

# The 2017 Tax Act – International Updates for the Trust and Estates Practitioner



**Section of Taxation  
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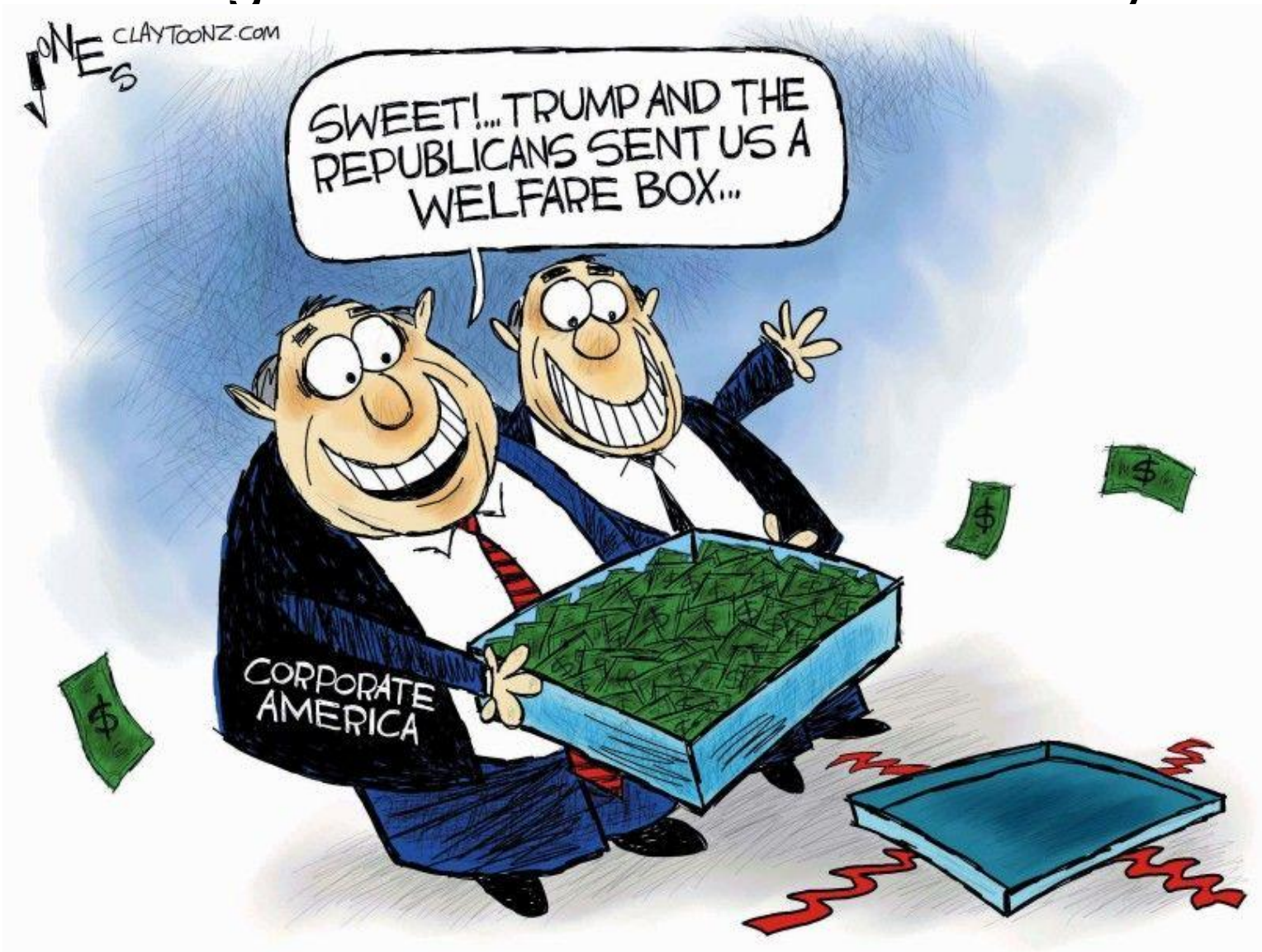
With thanks to Pamela Drucker (Andersen Tax) and Michael Miller (Roberts & Holland)



# Overview

- Survey of existing rules
- 2017 changes
- Problems for individuals, trusts and estates
- Planning possibilities

# This Program Is Not About These Guys . . .



# It's About These Guys



# The Old



# Objectives of Outbound Investors

- Tax deferral
- Low effective tax rate
- Capital gains rates on sales of property and sale of business
- Avoid double taxation
- Avoid over-withholding

The new tax law has not changed these objectives but it has radically changed planning for deferral

# Current Taxation v. Deferral

- US persons are taxed on a current basis on income from all sources worldwide. There is almost no preferential treatment of income earned abroad
- Foreign persons generally are taxed only on income from US sources
- It follows that, before 2017, the principal planning opportunity for a US person, whether a large multinational or a closely held business, was to form or acquire a foreign corporation that paid no US tax on foreign operations. US tax would not be paid until foreign corporation distributed income to the US person. This is known as “deferral”
- Before 2017, the principal vehicles for counteracting deferral using foreign corporations were the CFC rules for Subpart F income and the PFIC rules

# Controlled Foreign Corporations

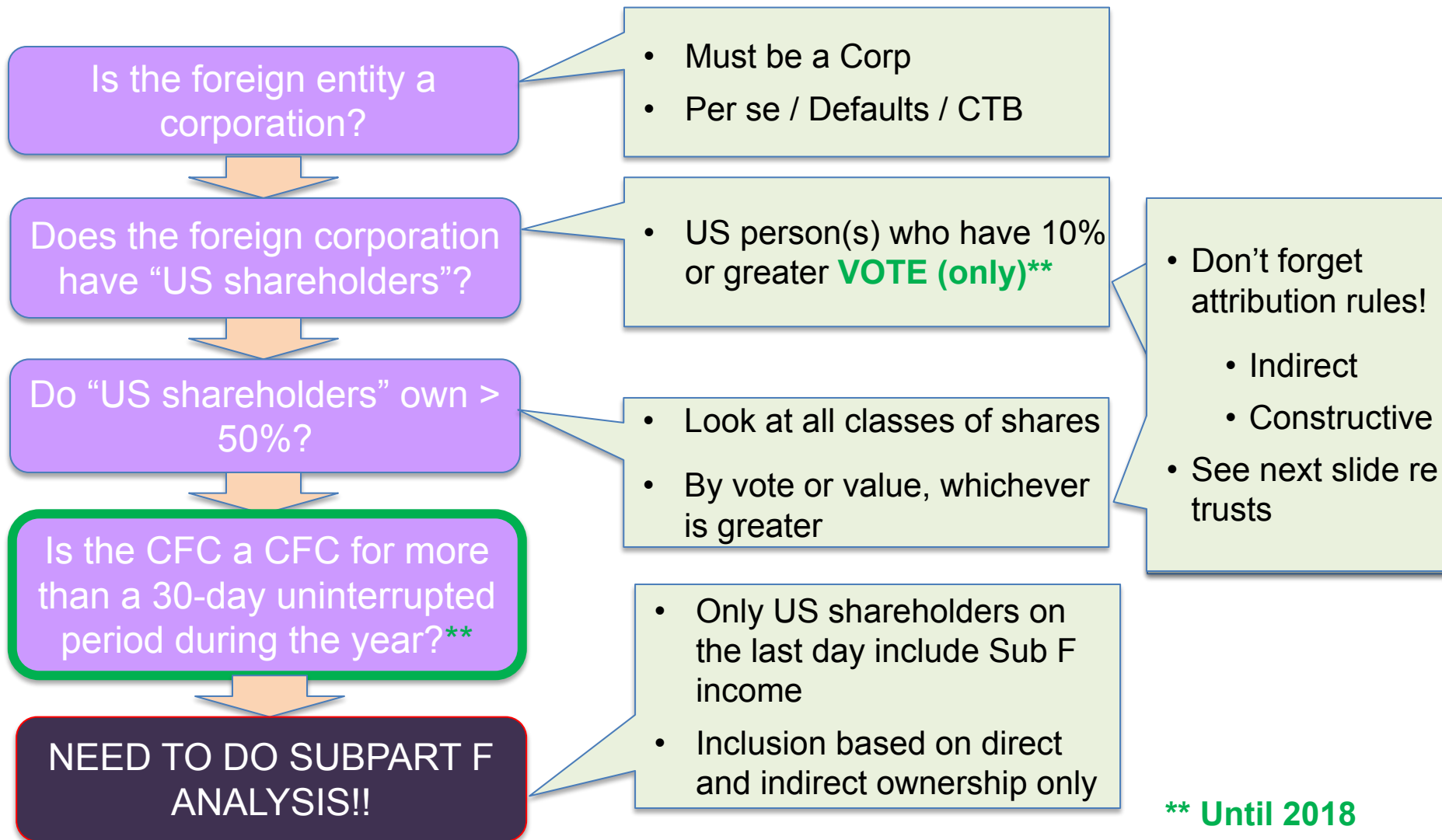
- Foreign corporations do not pay US tax unless they do business or invest in the United States
  - ◆ This is true even if all shareholders are US persons
  - ◆ However, US shareholders of foreign corporation are subject to special rules, especially the CFC rules
- Foreign corporation controlled by certain US shareholders is known as a “controlled foreign corporation”, or CFC
- Three major consequences of owning a CFC
  - ◆ CFC’s “Subpart F income” taxed to US shareholders every year
  - ◆ CFC’s other income taxed to US shareholders when:
    - Income is distributed as a dividend
    - US shareholders sell the shares
    - CFC invests in US assets – especially by lending to its US shareholders



