**
- No partnership-level calculations are performed because FP is not a US Shareholder
- US1 is not a US Shareholder with respect to either FC1 or FC2. Therefore US1 has no GILTI inclusion for the year
- US2 is a US Shareholder with respect to both FC1 and FC2. Therefore US2 computes its GILTI inclusion by taking into account its pro rata share of the CFC tested items of FC1 and FC2
  - Under section 958(a)(2), US2 owns stock of FC1 in proportion to its interest in FP (95%). Accordingly, US2’s pro rata share of FC1’s tested income is $95 ($100 x 95%)
  - US2’s pro rata share of FC2’s tested loss is $25 ($25 x 100%)
  - US2’s net CFC tested income is $70 ($95 - $25), and US2’s GILTI inclusion amount is $70
- US2 increases the basis of its interest in FP by $70 under section 961(a)

**May FP increase its basis in FC1 stock for the GILTI amount included by US2 with respect to its interest in FC1 that is held indirectly through FP?**
- The final regulations under section 965 provided for a specified basis adjustment to be made by a foreign partnership, with respect to the US Shareholder partner, to the foreign corporation stock. See Prop. Reg. § 1.965-2(h)(5)(ii)
- The proposed regulations under section 951A are silent as to section 961 basis adjustments with respect to foreign partnerships
- The preamble requested comments on the application of section 961 to domestic partnerships with US Shareholder partners

*All entities have taxable years ending on 12/31
GILTI

Domestic Partnerships with US Shareholder Partners

- A domestic partnership that is a US Shareholder of a CFC (a “US Shareholder Partnership”) determines its GILTI inclusion amount under the general rules applicable to US Shareholders

- However, the proposed regulations rules apply special rules to the partners’ distributive shares of the US Shareholder Partnership’s GILTI inclusion amount depending on whether each partner is itself a US Shareholder of the CFC owned by the US Shareholder Partnership
  - Each partner of a US Shareholder Partnership that is not a US Shareholder of the CFC takes into account its distributive share of the US Shareholder Partnership’s GILTI inclusion amount
  - If the partner is a US Shareholder of the CFC (a “US Shareholder Partner”):
    - Section 958(a) stock owned by the US Shareholder Partnership is treated as section 958(a) stock owned by the US Shareholder Partner (in the same manner as if the US Shareholder Partnership was treated as a foreign partnership under section 958);
    - The US Shareholder Partner determines its pro rata share of any CFC tested item (e.g., tested income, tested loss, QBAI, etc.) by reference to the section 958(a) stock owned by the US Shareholder Partner (based on application of the previous rule); and
    - The US Shareholder Partner’s distributive share of the GILTI inclusion amount of the US Shareholder Partnership is determined without regard to the partnership’s pro rata share of any CFC tested item of the CFC

- The rules apply to tiered US Shareholder Partnerships

- The proposed regulations requested comments on adjustments to the partner’s basis in its partnership interest, the partner’s section 704(b) capital account, the partnership’s basis in CFC stock under section 961, and a CFC’s previously taxed earnings and profits with respect to the partner or partnership under section 959
**GILTI**

**Example: US Shareholder Partner**

**Facts**
- US1 and US2 each own 5% and 95%, respectively, of a domestic partnership, PRS
- PRS owns 100% of the single class of stock of FC1, a CFC
- US2 owns 100% of the single class of stock of FC2, a CFC
- In Year 1, FC1 has $100 of tested income, and FC2 has $25 of tested loss

