BEAT and GILTI Issues for Insurance Companies

Section of Taxation
2019 Midyear Tax Meeting
January 18, 2019
Today’s Speakers

• Clarissa C. Potter
  • Principal, Washington National Tax
  • KPMG LLP, New York City, NY
  • +1 212 872 6913

• Kristan Rizzolo
  • Partner
  • Eversheds Sutherland (US) LLP, Washington DC
  • +1 202 383 0908

• Angela J. Walitt
  • Office of Tax Policy, U.S. Department of the Treasury
  • Washington DC

• Ted Clabault (Moderator)
  • Senior Manager
  • Ernst & Young LLP, Washington DC
  • +1 202 327 6839
BEAT Issues for Insurance Companies
BEAT Background

• Purpose of BEAT -- minimum tax
  • 2018 rate – 5% (6% for banks and registered securities dealers)
  • 2019-2024 rate – 10% (11% for banks and registered securities dealers)
  • 2025 and after rate – 12.5% (13.5% for banks and registered securities dealers)

• Applies to US taxpayers in an aggregate group with
  • annual average gross receipts over a three-year period of at least $500 million
  • “base erosion percentage” of at least 3% (or 2% in the case of banks and registered securities dealers)

• Each US taxpayer in group subject to BEAT

• BEAT due if
  • US taxpayer’s “modified taxable income” (MTI) multiplied by the applicable BEAT rate is greater than
    • the taxpayer’s regular tax liability for the taxable year without taking into account certain credits.

• No BEAT if regular tax liability exceeds its MTI multiplied by the applicable BEAT rate
BEAT Proposed Regulations

• Issued December 13, 2018
• Notable points for insurance companies
  • Payments made to a U.S. branch are not treated as BEAT payments to the extent included in ECI or allocable to a PE
  • General federal tax principles govern whether payment is a deductible payment treated as a base eroding payment, or a reduction to gross income not treated as a base eroding payment
  • De minimis exception decreases base erosion percentage applicable to registered securities dealers
Aggregate Group versus Taxpayer

• Application of the gross receipts and base erosion percentage test on an aggregate basis
  • Includes all corporations within a section 52(a) controlled group (using 50% instead of 80%)

• Determination of MTI and calculation of the BEAT amount on a single taxpayer basis
  • Only taxpayers included in a consolidated group treated as a single taxpayer
  • US branches and life subgroups each treated as separate taxpayers

• Payments between members of the aggregate group not taken into account in applying the gross receipts test or determining the base erosion percentage
  • Includes payments treated as ECI of a non-US member of the aggregate group
Base Erosion Percentage

• Amount of base erosion payments for taxable year divided by taxpayer’s total deductible payments for tax year

• Section 965(c) deductions are to be included in denominator of fraction

• Amounts excluded from treatment as a base erosion payment are not included in denominator in calculating base erosion percentage
  • Examples: qualified derivative payments and the portion of a services payment that is eligible for the services cost method exception
Base Erosion Payments

• Services exception clarified
  • Applies even if the payment includes mark-up
  • Mark-up component treated as a base erosion payment
  • Taxpayer must maintain appropriate books and records from which the mark-up component can be determined

• Other clarifications regarding determination of whether an amount is treated as a base erosion payment include:
  • Payments in cash or any form of non-cash consideration may be treated as base erosion payments
  • Exchange loss from a section 988 transaction is not treated as a base erosion payment
  • Only amounts accrued in tax years beginning after December 31, 2017 are treated as base erosion payments
De minimis Exception for Registered Securities Dealers

• Aggregate group is not subject to the lower base erosion percentage trigger of 2% if de minimis test met
  • Test -- Gross receipts attributable to registered securities dealer less than 2% of aggregate group’s gross revenue
  • Same test applies in the case of bank gross revenue

• No de minimis exception for higher BEAT rate
  • If 3% base erosion percentage trigger is met (as well as the gross revenue trigger) higher BEAT rate applicable to registered securities dealer (or bank)
Special Rules Relating to Insurance Companies

- Proposed regulations provide limited guidance for insurance companies, request further comments

- Amounts paid under a reinsurance contract not netted
  - Reinsurance payments calculated on gross basis even if contract is settled on net basis
  - Proposed regulations appear to indicate return premiums reduce amount of premium subject to BEAT

- Claim payments may be subject to the BEAT
  - Payments treated as reductions to gross income under section 832(b)(3) may not be subject to the BEAT
  - Preamble notes the potential difference between the treatment of claim payments by life and non-life insurance companies
    - Comments requested on this issue.