# Subpart F Income

- Foreign base company income (FBCI), including:
  - ◆ Foreign personal holding company (FPHC) income (basically passive investment income and gains)
  - ◆ Foreign base company sales income and foreign base company services income – business income from related party transactions earned outside the country of incorporation of the CFC
- Major exception: High (foreign) tax kickout income
  - ◆ Income that would otherwise be FBCI taxed in foreign country at 90% of maximum U.S. corporate rate, i.e., 31.5% before 2018
  - ◆ Requires election by controlling US shareholders
- *De minimis* rule

# Triggering CFC Status



# Attribution Rules for Trusts

- For purposes of determining stock ownership (both for measuring CFC status and US shareholder status), we consider direct, indirect and constructive ownership of a foreign corporation
- Indirect ownership (Section 958(a)):
  - ◆ Stock owned, directly or indirectly, by or for a foreign trust or foreign estate shall be considered as being owned proportionately by its shareholders, partners, or beneficiaries. Stock considered to be owned by a person by reason of the application of the preceding sentence shall, for purposes of applying such sentence, be treated as actually owned by such person
  - ◆ Treas. Reg. 1.958-1(c)(2) provides the determination of a person's proportionate interest in a foreign trust will be made on the basis of all the facts and circumstances in each case.
    - For these purposes, entitlements to income are important, but actuarial valuations are not determinative

# Attribution Rules for Trusts

- **Constructive ownership (Section 958(b)):**
  - ◆ Constructive ownership rules only apply with respect to determining CFC and US shareholder status. Those deemed to constructively own CFC shares are not subject to Subpart F inclusions
  - ◆ Apply constructive ownership rules of Section 318(a) with certain modifications:
    - Stock owned, directly or indirectly, by or for a trust (foreign or domestic) shall be considered as owned by its beneficiaries in proportion to the actuarial interest of such beneficiaries in such trust
    - In applying subparagraphs (A), (B), and (C) of section 318(a)(2), if a partnership, estate, trust, or corporation owns, directly or indirectly, more than 50 percent of the total combined voting power of all classes of stock entitled to vote of a corporation, it shall be considered as owning all the stock entitled to vote
    - Stock owned, directly or indirectly, by or for a beneficiary of a trust shall be considered as owned by the trust, unless such beneficiary's interest in the trust is a remote contingent interest. For purposes of this clause, a contingent interest of a beneficiary in a trust shall be considered remote if, under the maximum exercise of discretion by the trustee in favor of such beneficiary, the value of such interest, computed actuarially, is 5 percent or less of the value of the trust property
      - This is downward attribution, which prior to the TCJA, was not allowed to determine constructive ownership of a CFC

# Attribution Rules for Trusts

- US shareholder status, under the “old”, looked to control when determining whether a foreign corporation was a CFC. It did this by limiting US shareholders to those shareholders that owned 10% or more of the voting stock
- A primary argument against application of indirect and constructive ownership rules in the case of a foreign trust with US beneficiaries was that the US beneficiaries had no ability to vote the shares of stock held by a foreign trust. Thus, it was incompatible with the intent of the “controlled” foreign corporation rules to attribute voting stock to beneficiaries who had little or no practical ability to control the decisions of the trustee
  - ◆ As we will see, this argument is no longer applicable after TCJA
- See Appendix A for examples of CFC attribution rules.

# Subpart F – The Old



← US person

CFC

Subpart F income – section 951(a) (passive income and certain related party business income, unless taxed at 90% of US corporate rate (31.5%) – the so-called high tax kickout)	Other income
<ul style="list-style-type: none"> <li>■ Immediate taxation</li> <li>■ Full rates (individuals cannot treat Subpart F inclusion as qualified dividend)</li> <li>■ Actual dividend not taxed (PTI)</li> <li>■ Basis in CFC increased by PTI (and reduced by distribution of PTI)</li> <li>■ Foreign tax credit available:                             <ul style="list-style-type: none"> <li>◆ Foreign withholding tax when PTI distributed but timing issue</li> <li>◆ Indirect credit only for C corporations</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>■ Deferred taxation. Deferral ends:                             <ul style="list-style-type: none"> <li>◆ When dividend paid (can qualify as qualified dividends, if CFC in treaty country)</li> <li>◆ CFC invests in US property (section 956) – treated like Subpart F income</li> <li>◆ When shares sold (section 1248)</li> </ul> </li> <li>■ Foreign tax credit available:                             <ul style="list-style-type: none"> <li>◆ Foreign withholding tax</li> <li>◆ Indirect credit only for C corporations</li> </ul> </li> </ul>

# Passive Foreign Investment Company

- PFIC classification based on type of assets and income
  - ◆ 75% or more of gross income is passive or
  - ◆ 50% or more of assets produce passive income
- Ownership % irrelevant; no *de minimis* rules
- Three tax regimes
  - ◆ PFIC (“pedigreed fund”) – deferral, at cost of ordinary income characterization and interest charge at time of distribution or disposition
  - ◆ Qualified electing fund – no deferral, via limited look-through mechanism; maintain character of net capital gain; no foreign tax credits for foreign tax paid by PFIC
  - ◆ Mark to Market – no deferral, ordinary income or loss
- Various rules deal with situations where foreign corporation becomes PFIC as to a US person or US shareholder of PFIC becomes a 10% shareholder of CFC (these can happen in several ways)

# Taxation of Foreign Trust Income and Distributions

- Pre-1997 law still applies:
  - ◆ Must compute DNI and UNI
  - ◆ Distributions are first from DNI, then UNI, then capital
  - ◆ UNI distribution attracts throwback tax and interest charge
  - ◆ To determine DNI and UNI, US beneficiary can use actual method or default method (all distributions are taxable, with formula for determining number of years of accumulation) – but once default method used, cannot use actual method until liquidation of trust
- But where CFC and PFIC income is taxed directly to beneficiaries of trust that owns the foreign corporation, presumably such income is not included in DNI or UNI computations
  - ◆ What happens when foreign trust makes actual distribution to beneficiaries?
  - ◆ What if distribution is not based on percentages previously determined based on “facts and circumstances”? No apparent provision for lookback



# The New



# Expanded Reach of Subpart F

- Definition of “US shareholder” (Old: 10% votes; New: 10% votes or value)
- Downward attribution from foreign person
- Elimination of requirement that foreign corporation be a CFC for at least 30 days during the year
- Effect of reduction in corporate rate on high-tax kickout
- Expanded application of transition tax