**Analysis**
- **Partnership-level calculation**
  - PRS is a US Shareholder partnership with respect to FC1
  - PRS determines its GILTI inclusion amount under Prop. Reg. § 1.951A-5(b)(1)
  - PRS’s pro rata share of FC1’s tested income is $100 ($100 x 100%)
  - PRS’s GILTI inclusion amount is $100
- **Partner-level calculation – US1**
  - US1 is not a US Shareholder partner with respect to FC1
  - US1 includes in income its distributive share ($5) of PRS’s GILTI inclusion amount
- **Partner-level calculation – US2**
  - Because US2 is a US Shareholder of FC1:
    - US2 is treated as owning section 958(a) stock of FC1 proportionately as if PRS were a foreign partnership. Thus, US2’s pro rata share of FC1’s tested income is $95 ($100 x 95%)
    - US2’s distributive share of PRS’s GILTI inclusion amount is determined without regard to PRS’s pro rata share of any item of FC1
  - US2’s pro rata share of FC2’s tested loss is $25 ($25 x 100%). Accordingly, US2’s net CFC tested income is $70 ($95 - $25)
  - US2’s GILTI inclusion amount is $70
  - This result is the same as if the partnership was a foreign partnership

*All entities have taxable years ending on 12/31*
GILTI
Example: Capital Accounts and Basis Adjustments for US Shareholder Partners

Facts
• Same facts as the prior example

Analysis
• Capital Accounts
  – Under the general rule, PRS has a GILTI inclusion of $100 and allocates that amount to its partners
  – US1’s capital account is increased by its share of PRS’s GILTI ($5)
  – However, the special rule for US Shareholder partners provides that US2 does NOT take into account its distributive share of PRS’s GILTI ($95)
  – Is there an increase to US2’s capital account for the share of GILTI that it would have included in the absence of the US Shareholder Partner rule?
  – If US2’s capital account is not increased, how do the partners maintain the economics of the partnership?
• Outside Basis
  – US1 increases its basis in PRS by the amount of its allocation of GILTI ($5) under section 705(a)
  – Does US2 have any adjustment to the basis of its interest in PRS under section 705?
  – Does US2 treat PRS as a foreign partnership for purposes of section 961 such that it increases its basis in the partnership under section 961(a)?
  – Section 951A(f)(1)(A) and Prop. Reg. § 1.951A-6(b)(1) provide that a GILTI inclusion is treated as a subpart F inclusion for purposes of section 961
• Inside Basis
  – By what amount does PRS increase its basis in FC1 stock under section 961(a)?
    ▪ Under the general rule, PRS has a GILTI inclusion of $100
    ▪ However, as a result of the US Shareholder Partner rule, the portion of PRS’s GILTI inclusion allocated to US2 ($95) is not included in any partner’s income
    – If the basis adjustment to FC1 stock is $5, is the adjustment attributable only to US1 in the event of a disposition or PTI distribution?

*All entities have taxable years ending on 12/31
Assume CFCA’s tested income exceeds CFCT’s tested loss

Assume that neither CFCA nor CFCT generates any subpart F income (either before or after the restructuring)

Although CFCT’s tested loss is included in the determination of USP’s net CFC tested income, prior to any restructuring, CFCT’s QBAI is not taken into account in determining USP’s GILTI inclusion

As a result of a section 332 liquidation/section 368 asset reorganization of CFCT with and into CFCA, CFCA is treated as owning CFCT’s QBAI potentially reducing USP’s GILTI inclusion

Assume that USP’s overall tax liability is reduced after taking into account any deemed paid taxes that are able to be claimed by USP as a result of the reduced GILTI inclusion

Will the IRS try to assert Prop. Reg. § 1.951-1(e)(6) (which is proposed to apply to taxable years of US shareholders ending on or after October 3, 2018) as a result of the restructuring?