- Treatment of section 953(d) companies and U.S. branches
  - Payments made or accrued to section 953(d) company or to a U.S. branch not subject to BEAT
  - A payment made by a section 953(d) company or a U.S. branch to a foreign related corporation may be subject to BEAT
GILTI Issues for Insurance Companies
GILTI Timeline: December 2017 – December 2018

- December 22, 2017: H.R. 1 signed into law
- September 13, 2018: Proposed GILTI Regs issued
- November 26, 2018: Proposed 163(j) Regs issued
- November 28, 2018: Proposed FTC Regs issued
- December 2018: Hybrids, PTI and other
GILTI Fundamentals

12/22/17
H.R. 1 signed into law

09/13/18
Proposed GILTI Regs issued

11/26/18
Proposed 163(j) Regs issued

11/28/18
Proposed FTC Regs issued

Guidance needed:

• Inclusion amount
• GILTI deduction
• Section 78 gross-up
• Expense allocation
• Consolidated vs separate TP
• Losses
• Allocation of taxes
• PTI
• 163(j)
• High-Taxed Income
• Hybrids
GILTI Fundamentals

**Current Inclusion**
US Shareholders are subject to current US taxation on their portion of a CFC’s global intangible low-taxed income (GILTI)

**Netting**
US Shareholders net “positive” GILTI and “negative” GILTI from their CFCs

**Tax Rate**
Lower tax rate is achieved through a deduction: 50% for tax years beginning before 12/31/25, and 37.5% thereafter

Total GILTI and foreign-derived intangible income (FDII) deduction is limited by taxable income (without regard to GILTI and FDII)

**Effective Date**
Effective for CFC tax years beginning after December 31, 2017
Each person who is a US shareholder of any CFC for any taxable year shall include in gross income such shareholder’s global intangible low-taxed income for such year.

Excess of “net CFC tested income” over “net deemed tangible income return”

Excess of: aggregate of pro rata share of tested income of each CFC, over aggregate of pro rata share of tested loss of each CFC

Excess of: gross income (other than ECI, Subpart F, High-taxed SubF, related party dividends, and FOGEI), less allocable deductions

QBAI: adjusted basis of depreciable tangible property used in trade or business (and used in the production of tested income)

Excess of: allocable deductions over gross income (other than ECI, Subpart F, High-taxed SubF, related party dividends, and FOGEI)

Excess of: 10% of pro rata share of “qualified business asset investment” (“QBAI”) of each tested income CFC, over interest expense taken into account in determining net CFC tested income
High Level GILTI Inclusion Computation

Tested income:
- All gross income of a CFC, other than:
  - Gross U.S. source effectively connected income (ECI)
  - Gross Subpart F income
  - Gross high-taxed Subpart F income for which the high tax exception of section 954(b)(4) is elected
  - Dividends received from a related person
  - Foreign oil and gas extraction income (FOGEI)
- Less deductions properly allocable to such gross income under rules similar to section 954(b)(5)
High Level GILTI Computation (cont.)

Net Deemed Tangible Income Return:

- **QBAI**
  - Measured on a quarterly average basis, using basis in tangible depreciable business property used to generate tested income, determined under ADS principles.
  - No QBAI from tested loss CFCs

- **Certain Interest Expense**
  - Interest paid to persons other than CFCs within the same US shareholder ownership chain that take the interest income into account in determining tested income or tested loss
  - Does not reduce QBAI below zero
U.S. shareholders that are corporations can take deemed paid foreign tax credits with respect to their GILTI inclusion
- The "inclusion percentage" of "aggregate tested foreign income taxes" is included in income as a dividend under the section 78 gross up rules
- The deemed paid credit for the taxes is haircut to 80% under the statute (and reduced by inclusion percentage)
- A separate FTC basket is created for GILTI inclusions

Inclusion percentage — the U.S. shareholder’s GILTI amount divided by the aggregate amount of its pro rata share of the tested income

Tested foreign income taxes
- Only the taxes that are properly attributable to CFC’s Tested Income
- Does not include taxes attributable to CFCs with Tested Losses or taxes attributable to tax exempt income
GILTI Fundamentals - Selected Issues

<table>
<thead>
<tr>
<th>Issue</th>
<th>Description</th>
<th>Status</th>
<th>Resolution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Section 78 Gross-Up</td>
<td>Basket of section 78 gross-up for FTC capacity purposes</td>
<td>Resolved by proposed regulations</td>
<td>In GILTI basket</td>
</tr>
<tr>
<td>Cross – Chain Losses</td>
<td>Ability to utilize tested losses in one chain against tested income in another chain</td>
<td>Resolved by proposed regulations</td>
<td>Losses may be utilized</td>
</tr>
<tr>
<td>FTC Capacity</td>
<td>Applicability of expense allocation to GILTI basket</td>
<td>Resolved by proposed regulations</td>
<td>Expense allocation applies Tested loss entities may contribute both benefits and detriments</td>
</tr>
<tr>
<td>Impact of Loss Entities</td>
<td>Loss utilization but no QBAI and impact of excluded interest</td>
<td>N/A</td>
<td></td>
</tr>
</tbody>
</table>
A perfect (GILTI) world – the conference report

“Under a 21-percent corporate tax rate, and as a result of the deduction for FDII and GILTI, the effective tax rate on FDII is 13.125 percent and the effective U.S. tax rate on GILTI (with respect to domestic corporations) is 10.5 percent for taxable years beginning after December 31, 2017, and before January 1, 2026. Since only a portion (80 percent) of foreign tax credits are allowed to offset U.S. tax on GILTI, the minimum foreign tax rate, with respect to GILTI, at which no U.S. residual tax is owed by a domestic corporation is 13.125 percent.

1526 13.125 percent equals the effective GILTI rate of 10.5 percent divided by 80 percent. If the foreign tax rate on GILTI is 13.125 percent, and domestic corporations are allowed a credit equal to 80 percent of foreign taxes paid, then the post-credit foreign tax rate on GILTI equals 10.5 percent (= 13.125 percent × 80 percent), which equals the effective GILTI rate of 10.5 percent.