# Subpart F – Transition (IRC Section 965)

- One-time tax for the last taxable year beginning before January 1, 2018, applicable to any “United States shareholder” of CFCs and any foreign corporation if has at least one “US shareholder” that is a domestic C corporation (such corporations are known as deferred income foreign corporations (DFIC))
  - ◆ To determine if US person is a US shareholder, direct, indirect and constructive ownership rules are used
- Must include in income its pro rata share of the undistributed, non-previously-taxed post-1986 foreign earnings of the foreign corporation, determined as of November 2, 2017 or as of December 31, 2017, whichever is higher, but only for time when foreign corporation was a “specified foreign corporation”
  - ◆ For inclusion purposes, US shareholder must be direct or indirect owner; constructive ownership not enough
- Tax is 15.5% (17.5% for non-corporate shareholders), to the extent of DFICs’ aggregate “cash position” and 8% (9.05% for non-corporate shareholders) for the balance. Foreign tax credit may be available, subject to allocation rules

# Subpart F – Transition (continued)

- Shareholder may elect to pay tax on mandatory inclusion may be paid over 8-year period, with 8% paid in each of the first five years, 15% in 6th year, 20% in 7th year, and 25% in 8th year
  - ◆ Special deferral provision for S corporations
  - ◆ Curiously, S corporation shareholder can defer start of 8-year period indefinitely until various events occur – election was due by due date of S corporation return without extensions
- Treasury Department and IRS have already issued guidance on the tax in Notices 2018-07, -13, -26 and -78, as well as Proposed Regulations
- Although tax has already been incurred and can no longer be planned for, still need to be very careful to avoid losing benefit of deferral
  - ◆ IRS says overpayment of other estimated taxes cannot be refunded and must be applied to deferred section 965 tax
  - ◆ Legislative fix may be needed but prospects uncertain
- Beware of potential taxation upon distribution of section 965 PTI due to insufficient basis resulting from section 965(b) deficits
  - ◆ Timing of electing section 965(b) basis adjustments – Notice 2018-78 extended due date/made them revocable – 90 days after final regs published

# Subpart F, GILTI and QBAI – The New



## CFC

Subpart F income	GILTI – section 951A (most business income)	Qualified business assets income (QBAI) and high taxed FBCI income
<ul style="list-style-type: none"> <li>■ No change but note high tax kickout income increased due to cut in US rate (i.e., passive and related-party income is not Subpart F income if foreign tax is 90% of 21% (18.9%), down from 90% of 35% (31.5%))</li> </ul>	<ul style="list-style-type: none"> <li>■ 10% C corporation shareholders:                             <ul style="list-style-type: none"> <li>◆ Immediate taxation at 50% (10.5%)</li> <li>◆ 80% foreign tax credit available</li> </ul> </li> <li>■ <b>Individuals</b> <ul style="list-style-type: none"> <li>◆ <b>Full individual rates</b></li> <li>◆ <b>Must consider section 962 election</b></li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>■ QBAI = 10% return on tangible depreciable assets</li> <li>■ High foreign tax FPHC (threshold now 18.9%)</li> <li>■ 100% dividends received deduction for 10% C corporation shareholders</li> <li>■ Other shareholders                             <ul style="list-style-type: none"> <li>◆ Deferral</li> <li>◆ Sections 956 and 1248 not repealed</li> </ul> </li> </ul>

# GILTI (Very) Basics – 1

- GILTI =
  - ◆ CFC net tested Income (computed on a consolidated or aggregate basis)
  - ◆ Less net deemed tangible income return
- “Tested income” = CFC gross income, except:
  - ◆ ECI
  - ◆ Subpart F income
  - ◆ High foreign tax FPHC income (effective rate of 90% of US corporate rate)
  - ◆ Dividends received from a related person
  - ◆ Foreign oil and gas extraction income
  - ◆ Less deductions allocable to such gross income
- Net deemed tangible income return =
  - ◆ Qualified business asset investment (“QBAI”) x 10%
  - ◆ Less interest expense

# GILTI (Very) Basics – 2

- Current inclusion as subpart F income
- 80% of foreign tax credits can be used against GILTI for C corporation shareholders
- Calculation of GILTI done at US shareholder level:
  - ◆ “**Net CFC Tested Income:**” Excess of shareholder’s pro rata share of the sum of tested income and tested losses from all of CFCs over
  - ◆ “**Net Deemed Tangible Income Return**”, i.e.:
    - Deemed 10% return on shareholder’s pro rata share of adjusted basis of tangible depreciable property of CFCs that earn **tested income**, reduced by
    - **Interest expense** taken into account in determining net tested income to the extent the related interest income is not taken into account in determining the shareholder’s net CFC tested income

# Dividends Received Deduction

- 100% dividend received deduction (“DRD”) for foreign source dividends and section 1248/964(e) amounts received from specified foreign corporations, but only if received by a US C corporation shareholder
  - ◆ Limited to income that is neither Subpart F income nor-GILTI
  - ◆ Subpart F income and GILTI income don’t need DRD because treated as previously taxed income
- Minimum 366 day holding period
- No DRD for hybrid dividends from a CFC
  - ◆ Think PECs or instruments treated as debt in foreign country but equity in United States
- No FTC on income for which DRD allowed



# S Corporations and Trusts

- S corporation eligibility (IRC § 1361(b)):
  - ◆ 100 or less shareholders
  - ◆ Shareholders are individuals, certain trusts or certain exempt organizations
  - ◆ Shareholders are US persons – nonresident aliens (NRAs) not permitted
  - ◆ Only has one class of stock
- Permitted trusts (IRC § 1361(c)(2)):
  - ◆ Grantor trusts (provided grantor is a US person)
  - ◆ Trust which was a permitted grantor trust above once the grantor dies, but only for two years after death of the grantor.
  - ◆ Trust receiving stock by will, but only for two years after death of the decedent.
  - ◆ Trust created primarily to exercise the voting power of stock transferred to it
  - ◆ An electing small business trust (ESBT)
  - ◆ Trust which constitutes an IRA account established to hold shares in a depository institution in limited circumstances

# NRAs as Qualifying Beneficiaries of an ESBT

- An ESBT is any trust if (IRC § 1361(e):
  - ◆ Beneficiaries limited to individuals, estates and certain charitable organizations
  - ◆ Trust makes a timely election
  - ◆ No interest in the trust was acquired by purchase
- Prior to TCJA:
  - ◆ Each potential current beneficiary of an ESBT was treated as a shareholder of the S corporation (IRC § 1361(c)(2)(B)(v)). Thus, if an NRA was a potential current beneficiary of the ESBT, the ESBT could not qualify to hold S corporate stock
- TCJA Amendment:
  - ◆ The provision that each potential current beneficiary of an ESBT be treated as a shareholder of the S corporation no longer applies for purposes of determining whether a non-US person is a shareholder.
    - Thus, NRAs (but not foreign corporations) can now be potential current beneficiaries of ESBTs that own S corporate stock
    - But NRAs still cannot be direct shareholders in S corporation

# Identifying Problems Relevant to Individuals



# Typical Business Profile (Especially Individually–Owned)



CFC

Subpart  
F  
income

QBAI

**GILTI**

# Application of GILTI



100%

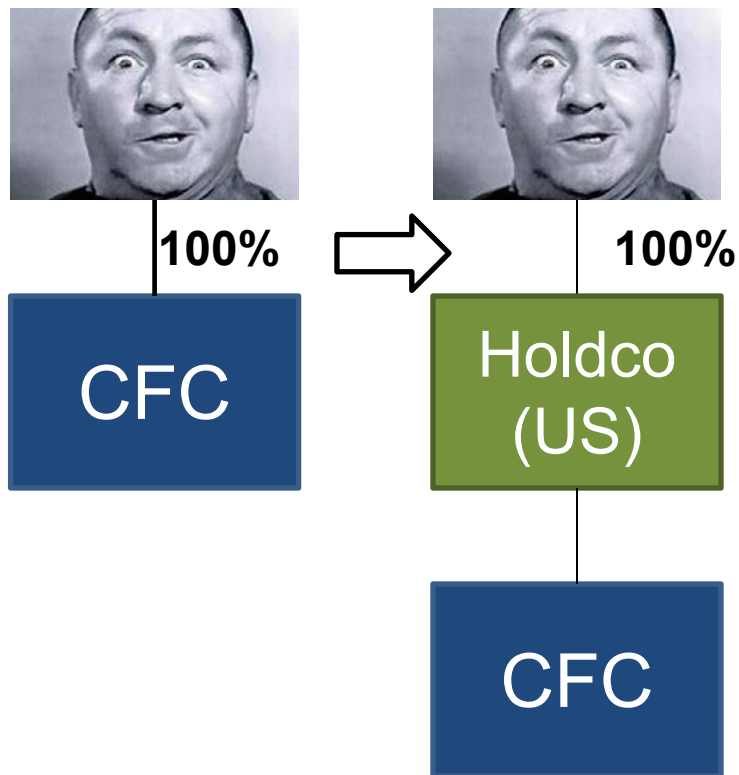
CFC

- Individuals who are US shareholders of CFCs are subject to harsh treatment on GILTI income:
  - ◆ Ordinary income treatment
  - ◆ Section 250 deduction not available to individual US shareholders
    - Likely true even if US shareholder makes a Section 962 election (see slides 49-54)
  - ◆ No indirect foreign tax credit
  - ◆ Uncertainty with respect to withholding taxes on later distributions of PTI arising from GILTI inclusion