Prop. Reg. § 1.951-1(e)(6) provides:

“For purposes of this paragraph (e), any transaction or arrangement that is part of a plan a principal purpose of which is the avoidance of Federal income taxation, including, but not limited to, a transaction or arrangement to reduce a United States shareholder's pro rata share of the subpart F income of a controlled foreign corporation, which transaction or arrangement would avoid Federal income taxation without regard to this paragraph (e)(6), is disregarded in determining such United States shareholder's pro rata share of the subpart F income of the corporation. This paragraph (e)(6) also applies for purposes of the pro rata share rules described in §1.951A-1(d) that reference this paragraph (e), including the rules in §1.951A-1(d)(3) that determine the pro rata share of qualified business asset investment based on the pro rata share of tested income.”
GILTI Planning

• Assume CFCB performs services on behalf of a related party in country B for purposes of FBC services income
• In structure 1, assume no FBC services income because CFCB performs services in country B (its place of incorporation) but income would result in tested income with a possible GILTI inclusion
• In structure 2, (after the CTB election), CFCA treated as performing services in country B on behalf of a related party (CFCA, which is incorporated in country A, is performing services for a related party in country B)
  — Potentially subpart F FBC services income (if yes, excluded from tested income/loss calculations for GILTI purposes) and, if foreign taxes are paid on such income, potential carryover of deemed paid foreign taxes by USP if not fully utilized (no carryover of foreign taxes for GILTI) and no haircut on the foreign tax credit (20% haircut on GILTI foreign taxes)
  — However, no section 250 deduction for subpart F income
  — If income related to providing such services is not included in subpart F income because of the section 954(b)(4) “high tax exception”, such income is also excluded from tested income
  — Potential benefit if USP isn’t able to fully claim allowable GILTI FTCs in Structure 1 (e.g., USP in NOL position or has FTC limitation)
• If USP’s tax liability is reduced by restructuring, will IRS try to assert Prop. Reg. § 1.951-1(e)(6)?
Section 250--Foreign Derived Intangible income ("FDII")
FDII and Choice of Entity

- Domestic corporations are entitled to a deduction for 37.5% of Foreign Deemed Intangible Income (FDII) under section 250

\[
FDII = \text{Deemed Intangible Income} \times \left[ \frac{\text{Foreign Derived Deduction Eligible Income}}{\text{Deduction Eligible Income}} \right]
\]

- Proposed Regulations provide detailed rules for determining which transactions result in “foreign derived deduction eligible income” (FDDEI): FDDEI Sales and FDDEI Services
  - FDDEI Sale must be a sale to a “foreign person” for foreign use
- Partnership is treated as a person for purposes of determining whether a sale to or by a partnership or a provision of a service to or by a partnership is a FDDEI transaction
  - See Prop. Reg. § 1.250(b)-3(g)
- Aggregate approach with respect to domestic corporate partners in partnerships
  - Domestic corporation’s share of gross deduction eligible income (DEI), gross FDDEI, and deductions of a partnership are determined in accordance with distributive share
  - Partnership may be domestic or foreign
  - Partnership must furnish information on these items with partner’s Schedule K-1
  - See Prop. Reg. § 1.250(b)-1(e)
FDII and Choice of Entity: Disposition of Foreign Branch Assets

- USP’s gain from sale of FDE1 is considered foreign branch income and excluded from DEI and FDDEI for purposes of section 250.
- Solely for FDII purposes, foreign branch income includes any income or gain from the “direct or indirect sale . . . of any asset (other than stock) that produces gross income attributable to a foreign branch, including by reason of the sale of a disregarded entity or interest in a partnership.”
  - See Prop. Reg. § 1.250(b)-1(c)(11)
  - Applies to section 367 transfer of branch assets as well
- In contrast, gain from the sale of a disregarded entity or partnership interest is not included in foreign branch income for foreign tax credit purposes
  - See Prop. Reg. § 1.904-4(f)(2)(iv)
FDII and Choice of Entity: CFC v. Disregarded Entity

- USP Sale to FC1 is a FDDEI Sale

- Sale to Customer is a FDDEI Sale but does not result in FDDEI to the extent income is foreign branch income
  - See Prop. Reg. § 1.250(b)-1(c)(14)(vi)

- Disregarded sale between USP and FDE1 may be taken into account in determining amount of foreign branch income
  - See Prop. Reg. §§ 1.250(b)-1(c)(11); 1.904-4(f)(2)(vi)
FDII and Choice of Entity: Domestic v. Foreign Partnership