Therefore, no U.S. residual tax is owed.

P.L. 115-97, Conference Report, December 15, 2017 (emphasis added)
A perfect (GILTI) world (conference report)

<table>
<thead>
<tr>
<th>CFC</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Income</td>
<td>$100</td>
</tr>
<tr>
<td>Deductions</td>
<td>$0</td>
</tr>
<tr>
<td>Tangible Assets</td>
<td>$0</td>
</tr>
<tr>
<td>Foreign Taxes</td>
<td>$13.13</td>
</tr>
</tbody>
</table>

USP

Tax rate: 13.125%

GILTI
- Tested Income: $86.87
- Net Deemed Tangible Income Return:
  - 10% of QBAI: $0.00
  - Excluded Interest: ($0.00)
- GILTI Amount: $86.87

GILTI Deemed Paid Taxes
- Inclusion Percentage
  - GILTI Amount: $86.87
  - Tested Income: $86.87
- Inclusion Percentage: 100.0%
- GILTI Haircut: 80.00%
- Tested Foreign Income Taxes: $13.13
- GILTI Deemed Paid Taxes: $10.50

Section 78 Gross-Up: $13.13

Section 250 Deduction
- GILTI: $43.43
- Section 78: $6.57
- Total Deduction: $50.00

US Tax Calculation
- GILTI: $43.43
- Section 78 Income: $6.57
- Total Income: $50.00
- Tentative US Tax @21%: $10.50
- Less: GILTI Deemed Paid Taxes: $10.50
- Residual US Tax/(Excess FTCs): $0
### GILTI Problem #2: FTC capacity

**Tax rate:** 13.125%

<table>
<thead>
<tr>
<th>CFC</th>
<th>Gross Income</th>
<th>$100</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Deductions</td>
<td>$(0)</td>
</tr>
<tr>
<td></td>
<td>Tangible Assets</td>
<td>$0</td>
</tr>
<tr>
<td></td>
<td>Foreign Taxes</td>
<td>$13.13</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>FTC Capacity</th>
<th>GILTI Income</th>
<th>$50.00</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Less: Expense Allocation</td>
<td>$(1.00)</td>
</tr>
<tr>
<td>Net GILTI Income</td>
<td>$49.00</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>FTC Capacity</th>
<th>GILTI Deemed Paid Taxes</th>
</tr>
</thead>
<tbody>
<tr>
<td>GILTI Income</td>
<td>$50.00</td>
</tr>
<tr>
<td>Lost FTCs:</td>
<td>$(0.21)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>GILTI</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tested Income</td>
</tr>
<tr>
<td>Net Deemed Tangible Income Return</td>
</tr>
<tr>
<td>10% of QBAI</td>
</tr>
<tr>
<td>Excluded Interest</td>
</tr>
<tr>
<td>GILTI Amount</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>GILTI Deemed Paid Taxes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inclusion Percentage 100.0%</td>
</tr>
<tr>
<td>GILTI Haircut 80.00%</td>
</tr>
<tr>
<td>Tested Foreign Income Taxes</td>
</tr>
<tr>
<td>GILTI Deemed Paid Taxes</td>
</tr>
</tbody>
</table>

| Section 78 Gross-Up | $13.13 |

<table>
<thead>
<tr>
<th>US Tax Calculation</th>
</tr>
</thead>
<tbody>
<tr>
<td>GILTI</td>
</tr>
<tr>
<td>Section 78 Income</td>
</tr>
<tr>
<td>Total Income</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Tentative US Tax @21%</th>
<th>$10.50</th>
</tr>
</thead>
<tbody>
<tr>
<td>GILTI Deemed Paid Taxes</td>
<td>$10.50</td>
</tr>
<tr>
<td>GILTI basket capacity:</td>
<td>$10.29</td>
</tr>
<tr>
<td>GILTI FTC:</td>
<td>$(10.29)</td>
</tr>
</tbody>
</table>

| Residual US Tax | $0.21 |
| Lost FTCs: | $(0.21) |
GILTI Problem #3: Benefits and Detriments of Losses

<table>
<thead>
<tr>
<th>Table</th>
<th>CFC1</th>
<th>CFC2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross income</td>
<td>$200</td>
<td>$100</td>
</tr>
<tr>
<td>Deductions</td>
<td>$(25)</td>
<td>$(110)</td>
</tr>
<tr>
<td>Tangible assets</td>
<td>$100</td>
<td>$100</td>
</tr>
<tr>
<td>Excluded interest</td>
<td>$2.50</td>
<td>$5.00</td>
</tr>
<tr>
<td>Foreign taxes</td>
<td>$10</td>
<td>$2</td>
</tr>
</tbody>
</table>

GILTI

Net CFC Tested Income
CFC1 Tested Income (Loss) $165.00
CFC2 Tested Income (Loss) $(12.00)
Total $153.00

Net Deemed Tangible Income Return
10% of QBAI $10.00
Excluded Interest $(7.50)
Total $2.50

GILTI Amount $150.50

GILTI Deemed Paid Taxes
Inclusion Percentage
GILTI Amount $150.50
Tested Income $165.00
Inclusion Percentage 91.2%
GILTI Haircut 80.0%
Tested Foreign Income Taxes $10.00
GILTI Deemed Paid Taxes $7.30