# PFICs

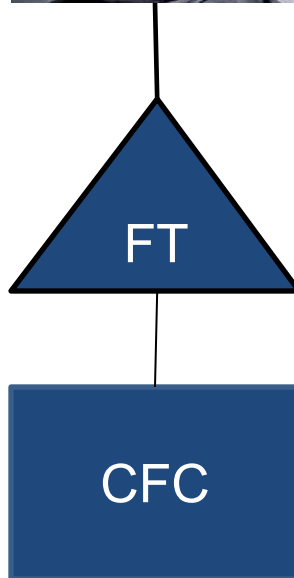
- The PFIC rules were not directly changed by the 2017 Act
- But note collateral effect of reduction in corporate rate:
  - ◆ As in the case of CFCs, less likely to have passive income, which is defined by reference to the Subpart F concept of FPHC income, because of the kickout for income subject to high effective rate of foreign tax – high is now 18.9% instead of 31.5%
- Also, expansion of definition of US shareholder and rules governing what is a CFC will mean more likely that CFC rather than PFIC rules will apply

# The True Forgotten Soldier: Expats and Temporary US Persons



- US expats income tax resident in a foreign country may not be able to utilize a US corporation holding company vehicle
  - Creating the structure may involve capital gains and transfer taxes
  - Operating the structure may involve undesirable “sandwich”
  - Exiting the structure, e.g., when US citizen moves to a different country or back to the US, may also involve taxes
- Temporary US persons who will exit in the short-to-medium term also may find it overly costly to utilize a US corporation holding company vehicle, which is unattractive after individual ceases to be a US person

# What about US Beneficiaries of Foreign Trusts?



- Attribution rules may result in a foreign corporation being a CFC if there are US beneficiaries that can be attributed control of the corporation
- Likely impractical to interpose a US corporation as a holding company of the CFC, especially if there are also foreign beneficiaries
- What happens with US beneficiaries of discretionary trusts?



# Planning

# Outbound Planning – Before and After 2017

- Historically has focused on:
  - ◆ Deferral
  - ◆ Secure benefit of capital gains rates on dividends
    - Typically, undertaken in US tax treaty jurisdictions or common to have business established in treaty country
  - ◆ Consideration of Subpart F rules, especially related party transactions
  - ◆ Avoid PFIC status for minority and joint venture holdings
- The 2017 Tax Act has changed the outbound landscape
  - ◆ Going forward, a flood of complex new rules and new acronyms
    - Limited future deferral due to tax treatment of GILTI
    - Controversial break for FDII
    - Large corporations also subject to BEAT
  - ◆ Harsh treatment for individuals and closely held businesses

# The New Regime Is Favorable to C Corporations



## CFC

Subpart F income – taxed at 21%	GILTI – taxed at 10.5%, less 80% of indirect foreign tax credit	Qualified business assets income (QBAI) and high taxed FBCI income – not taxed
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- New low corporate rate of tax
- Subpart F income and GILTI are repatriated tax-free
- Indirect foreign tax credit available

# Where a Foreign Corporation is Held by an Individual



## CFC

CFC		
Subpart F income – taxed at 37%	GILTI – taxed at 37%	Qualified business assets income (QBAI) and high taxed FPHC income – deferred but taxed when repatriated. Also, section 956 <u>has not been repealed</u>

- No foreign tax credit is allowed except foreign withholding taxes
- Note that there is a potential for FPHC income (when it is taxed at more than 18.9% in a foreign jurisdiction) to be deferred while certain active business income is GILTI, even if it is high taxed

# Holding Stock Directly



As the next slide shows, the combined effective tax rate for a US individual can be in the mid-60% range using realistic assumptions  
Most of the tax will be due when income earned

CFC

# Holding Stock Directly

	Income (Deduction)	Tax
Gross Income – GILTI	\$1,000,000	
Foreign Tax (20%)		\$200,000
Federal Tax (37%)		\$296,000
Distribution from CFC	\$800,000	
PTI	(\$800,000)	
Foreign Withholding Tax (15%)	\$120,000	\$120,000
State Tax (8%)		\$64,000
Net Investment Income Tax (3.8%)		\$30,400
<b>Total Taxes</b>		<b>\$710,100</b>

Effective Tax Rate: 71%

# Three and a Half Possible Solutions

- Interpose a domestic corporation
- Make a section 962 election
- Be taxed directly on the income
- And, in some cases, it may be possible to decontrol the corporation – but then have to watch out for PFIC exposure

# Holding Stock Through US Corporation



As the next slide shows, the combined effective tax rate using realistic assumptions could be in the low- to mid-50% range  
However, only about half of this will be taxed when earned and the rest when fully distributed (two levels of distribution – CFC to US Corp and US Corp to individual)



# Holding Stock Through US Corporation

	Income (Deduction)	Tax (Credit)	
Gross Income – GILTI	\$1,000,000		
Foreign Tax (20%)		\$200,000	
GILTI Deduction (until 2026)	(500,000)		
Net GILTI	\$500,000		
Federal Tax (21%)		\$105,000	
Deemed Paid Credit (80%x20%)		(\$105,000)	
<b>Total tax before CFC makes distribution</b>			<b>\$200,000</b>
Distribution from CFC to US Corp.	\$800,000		
Federal tax (\$0 because PTI)		0	
Foreign Withholding Tax (5%)		\$40,000	
State Tax (7%)		\$56,000	
<b>Total taxes on distribution from CFC</b>			<b>\$96,000</b>
Distribution from US Corp	\$704,000		
Federal Tax (20%)		\$140,800	
State Tax (8%)		\$56,320	
Net investment Income Tax (3.8%)		\$26,752	
<b>Total Tax on distribution from C corporation</b>			<b>\$223,872</b>
<b>Total taxes at all levels</b>			<b>\$519,872</b>

**Effective Tax Rate: 51.9%**

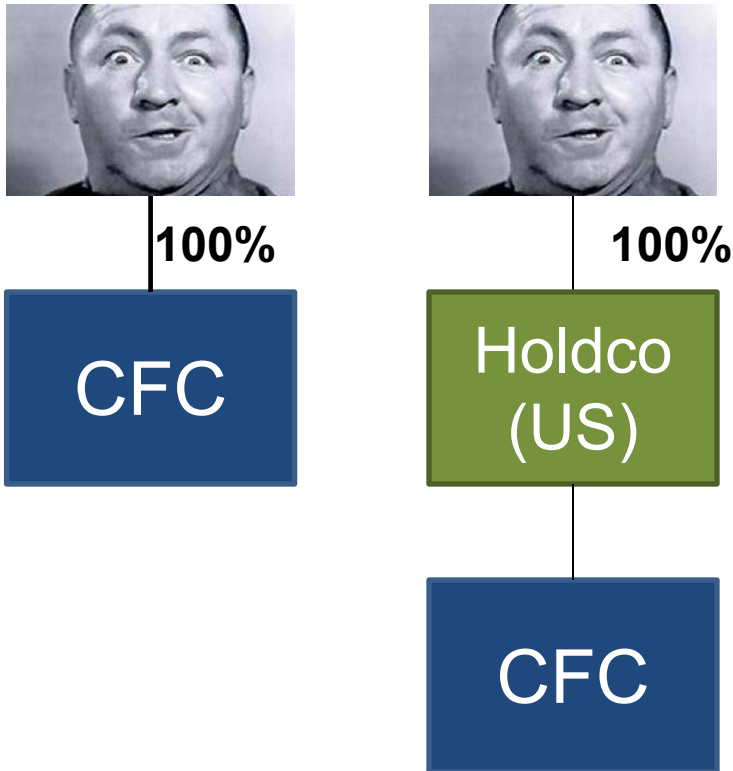
# Interposing a Domestic Corporation

- US individual could structure ownership interest in foreign corporation through a domestic corporation
- Domestic corporation would be taxed only on Subpart F income at 21% and on GILTI at favorable rate of 10.5% (reduced by foreign tax credits). No tax at all on QBAI or high tax kickout income
- Individual shareholder of domestic corporation is taxed, but only when domestic corporation makes distribution of earnings and then only at long-term capital gains rates
- Restructuring of existing CFC holding will generally involve a taxfree incorporation under section 351, so no US tax cost