- **US1 Sale to PRS is not a FDDEI Sale because PRS is not a foreign person**
- **PRS gain from sale to Customer may be included in FDDEI of US1 if it is attributable to a foreign branch**
- **See Prop. Reg. § 1.250(b)-3(g)(2), Ex. 1**

- **US1 Sale to PRS may be a FDDEI Sale because PRS is a foreign person**
- **PRS gain from sale to Customer is not included in FDDEI of US1 if it is attributable to a foreign branch**
- **See Prop. Reg. § 1.250(b)-3(g)(2), Ex. 1**

- **US1 Sale to PRS is not a FDDEI Sale because PRS is not a foreign person**
- **PRS gain from sale to Customer may be included in FDDEI of US1**
  - **PRS’s income from sale is not FDDEI if it is attributable to a foreign branch**
- **See Prop. Reg. § 1.250(b)-3(g)(2), Ex. 2**
Section 59A--Base Erosion and Anti-abuse Tax ("BEAT")
BEAT – Overview

- An **applicable taxpayer** under section 59A must be a corporation.
- A **base erosion payment** generally includes any amount paid or accrued by a **taxpayer** to a foreign person which is a related party of the taxpayer:
  - With respect to which a deduction is allowable under Chapter 1 of the Code, or
  - For property that is subject to the allowance for depreciation or amortization.
- A **base erosion tax benefit** generally includes:
  - Any deduction allowed with respect to a base erosion payment, or
  - Any deduction for depreciation or amortization allowed with respect to property acquired with a base erosion payment.
- **Base erosion percentage** of an applicable taxpayer generally determined by dividing base erosion tax benefits (numerator) by aggregate deductions (denominator).
- For BEAT purposes, a “related party” is defined by its relationship to the “taxpayer.” See section 59A(g).
BEAT and Choice of Entity

• A foreign person is defined under section 7701(a) as any person other than a US person and includes a foreign partnership
• Proposed BEAT Regulations generally adopt an aggregate approach to partnerships
• Base erosion payments and partnerships:
  – Payment made BY a partnership is treated as paid or accrued by the partners (in proportion to their distributive share of deductions with respect to the payment)
  – Payment made TO a partnership is treated as paid or accrued to the partners (in proportion to their distributive share of the income with respect to the payment)
• Base erosion tax benefits of partnerships:
  – Partner takes into account its distributive share of a partnership’s base erosion tax benefits unless *de minimis* exception applies:
    ▪ Partner owns less than 10% of capital and profits interest in partnership,
    ▪ Partner receives less than 10% of each partnership item, and
    ▪ Partner’s interest in the partnership has FMV less than $25 million
• Related party determination made at partner level
Proposed BEAT Regulations
Payments by Partnerships

US1
• Treated as paying $90 to FC1. Prop. Reg. § 1.59A-7(b)(2)
• Related party status tested at partner level: US1 is related to FC1. Prop. Reg. §§ 1.59A-1(b)(17)(i)(B), 1.59A-7(c)
• $90 payment treated as made by US1 to FC1 is a base erosion payment
• US1’s base erosion tax benefits includes its distributive share of deduction with respect to that base erosion payment
  – Compare purchase of amortizable property by PRS—consider possibility that percentage of base erosion payment may be different than percentage of amortization in later years

US2
• Treated as paying $10 to FC1
• US2 is not related to FC1
• $10 payment treated as made by US2 is not a base erosion payment

FC1

US1

US2

USP

$100 Deductible Payment

90%

10%
Proposed BEAT Regulations
Payments to Partnerships

USP
- Treated as paying $95 to FC1 and $5 to US1. Prop. Reg. § 1.59A-7(b)(3)
- Related party status tested at partner level: USP is related to FC1. Prop. Reg. §§ 1.59A-1(b)(17)(i)(B), 1.59A-7(c)
- $95 payment treated as made by USP to FC1 is a base erosion payment
- USP has $95 base erosion tax benefit (included in BEAT numerator)
- USP’s entire $100 deduction is included in BEAT denominator
Proponent BEAT Regulations
Non-Cash Consideration: Check-the-Box Liquidation