Section 78 Gross-Up $9.12

US Tax Calculation
GILTI $75.25
Section 78 Gross-Up $4.56
Total Income $79.81
Tentative US Tax @21% $16.76
Less: GILTI Deemed Paid Taxes $7.30
Residual US Tax $9.46
GILTI Proposed Regulations

12/22/17
H.R. 1 signed into law

09/13/18
Proposed GILTI Regs issued

11/26/18
Proposed 163(j) Regs issued

11/28/18
Proposed FTC Regs issued

Guidance received:
- Inclusion amount
- GILTI deduction
- Section 78 gross-up
- Expense allocation
- Consolidated vs separate TP
- Losses
- Allocation of taxes
- PTI
- 163(j)
- High-Taxed Income

Guidance needed:
- Inclusion amount
- GILTI deduction
- Section 78 gross-up
- Expense allocation
- Consolidated vs separate TP
- Losses
- Allocation of taxes
- PTI
- 163(j)
- High-Taxed Income
GILTI Proposed Regulations

• Computational rules
• Consolidated groups and partnerships
• Pro Rata Share Rules
• Reduction in basis for “used” tested losses
• Anti-abuse rules
  • Step-up transactions in the “disqualified period” (both tangible and intangible property)
  • Property held temporarily (only tangible property)
  • Pro rata share anti-abuse rules
GILTI Proposed Regulations – Computational Rules

- Gross income and deductions determined using subpart F income regulations (Reg §1.952-2)
  - §§ 163(j), 245A, and 267A to be addressed in future guidance
  - Some now addressed (e.g., § 163(j))

- Allocate and apportion deductions using subpart F income regulations (Reg §1.954-1(c))

- Deductions for accrued unpaid amounts owed to related CFCs
  - If a CFC payer’s accrued but unpaid expense increases a US shareholder’s pro rata share of the payee CFC’s tested income, reduces a US shareholder’s pro rata share of payee CFC’s tested loss, or both, for a US shareholder inclusion year, the payer CFC may accrue the deduction
  - May significantly reduce impact of §§ 267(a)(3)(B) and 163(e)(3)(B)
• Subpart F income limitations (§952(c)) and GILTI
  • No current-year E&P limit for tested income
  • Income excluded from subpart F income under §952(c) is not tested income
  • E&P recaptured as subpart F income is not excluded from tested income
    • Income in recapture year treated as both tested income and subpart F income
    • Applies to pre-2018 recapture accounts (as well as post-2017 accounts)
  • No mitigation of statutory rule (§951A(c)(2)(B)(ii)) that current-year E&P limit increased by the full amount of a tested loss, even if tested loss only partially used to offset tested income
Year 1
- A Corp has no inclusion with respect to FS under §951(a)(1)(A)
- Gross tested income of FS is determined without regard to §952(c)(1)
- The FBCI of FS is excluded in determining gross tested income; therefore, FS has no gross tested income

FS

\[
\text{Foreign base company income (FBCI)} = 100
\]
\[
\text{FOGEI} = (100)
\]
\[
\text{Other income} = 0
\]
\[
\text{E&P} = 0
\]

Year 2
- FS’s E&P in excess of its subpart F income are treated as subpart F income under §952(c)(2)
- A Corp has §951(a)(1)(A) inclusion of 100x
- FS’s subpart F income not excluded from gross tested income; accordingly, FS also has 100 gross tested income
- Thus, A Corp could potentially also have §951A inclusion up to 100

\[
\text{E&P in excess of subpart F income} = 100
\]
\[
\text{Without regard to §952(c)(2), gross income excluded from gross tested income under §1.951A-2(c)(1)(i) through (v)} = 0
\]
\[
\text{Allowable deductions properly allocable to gross tested income} = 0
\]
GILTI Proposed Regulations – Consolidated Taxpayers

• Generally a consolidated approach for determining a member’s GILTI inclusion (Prop §1.1502-51)

• Consolidated approach aggregates and allocates tested losses, QBAI, and specified interest expense

• Each member
  • Determines its pro rata shares of tested income on a stand-alone basis
  • Is allocated a share of the consolidated group’s total tested losses, QBAI, and specified interest expense based on its “GILTI allocation ratio”

• “GILTI allocation ratio” based on member’s share of total tested income of consolidated group
GILTI Proposed Regulations – Consolidated Taxpayers

- GILTI inclusions
  - **USS1** = 200 tested income - 100 tested loss - 25 net DTIR = **75**
    - GILTI inclusion amount
  - **USS2** = 600 tested income - 300 tested loss - 75 net DTIR = **225**
    - GILTI inclusion amount

```
Tested Loss = (400)  
Tested Income = 200  
QBAI = 1000
```

```
Tested Loss = (400)  
Tested Income = 200  
QBAI = 0
```

```
Tested Loss = (400)  
Tested Income = 600  
QBAI = 0
```
GILTI Proposed Regulations – Pro Rata Share of Income and QBAI