# But . . .

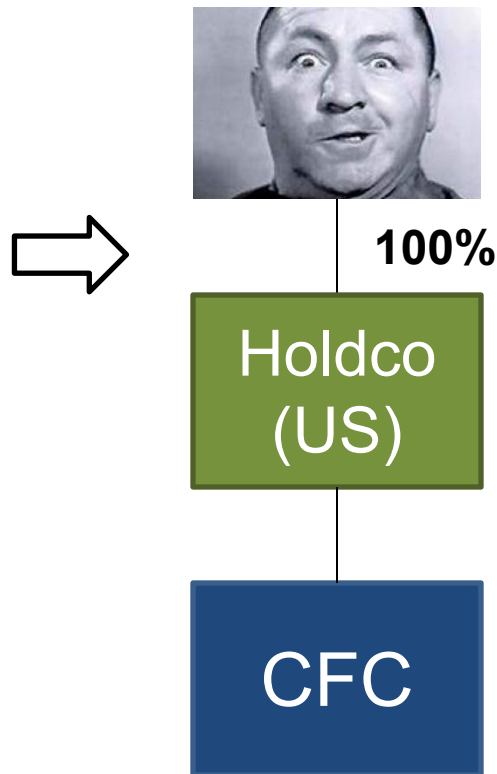
- Have to avoid personal holding company and accumulated earnings tax on undistributed earnings
  - ◆ AET can apply even if earnings retained in CFC
  - ◆ Not known whether IRS will enforce AET with heavy or light touch
- Have to consider foreign tax consequences

# Foreign Country Problems



- To mitigate harsh individual treatment, interposing a US corporation as a holding company may seem like a logical solution
  - ◆ But, such reorganizations may have tax consequences in the CFC home country making such planning cost prohibitive
  - ◆ Foreign country may tax contribution of CFC shares to domestic corporation
    - Many countries do not have section 351 equivalent
    - Consider application of capital gains article of treaty (but not if CFC primarily holds real property)
    - Do not assume that domestic corporation will automatically qualify for reduced dividend withholding rates (0% or 5% v 15%)
  - ◆ For US citizen living in foreign country, may create “sandwich structure” with undesirable consequences

# Planning for Eventual Sale of CFC



- Interposing US corporation holding vehicle to mitigate GILTI adds a second level of tax on sale of CFC stock that was directly held by US individual shareholder

# Check the Box



As the next slide shows, the combined effective tax rate using realistic assumptions could be in the mid-40% range  
All of this would be taxable when earned

Foreign  
Company  
(Flow-Through)

# Check the Box on Foreign Entity

	Income (Deductions)	Tax
Gross Income	\$1,000,000	
Foreign Tax (20%)		\$200,000
Federal Tax (37%)		\$370,000
Foreign Tax Credit		(\$200,000)
State Tax (8%)		\$80,000
<b>Total Tax</b>		<b>\$450,000</b>

Effective Tax Rate: 45.0%

Assumption is that taxpayer materially participates, so no net investment income tax. Otherwise, add another 3.8% to the effective rate

# Section 962 Election – What’s the Problem?



100%

CFC

CFC had \$1,000,000 of Subpart F income, and paid \$300,000 of foreign tax, in 2017

Absent any section 962 election, Curly is subject to US tax as follows:

- \$700,000 taxed at 39.6% = \$277,200
- **Ordinary income rate!**
- **No foreign tax credit!**
- The 2019 distribution is tax-free PTI

Total tax = \$300,000 + \$277,200 = \$577,200.

If after 2018, no FTCs!

2017:

\$1,000,000 Sub F

\$300,000 For. tax



# Section 962 Election – Suppose There Had Been a US Holdco



100%

Holdco  
(US)

CFC

## Corporate-level tax:

Holdco taxed at lower corporate rate of 35%

Holdco gets indirect FTC

So, Holdco tax =  $\$350,000 - \$300,000 = \$50,000$

## Shareholder-level tax:

Shareholder-level US tax =  $\$650,000 \times 20\% = \$130,000$

## Total tax:

$\$300,000 + \$50,000 + \$130,000 = \$480,000$

2017:

\$1,000,000 Sub F

\$300,000 For. tax

# Section 962 Election – Basic Rules



100%

CFC

2017:

\$1,000,000 Sub F

\$300,000 For. tax

Section 962 partly addresses this disparity in treatment

## Corporate-type tax

Curly pays tax on the Subpart F income at *corporate* rates, taking into account *indirect FTC*

As in the case of domestic Holdco, corporate (type) tax paid by Curly after FTC is \$50,000. ( $\$350,000 - \$300,000 = \$50,000$ )

## Second/shareholder-level tax:

Only \$50,000 of Subpart F income is tax-free PTI

The remaining \$650,000 is taxable to Curly when distributed under section 962(d) (see next slide)

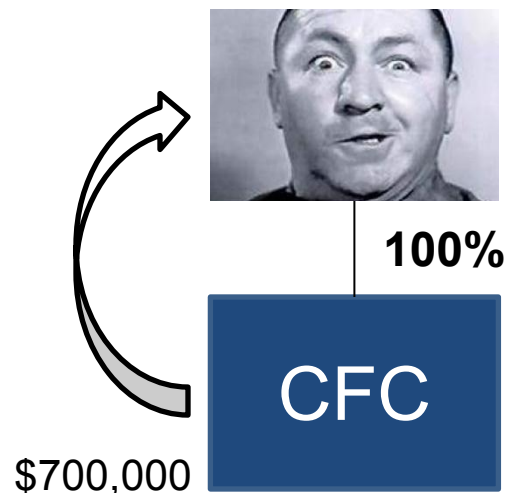
So, Curly pays tax twice!

If distribution of the \$650,000 is a qualified dividend\*, then total tax will be the same as in the domestic Holdco example:  $\$300,000 + \$50,000 + \$130,000 = \$480,00$

And, of course, the second tax is deferred, possibly for a long time

\* CFC must be a qualified resident of a treaty country

# Section 962 Election – Tax on the Distribution



- Under section 962(d), the E&P in excess of the US corporate-type tax previously “shall, when such earnings and profits are distributed, notwithstanding the provisions of section 959(a)(1), be included in gross income ...”
- Is the distribution a *dividend*?
- If so, is the dividend *qualified*?
- See *Smith v. Commissioner*, 151 T.C. No. 5 (2018)

# Section 962 Election – GILTI Example



100%

CFC

2018:

\$1,000,000 GILTI

\$250,000 For. tax

GILTI without section 962 election

$$\$750,000 \times 37\% = \$277,500$$

GILTI with section 962 election

$$\begin{aligned} \text{Corporate-type tax}^* &= \$210,000 - (80\% \times \$250,000) \\ &= \$210,000 - \$200,000 \\ &= \$10,000 \end{aligned}$$

$$\text{Shareholder-level tax}^{**} = \$750,000 \times 20\% = \$150,000$$

$$\text{Total US tax} = \$10,000 + \$150,000 = 160,000$$

\* Assumes no 50% GILTI deduction

\*\* Assumes CFC is a qualified foreign corporation (qualified resident of treaty country) and the dividend is a qualified dividend

# Section 962 Election – Who Can Elect?



2%



100%



- Domestic Fund, a US shareholder, has GILTI
  - Or Subpart F income
  - Or an investment in US property
- Curly would like to select section 962
- However, only US shareholder, as defined in section 951(b), may elect
- Curly does not qualify (nor would a domestic trust of which Curly was a beneficiary)

# Section 962 Election – Other Issues

- Will Curly pay state and local tax twice?
  - ◆ Nothing in section 962 provides that any amount (other than the corporate-type tax) is excluded from income
  - ◆ Cf. *Smith v. Commissioner*, supra
- How about three (or more) levels of federal tax?
  - ◆ Is it clear that old-style Subpart F income for which section 962 election is made in 2017 or in a prior year cannot also be included in post-1986 accumulated deferred foreign income?
- Election may be less favorable for section 965 income, since the section 965(c) deduction is consumed at the corporate level, and then entire distribution is taxable (even if at qualified dividend rates)
- Any problem if temporary (non-long-term) resident becomes NRA?