- If USP makes deductible payments to FC1, it may undertake a check-the-box liquidation in order to reduce its base erosion payments.
- Proposed Regulations provide that a transfer of “any form of consideration” can be a payment for purposes of determining base erosion payments, including stock and other non-cash consideration. See Prop. Reg. § 1.59A-3(b)(2)(i)
  - Preamble cites sections 351, 332, and 368 as examples of nonrecognition transactions that can result in base erosion payments.
- USP treated as making payment to related person FC1 in the form of FC1 stock that is extinguished in the liquidation.
  - Payment is a base erosion payment to the extent FDE1 assets include depreciable property.
- Contrast with in-kind distributions under section 301.
  - Preamble states that “there is no payment or accrual” in the case of a distribution.
Proposed BEAT Regulations
Non-Cash Consideration: Contribution by a Foreign Partner

• Preamble to Proposed Regulations states:
  – “[I]f a foreign related party and a taxpayer form a partnership, and the foreign related party contributes depreciable property, deductions for depreciation of the property generally are base erosion tax benefits, in part, because the partnership is treated as acquiring the property in exchange for an interest in the partnership under section 721.”

• US1 treated as making payment in part to FC1 (in the form of partnership equity interest) under aggregate theory
  – Note that US1 is being diluted and is not the entity that is issuing equity

• Consider application of ECI exception (Prop. Reg. § 1.59A-3(b)(3)(iii)) to the extent FC1’s allocation of income from PRS is ECI?

<table>
<thead>
<tr>
<th>Partner’s Capital</th>
<th>FC1</th>
<th>US1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beginning</td>
<td>100</td>
<td>300</td>
</tr>
<tr>
<td>Contribution</td>
<td>100</td>
<td>0</td>
</tr>
<tr>
<td>Ending</td>
<td>200</td>
<td>300</td>
</tr>
</tbody>
</table>
Section 245A--Participation Exemption
Some Situations in which Section 245A May Apply

- If certain requirements are satisfied, section 245A may apply to the above transactions
  - Note—Section 245A does not apply to distributions of PTEP
Participation Exemption for Foreign Corporations Owned through Partnerships

Overview

General Rules

- Section 245A provides for a dividends received deduction ("DRD") for foreign-source dividends received by certain domestic corporations from "specified 10-percent owned foreign corporations" if the domestic corporation is a US Shareholder with respect to such foreign corporation.

- A "specified 10-percent owned foreign corporation" is a foreign corporation with respect to which any domestic corporation is a US Shareholder with respect to such corporation. Such term does not include any corporation which is a PFIC (as defined in section 1297) with respect to the shareholder and which is not a CFC.

- The Conference Report provides that the meaning of "dividend received" is intended to be interpreted broadly and consistent with sections 243 and 245.

- For example, if a domestic corporation indirectly owns stock of a foreign corporation through a partnership and the domestic corporation would qualify for the participation DRD with respect to dividends from the foreign corporation if the domestic corporation owned such stock directly, the domestic corporation would be allowed a participation DRD with respect to its distributive share of the partnership’s dividend from the foreign corporation.” H.R. Conf. Rep. No. 115-466, at 599 (2017)

- Section 245A(g) provides regulatory authority to address the treatment of US Shareholders owning stock of a specified 10-percent owned foreign corporation through a partnership.

- Other special rules, including rules relating to the treatment of hybrid dividends and denying the foreign tax credit.

Holding Period Requirement

- Under section 246(c)(5), the section 245A DRD is available only if stock of the specified 10-percent owned foreign corporation is held by the "taxpayer" for more than 365 days within the 731-day period beginning 365 days before the dividend and ending 365 days after the dividend (the "Holding Period Requirement").