• Section 951A(e)(1): for purposes of determining a USSH’s GILTI inclusion amount, the USSH’s pro rata share of a CFC’s tested income, tested loss, and QBAI are determined under subpart F rules (section 951(a)(2)) in the same manner as subpart F income.
  • Prop. Reg. §1.951A-1(d): pro rata share of any CFC item necessary for calculating GILTI inclusion amount determined by reference to stock USSH owns (section 958(a)) in the CFC as of close of CFC’s taxable year, including stock treated as owned by USSH thru domestic partnership
  • Prop. Reg. §1.951-1(d)(2): pro rata share of tested income generally based on relative amount that would be received by USSH in year end “hypothetical distribution.”
  • Prop. Reg. §1.951-1(d)(3): pro rata share of QBAI generally proportionate to amount of CFC’s tested income distributed in hypothetical distribution
    • Prop. Reg. §1.951-1(d)(4): Limitation applies for preferred shareholders when QBAI exceeds 10 times the tested income of the CFC
      • Excess QBAI allocated to common stock
Prop. Reg. §1.951-1(e), Example 6

Hypothetical Distribution:
- Preferred: 4% x 100 x 300 = $1,200
- Common: $11,000 – $1,200 = $9,800

Subpart F Income:
- USSH1: $2,000 x $(9,800/11,000) = $1,782
- USSH2: $2,000 x $(1,200/11,000) = $218

Tested Income:
- USSH1: $9,000 x $(9,800/11,000) = $8,018
- USSH2: $9,000 x $(1,200/11,000) = $982

<table>
<thead>
<tr>
<th>Preferred stock</th>
<th>300 shares</th>
<th>4% non-participating</th>
<th>$100 par value</th>
</tr>
</thead>
<tbody>
<tr>
<td>USSH1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>USSH2</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CFC</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Subpart F</th>
<th>Tested Income</th>
<th>E&amp;P</th>
</tr>
</thead>
<tbody>
<tr>
<td>CFC</td>
<td>$2,000</td>
<td>$9,000</td>
</tr>
</tbody>
</table>

GILTI Proposed Regulations – Pro Rata Share of Income
GILTI Proposed Regulations Pro Rata Share of Tested Losses

- Prop. Reg. §1.951A-1(d)(4): determining pro rata share of tested loss, amount distributed in hypothetical distribution is amount of tested loss, NOT CFC’s current E&P
  - Tested losses generally allocated only to common stock
  - Allocated to preferred stock only in two situations:
    - Preferred stock has accrued but unpaid dividends, which exceed E&P
    - Common stock has no liquidation value
    - Subsequent tested income is “specially allocated” to follow the tested loss
GILTI Proposed Regulations – Pro Rata Share of Subpart F and Tested Loss

Hypothetical Distribution:

- Preferred: 4% x 100 x 300 = $1,200
- Common: $11,000 – $1,200 = $8,800

Subpart F Income:

- USSH1: $10,000 x (8,800/10,000) = $8,800
- USSH2: $10,000 x (1,200/10,000) = $1,200

Tested Loss:

- USSH1: ($2,000)
- USSH2: $0

*For purposes of determining subpart F income, current year E&P is increased by tested loss under the coordination rule*
GILTI Proposed Regulations- Basis Adjustments

• Basis in stock held directly or indirectly by corporate US shareholder (other than RICs/REITs) reduced immediately before disposition of such stock
  • Reduction based on US corporation’s “net used tested loss amount” attributable to the stock
  • Gain recognized to the extent reduction exceeds existing basis
  • “Net used tested loss amount” based on use of tested losses to offset tested income
  • Applies to direct or indirect dispositions
  • No corresponding basis increase for “net offset tested income amounts”

• Addresses perceived double benefit
  • Use of tested loss to offset tested income
  • Recognition of loss, or reduction in gain, on disposition of “specified stock”
GILTI Proposed Regulations – Basis Adjustments

Year 2

- CFC1’s basis in the CFC2 stock is reduced by USP’s net used tested loss amount with respect to CFC2 of $100

- No adjustment to the basis of the CFC1 stock
GILTI Proposed Regulations – Anti-Abuse Rules

• Basis step-ups during disqualified period
  • Disqualified basis in specified tangible property disregarded for purposes of determining QBAI
  • Deductions/losses attributable to disqualified basis in specified property and allocated/apportioned to gross tested income disregarded for purposes of determining tested income/loss
  • Apply to basis (“disqualified basis”) arising from related-party transfers (“disqualified transfers”) that occur between 1/1/18 and the close of the transferor’s last pre-GILTI year (the “disqualified period”)

• Tangible property that is “held temporarily”
  • Property held temporarily (but over at least one quarter-end) with a principal purpose of reducing a GILTI inclusion is disregarded for purposes of determining QBAI

• Anti-abuse rule for determination of pro rata share
  • Any transaction or arrangement that is part of plan to reduce federal income tax is disregarded for purposes of determining a US shareholder’s pro rata share of subpart F income or CFC tested items
GILTI Proposed Regulations

Sale of F3 to F2 is a “disqualified transfer” because the sale is between related parties and occurs between 1/1/18 and the end of F1’s last pre-GILTI tax year.

F2’s basis in the intangible property (IP) and the tangible property (TP) is “disqualified basis.”

The “disqualified basis” in the TP is disregarded when determining F2’s QBAI.

Deductions/losses allocated and apportioned to F2’s gross tested income that are attributable to the “disqualified basis” are disregarded when determining F2’s tested income/loss.