## Upside Down – Investing in High Tax Country Real Estate

- Old Wisdom: Do your best to qualify real estate income as active rentals and therefore not Subpart F income
  - ◆ High tax kickout exemption difficult to obtain when US corporate rate was 35%
- New Wisdom: If foreign corporate tax rate at least 18.9%, have income classified as foreign personal holding company and avoid classification as either Subpart F income or GILTI
- REALLY?? (But what if US corporate tax rate rises again?)

# The Message

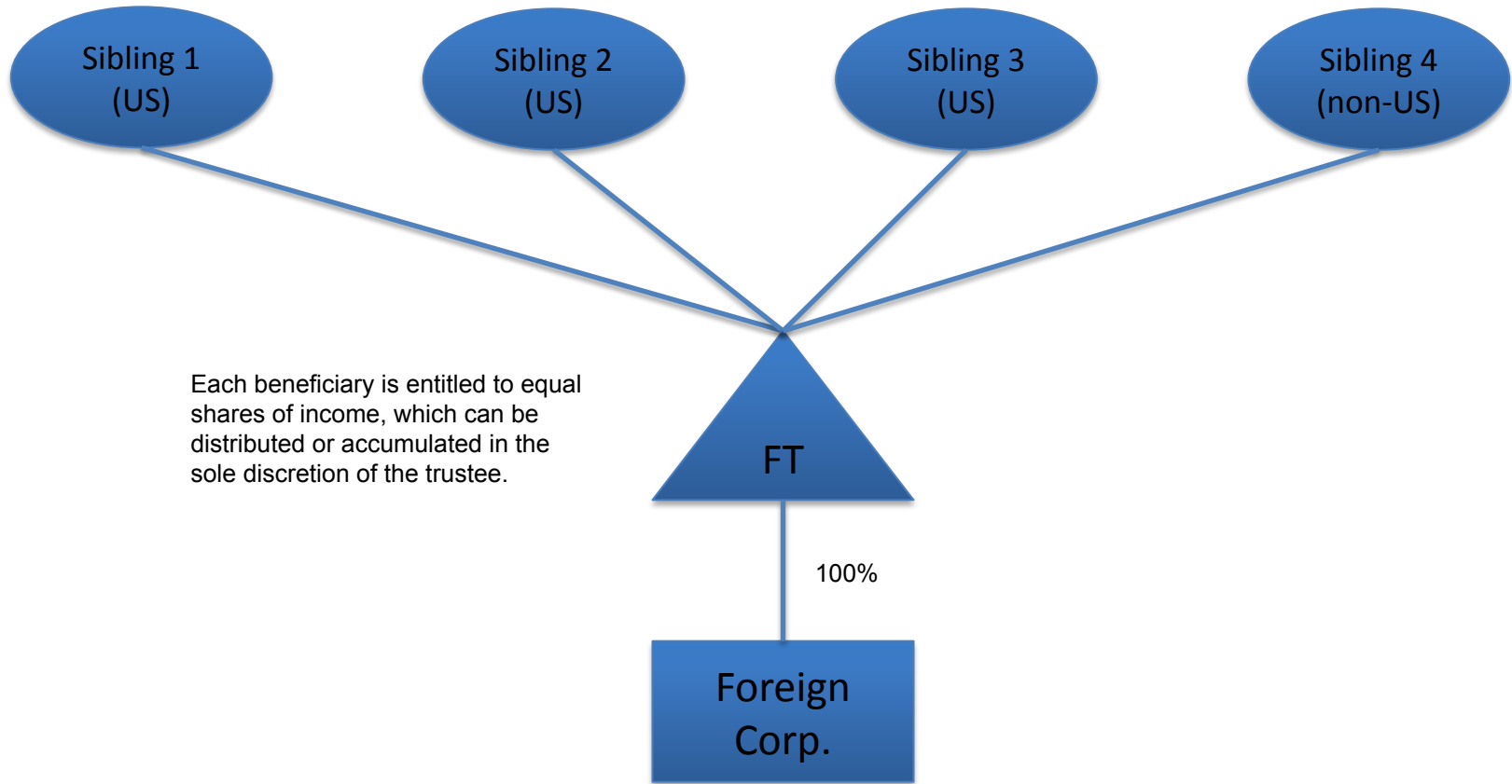
- It's all about timing and projections
- Is distribution from foreign corporation needed?
  - ◆ May trigger state corporate tax
- Is distribution from US corporation needed?
  - ◆ Triggers Federal and state income tax
  - ◆ But failure to distribute from foreign corporation to US corporation or US corporation to individual may lead to accumulated earnings tax