- For example, for a dividend paid on December 31, 2018, the 731-day period is December 31, 2017 through December 31, 2019.

- For purposes of the Holding Period Requirement, the "taxpayer" is treated as holding stock for a period only if, for the entire period –

  - The "taxpayer" is a US Shareholder with respect to the foreign corporation; and

  - The foreign corporation is a specified 10-percent owned foreign corporation.

- Section 246(c)(3) provides that a taxpayer’s holding period includes date of disposition but not date of acquisition and does not include holding period described in section 1223(3).

- The cross-reference to section 1223(3) arguably implies that the section 246 holding period takes into account the application of other provisions of section 1223.
The Conference Report provides that US1 and US2 are expected to be eligible for the section 245A DRD on their distributive share of dividends received by PRS from FC1 if US1 and US2 had actually owned the stock of FC1 directly.

Therefore it must be determined whether US1 and US2 meet the Holding Period Requirement under section 246(c).

Assume PRS is a domestic partnership---should the Holding Period Requirement be tested with respect to the domestic corporate partners’ holding periods in PRS or PRS’s holding period in FC1?

Rev. Rul. 68-79 provides that character is determined at the partnership level.

Section 735(b) provides that a partner’s holding period in property distributed from a partnership includes the partnership’s holding period in the property.

Sections 1223(1) and (2) also generally support the tacking of a partnership’s holding period to the partner’s holding period of property received in a distribution from the partnership.

Can the domestic partnership satisfy the US Shareholder/10% owned foreign corporation component of the Holding Period Requirement or must that be satisfied by the domestic corporate partner?

Suppose PRS is a foreign partnership. What result? Note the approach in section 956 proposed regulations and modification of section 246 with respect to a US corporation that owns the stock of the CFC indirectly by application of section 958(a)(2).

*All entities have taxable years ending on 12/31
Participation Exemption and Section 956 Inclusion

General Rule and Request for Comment

- Proposed regulations under section 956 generally reduce the section 956 amount (and generally the section 956 inclusion) of a US Shareholder that is a domestic corporation by the amount which would be allowed as a section 245A DRD if the amount of the section 956 inclusion were distributed to the US Shareholder by the CFC with the investment in US property.

- Prop. Reg. § 1.956-1(a)(2)(ii) provides special rules that implement the reduction to a domestic corporation’s section 956 amount in situations where the domestic corporation is a US Shareholder of a CFC and owns the stock of the CFC indirectly by application of section 958(a)(2) (which deals with ownership through foreign entities).
  - These rules include (among other rules) a rule providing that section 246(c) applies to the hypothetical distribution by substituting the phrase “owned (within the meaning of section 958(a))” for the term “held” each place it appears in section 246(c).

- The proposed regulations also provide that section 246(c) applies to the hypothetical distribution by substituting “the last day during the taxable year on which the foreign corporation is a controlled foreign corporation” for the phrase “the date on which such share becomes ex-dividend with respect to such dividend” in section 246(c)(1)(A).

- The proposed regulations make no provision for any reduction to the section 956 amount of a domestic partnership that has a domestic corporate partner who would be eligible for a section 245A DRD on its distributive share of dividends paid by a CFC to the domestic partnership.

- The preamble to the proposed regulations requested comments as to the appropriate coordination of section 956 with domestic partnerships that have domestic corporate partners. The preamble proposed two approaches for comment:
  - The first approach would reduce the amount otherwise determined under section 956 with respect to a domestic partnership to the extent that a domestic corporate partner would be entitled to a section 245A deduction if the partnership received the amount as a distribution.
  - The second approach would determine a domestic partnership’s section 956 amount and section 956 inclusion without regard to the status of its partners, but then provide that a corporate US Shareholder partner’s distributive share of the section 956 inclusion is not taxable.
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