<table>
<thead>
<tr>
<th></th>
<th>IP</th>
<th>TP</th>
</tr>
</thead>
<tbody>
<tr>
<td>F3</td>
<td>FMV: 50</td>
<td>100</td>
</tr>
<tr>
<td></td>
<td>AB: 0</td>
<td>0</td>
</tr>
<tr>
<td>F1</td>
<td>FMV: 50</td>
<td>100</td>
</tr>
<tr>
<td>11/30 TYE</td>
<td>AB: 50</td>
<td>100</td>
</tr>
</tbody>
</table>

Taxable Sale on 6/30/18 for 150 (“Disqualified Transfer”)
163(j) Proposed Regulations

Guidance received:
- Confirmation of applicability to CFCs
- Impact on E&P
- Methodology
- Special election for CFCs—and special rules for financial groups

Guidance needed:
- Inclusion amount
- GILTI deduction
- Section 78 gross-up
- Expense allocation
- Consolidated vs separate TP
- Losses
- Allocation of taxes
- PTI
- 163(j)
163(j) Proposed Regulations – Definition of Interest

<table>
<thead>
<tr>
<th>Rules</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Amounts paid, received or accrued for the use or forbearance of money and amounts treated as interest under other Code provisions</td>
<td>OID, qualified stated interest, acquisition discount, market discount bonds, repurchase premium, amounts treated as interest under 467, 988, 7872, etc.</td>
</tr>
<tr>
<td>2. Specifically enumerated items not falling within general rule</td>
<td>Swaps with nonperiodic payments, contingent payment debt instruments, substitute interest payments, yield adjustments, commitment fees, debt issuance costs, guaranteed payments, factoring income, etc.</td>
</tr>
<tr>
<td>3. Any expense or loss that is predominantly incurred in consideration of the time value of money</td>
<td>Guarantee fees? Other examples?</td>
</tr>
</tbody>
</table>

- Appears to be limited to section 163(j) purposes only
- Applies to both interest income and interest expense
• Confirms that section 163(j) applies to CFCs
• E&P of a CFC is not adjusted to reflect any disallowance of interest expense
  • Will subject subpart F income to E&P limitation under section 952(c) ... Taxpayers will need to track recapture accounts
  • When income is recaptured in a year in which current-year E&P exceeds subpart F income, under current rules, recapture is allocated between GILTI and subpart F even though GILTI is not subject to E&P limitation.
• Provides two available methods for applying section 163(j) at the CFC level:
  • The default CFC-by-CFC method (the “default method”)
  • The elective CFC group method (the “CFC group method”)
• CFC Group method allows
  • Netting business interest income/expense group wide
  • Tiering up of excess taxable income
163(j) Proposed Regulations – Definition of CFC Group

- CFC Group is two or more CFCs if at least 80% of the value of such CFCs is owned by the same U.S. shareholder or by multiple related U.S. shareholders that own the CFCs “in the same proportions”

- Consolidated group is treated as a single U.S. shareholder, so CFCs in different U.S. shareholder chains can be a part of the same CFC Group

- U.S. person is treated as owning directly CFC shares owned through a pass-through if such person owns more than 80% of the interests in such pass-through and such pass-through is a U.S. shareholder of such CFC

- Partnership is treated as a group member if CFC group members own more than 80% in capital or profits of the partnership
  - Partnership interest is treated as stock for this purpose

- CFC groups exclude:
  - CFCs with ECI (but included as CFC Group member for limited purpose of applying CFC Group ownership aggregation test)
  - CFCs that conduct financial services businesses are treated as part of a “financial services subgroup” and ring-fenced from the remaining CFC Group
163(j) Proposed Regulations – Special Rules for Active Financial CFCs

• CFCs that conduct financial services businesses are treated as part of a “financial services subgroup” and ring-fenced from the remaining CFC Group

• Odd application to insurance CFCs: CFCs that are qualifying insurance companies within the meaning of section 953(e)(3), as a separate group.
  • Preamble states that this subgrouping rule is intended to avoid distortions created by including in the general group any CFCs that tend to have disproportionate amount of business interest income or expense
  • Could create distortions by excluding from the subgroup a finance or treasury operation that centralizes borrowing in a separate entity that is not a qualifying insurance company, or by excluding CFCs that are active, regulated insurance companies that do not meet the 50% home country net written premium requirement of section 953(e)(3).

• Upshot: Think carefully about CFC Election
FTC Proposed Regulations

12/22/17
H.R. 1 signed into law

09/13/18
Proposed GILTI Regs issued

11/26/18
Proposed 163(j) Regs issued

11/28/18
Proposed FTC Regs issued

Guidance received:
• Expense allocation
• Look-through
• Transition rules
• Section 78 GU

Guidance needed:
• Inclusion amount
• GILTI deduction
• Section 78 gross-up
• Expense allocation
• Consolidated vs separate TP
• Losses
• Allocation of taxes
• PTI
• 163(j)
Key FTC Changes

• Foreign taxes paid or accrued directly by US persons remain creditable under Section 901.

• Deemed paid foreign taxes
  • §902 is repealed effective for taxable years of foreign corporations beginning after December 31, 2017.
  • §960 is amended and the sole mechanism for a domestic corporation to be treated as paying foreign taxes paid by a foreign corporation (but only from a controlled foreign corporation (CFC)).