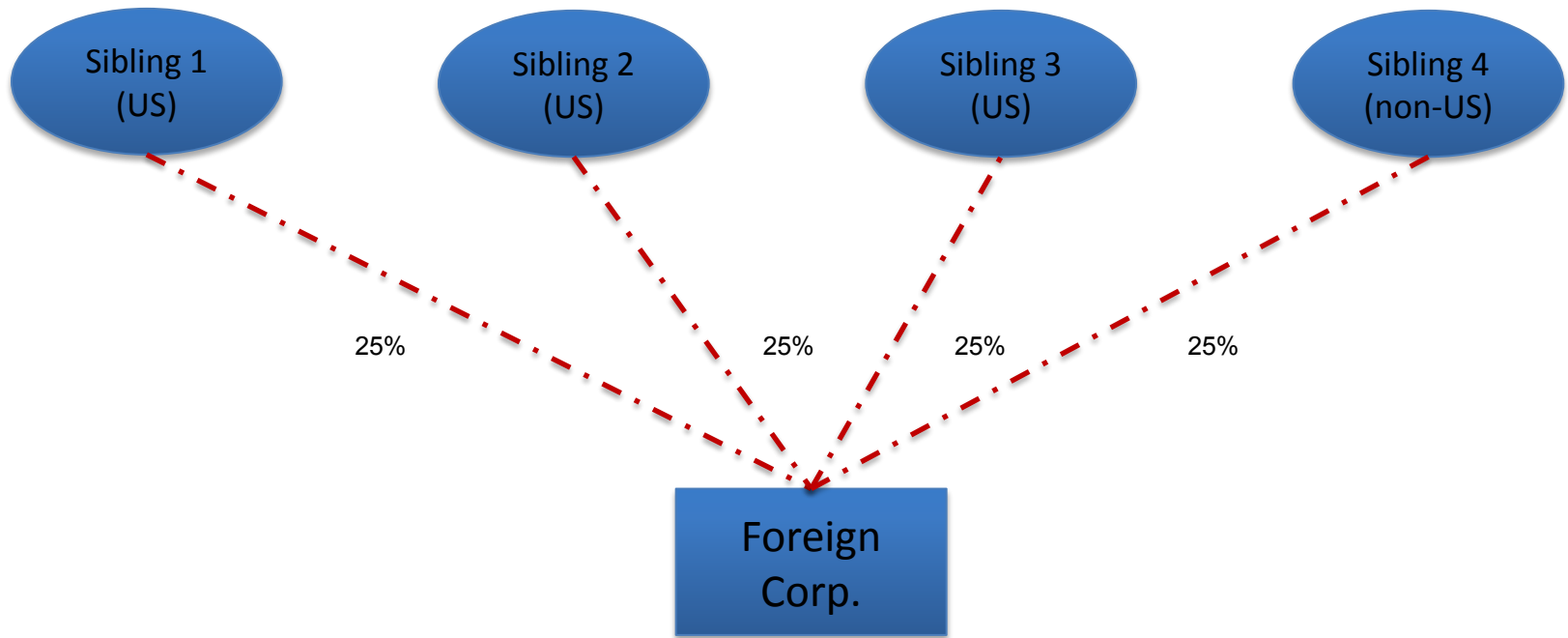
# Questions



# Appendix A

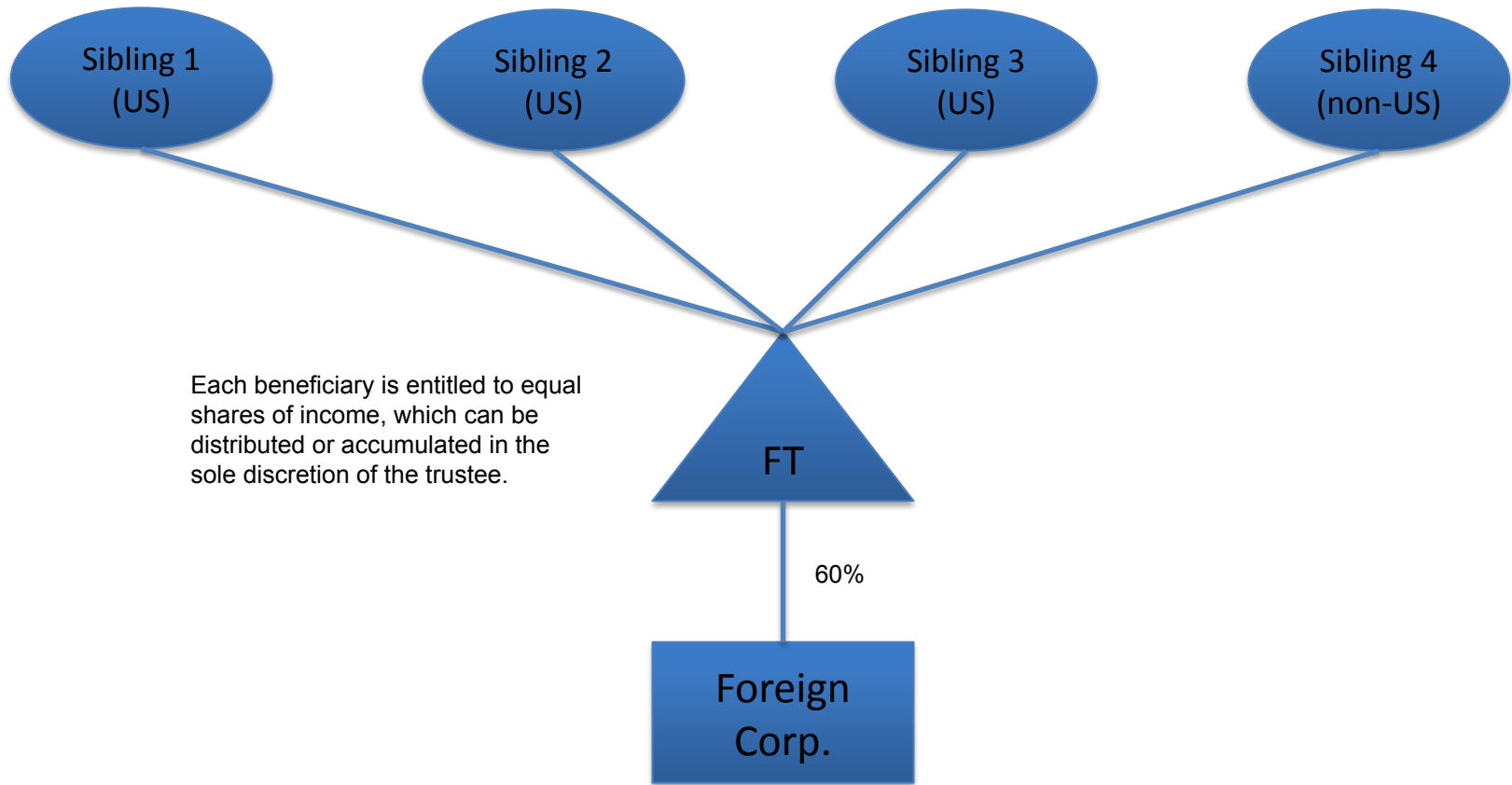


# Appendix A

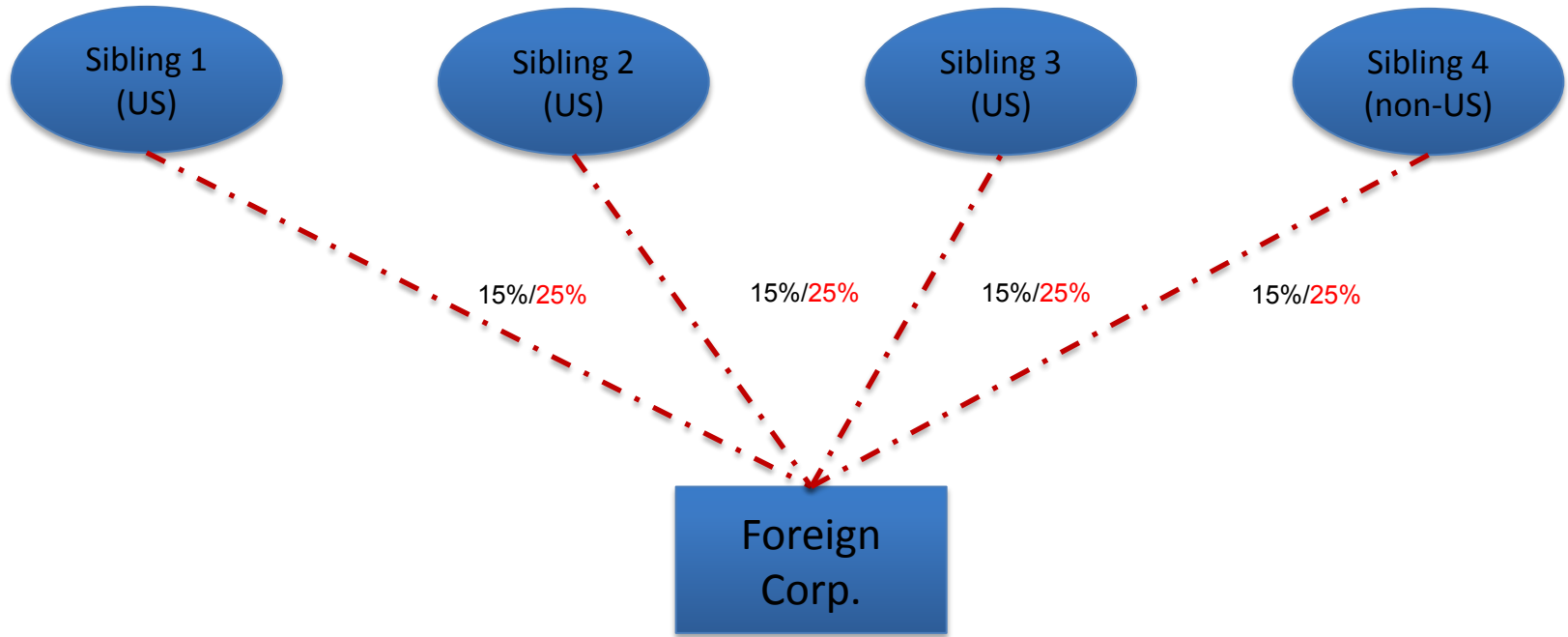


US Persons	Indirect Percent	US Shareholder	Pro Rata Share
Sibling 1	25%	Yes	25%
Sibling 2	25%	Yes	25%
Sibling 3	<u>25%</u>	Yes	25%
	75% = CFC		