• Amendments to §904
  • Separate limitation added for income inclusions under §951A (no carryover or carryback of excess foreign taxes) and foreign branch income
  • A domestic corporation’s limitation for each §904 category is determined generally without regard to,
    • the foreign-source portion of any dividend received from a foreign corporation that is eligible for a deduction under §245A, and
    • any deductions properly allocable or apportioned to,
      • income (other than inclusions under section 951(a) (subpart F income) or 951A (GILTI)), or
      • Stock of such foreign corporation to the extent income from such stock is not subpart F income or GILTI.
FTC Amendments to Section 960

• §960(a): Treats a domestic corporation that includes an item of income in gross income under §951(a)(1) with respect to a CFC as paying “so much of such foreign corporation’s foreign income taxes as are properly attributable to such item of income.”

• §960(d): Treats a domestic corporation that has a GILTI inclusion as paying foreign taxes equal to “80 percent of the product of (A) such domestic corporation’s inclusion percentage, multiplied by (b) the aggregate tested income taxes paid or accrued by controlled foreign corporations.”

• §960(b): Deems a US corporation to pay certain foreign taxes paid or accrued (or deemed paid or accrued) by a CFC that are properly attributable to an amount distributed by the CFC to the US corporation that is excluded from gross income by the US corporation under §959(a) (PTI distribution).

  • Old §960(b) re-designated as §960(c)
  • Old §960(c) repealed
Section 78

• An amount equal to any foreign taxes deemed paid under §960(a), (b) and (d) is treated generally as a dividend received by the domestic corporation from the CFC.
  • However, the 80 percent limitation for foreign taxes deemed paid with respect to GILTI inclusions does not apply for this purpose – income inclusion equals 100% of GILTI taxes; and
  • a §78 dividend is not treated as a dividend for purposes of claiming a dividends received deduction under §§245A and 245.
**FTC Proposed Regulations--Highlights**

**Generally Address:**
- Expense allocation, including rules to address GILTI and section 904(b)(4)
- Section 904 basketing of income and foreign taxes, including look-through rules
- FTC limitation
- Calculation of section 960 taxes

**Fail to Address:**
- R&D, Stewardship, and G&A expense allocation
- Interaction with DCL rules
- Section 905(c) redeterminations

**Applicability Dates:**
- The effective date of the proposed regulations generally fall into three categories—(1) tax years beginning after December 31, 2017, (2) tax years ending after the date on which the proposed regulations were filed with the Federal Register (apparently, November 28, 2018), or (3) tax years which meet both of those criteria
Highlights

- GILTI is treated as partially exempt under section 864(e)(3) to the extent of the US shareholder’s section 250 deduction
- Transition Rules
  - Taxpayer favorable elective transition rules for FTC carryforwards and OFL, ODL, and SLL accounts
- Guidance on the Branch Basket
  - Branch income determined at corporate/individual level, not at pass-through level
  - No per se rule for partnerships as a qualified business unit – must have trade or business
  - Branch income does not include income arising from activities taking place in US
  - Disregarded transactions DO impact branch income and can CREATE trade or business status
  - Branch category applies before residual category for financial services (unlike passive)
- Look-through only for passive income (not GILTI)
- Section 245A does not apply to the section 78 gross-up of a fiscal year taxpayer for the section 965 inclusion year, but prior to the effective date of GILTI
- No deemed-paid taxes on section 956 inclusion or distribution of section 959(c)(3) E&P
Highlights (continued)

• Areas of Complexity
  • Complicated rules for dividing CFC stock between GILTI and 245A
  • Complicated rules in section 960 for CFCs and potentially harsh results for those with different US/foreign year ends or significant timing differences
  • Rules for the branch basket will likely require companies to implement new systems to track otherwise disregarded payments
  • Subpart F high-tax exception calculations
The proposed regulations provide transition rules for taxpayers’ FTC carryovers and SLL/OFL/ODLs in light of the new §904 categories (e.g., the branch basket).

- Excess general FTCs: Carryforward to general, unless taxpayers elect to assign taxes to branch category.
- Excess branch FTCs: Carryback to general.
- Excess GILTI FTCs: Not allowed.
The most significant modifications address the apportionment of expenses to GILTI and impact of the §250 deduction for GILTI and FDII on the foreign tax credit limitation under §904(a):

- In general: Interest expense still apportioned between US and foreign source income based on the relative value of US and foreign assets (calculated either using TBV or ATBV method) and to FTC baskets based on the character of foreign assets.
- §951A: Prop. Reg. §1.861-13 characterizes CFC stock in various groupings, including as a §951A category asset. These rules are needed to determine the degree to which CFC stock is a §951A category asset.
- §864(e)(3): In order to address the “over allocation” of interest expense to the §951A category, the proposed regulations treat a portion of CFC stock as an “exempt asset” under §864(e)(3) by treating income qualifying for the §250 deduction as “exempt income.”
- §904(b)(4): Special rules for expenses allocable to dividend income qualifying for the §245A DRD and portion of CFC stock attributable to non-currently included §959(c)(3) earnings (“§245A subgroup earnings”).
FTC Proposed Regulations: Exempt Income and Assets

• Exempt income (not included when apportioning expenses using a gross income method) includes the following amounts:
  • FDII: gross income included in foreign-derived intangible income (as defined in §250(b)(1)) and
  • GILTI: gross income from an inclusion under §951A(a) and the associated §78 gross up;
  • in each case equal to the §250(a) deduction for such gross income (taking into account the taxable income limitation under §250(a)(2)(B), if any).

• Exempt assets (not included when apportioning expenses using an asset method) include:
  • FDII: the portion of assets that produce gross income included in foreign-derived intangible income equal to the amount of such assets multiplied by the fraction that equals the §250(a)(1)(A) deduction (taking into account the taxable income limitation under §250(a)(2)(B), if any) divided by foreign-derived intangible income.
  • GILTI: The portion of the value of CFC stock that is characterized as GILTI inclusion stock multiplied by a fraction that equals the §250(a)(1)(B)(i) deduction (taking into account the taxable income limitation under §250(a)(2)(B)(ii), if any) divided by its GILTI inclusion amount.

• Dividends eligible for a §245A deduction are NOT exempt income (but see §904(b)(4) and Prop. Reg. §1.904(b)-3.)
• Previously-taxed earnings and profits (PTI) does not cause CFC stock to be treated as an exempt asset.
• Exempt income/ asset rules do not apply to determine FDII when applying §250 as the operative section.
PTI

12/22/17
H.R. 1 signed into law

12/14/18

Guidance needed:

• Inclusion amount ✓
• GILTI deduction ✓
• Section 78 gross-up ✓
• Expense allocation ✓
• Consolidated vs separate TP ✓
• Losses ✓
• Allocation of taxes ✓
• PTI ✓
• 163(j) ✓
• High-taxed income ✓
• Hybrids

Interim guidance on PTI:

• Notice 2019-01
• But now called “PTEP”
Anti-Hybrids

12/22/17
H.R. 1 signed into law

Guidance needed:
- Inclusion amount
- GILTI deduction
- Section 78 gross-up
- Expense allocation
- Consolidated vs separate TP
- Losses
- Allocation of taxes
- PTI
- 163(j)
- High-taxed income
- Hybrids

12/20/18

New Proposed Regulations:
- §254A(e)
- §267A
Where are we today?

12/22/17
H.R. 1 signed into law

Today (?)

Guidance needed:
- Inclusion amount
- GILTI deduction
- Section 78 gross-up
- Expense allocation
- Consolidated vs separate TP
- Losses
- Allocation of taxes
- PTI
- 163(j)
- High-taxed income
- Hybrids

Awaiting Guidance/Open Issues:
- 909 splitter rules
- 901(m)
- 905(c) redeterminations
- Taxable year issues
- 250 Deduction
- PTI (but see Notice 2019-01)
- And many more?
PFIC Exception for Insurance Companies
The PFIC rules generally apply to widely owned offshore companies with significant amount of passive income or passive income generating assets (other than in support of insurance business)

- In cases where these offshore companies earn mostly passive income and/or hold assets that produce mostly passive income, these might be classified as passive foreign investment vehicles (PFICs)
- A US owner of stock in a PFIC must either include its pro rata share of the PFIC’s income on a current basis, or pay a large interest amount when it receives a distribution

Insurance companies generally hold assets that produce passive income, resulting in them being at risk of being classified as PFICs. Under prior law, a company “predominantly” in the business of insurance could classify its passive assets as active assets in determining its PFIC status (the insurance exception)
The TCJA amended the PFIC exception for insurance companies. It now applies a more objective test.

- Exception for insurance companies to apply only if the foreign corporation would be taxed as an insurance company if it were a US corporation and if the applicable insurance liabilities constitute:
  - More than 25% of the foreign company’s assets, or
  - At least 10% of the entity’s assets if the dip below 25% is due to certain circumstances

- Applicable insurance liabilities means:
  - Loss and loss adjustment expenses and
  - Reserves (other than deficiency, contingency, or unearned premiums reserves) for life and health insurance risks and life and health insurance claims for contracts providing coverage for mortality and morbidity risks

- If the 25% test fails, then look to standard PFIC asset and income tests at year end 2018.

- Assets of foreign insurance companies might now be considered passive assets.
PFIC Exception for Insurance Companies

- ABA Comments on the QIC Exception from the TCJA were submitted on January 3, 2019.
  - Proposed regulations are expected shortly
- Items in the ABA Comments:
  - Requested clarification that “loss and loss adjustment expenses” includes both paid and unpaid losses.
  - Asked that losses be shown as undiscounted losses (as they would on the insurance company’s statutory statement) rather than discounted (as they would on a US tax return)
  - Requested the liability/asset ratio calculation be done on a quarterly basis rather than at year-end – Better reflection of the insurance company’s activities.
  - Asked that the regulations make a provision for insurance companies whose applicable insurance liabilities fluctuate year to year – Particularly applicable for companies that assume catastrophic risks. Suggest a 3-year rolling average.
  - Clarification on which financial statements to use in determining the percentage – US GAAP, IFRS, Local GAAP, etc.
  - Addressing the treatment of the income and assets of domestic insurance companies that are subsidiaries of foreign tested companies – Among the alternative suggested is that the assets/income of a US insurance company subject to US tax be considered all active.
  - Guidance on the alternative test that permits a company with between 10% and 25% insurance liability-to-total assets ratio to be a QIC.