# Appendix A

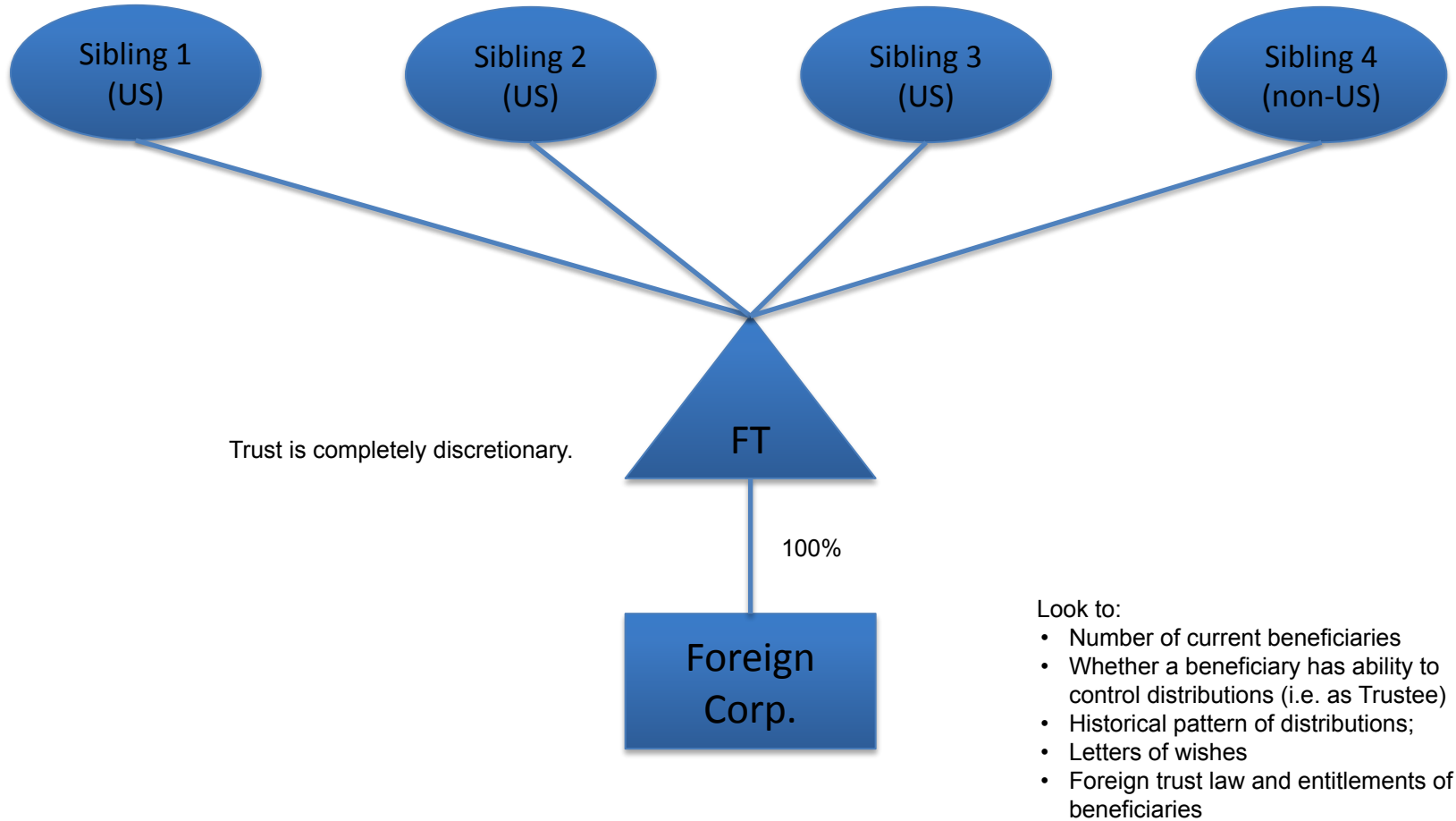


# Appendix A

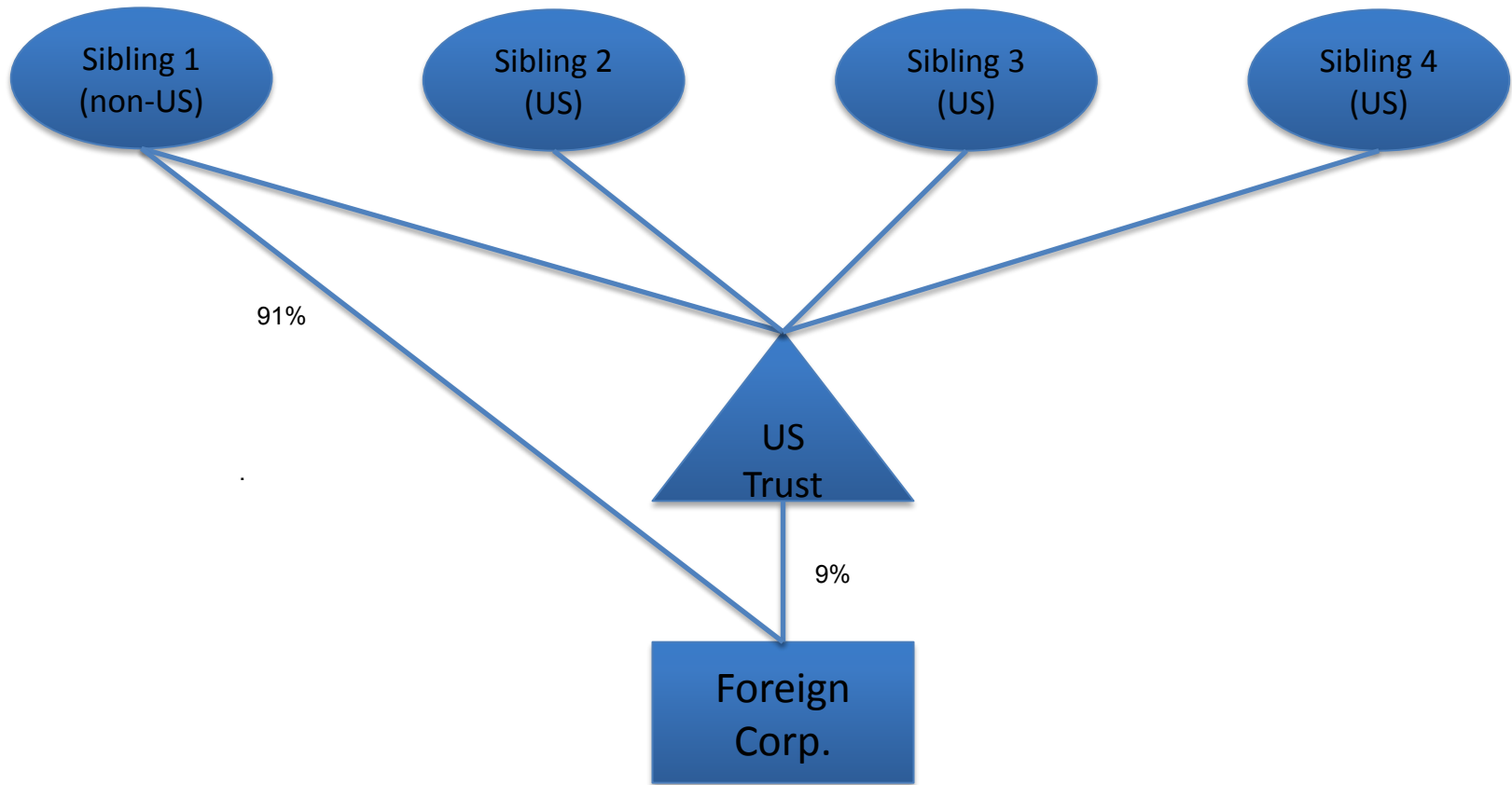


US Persons	Indirect Percent	Constructive Percent	US Shareholder	Pro Rata Share
Sibling 1	15%	25%	Yes	15%
Sibling 2	15%	25%	Yes	15%
Sibling 3	<u>15%</u>	<u>25%</u>	Yes	15%
	45%	75% = CFC		

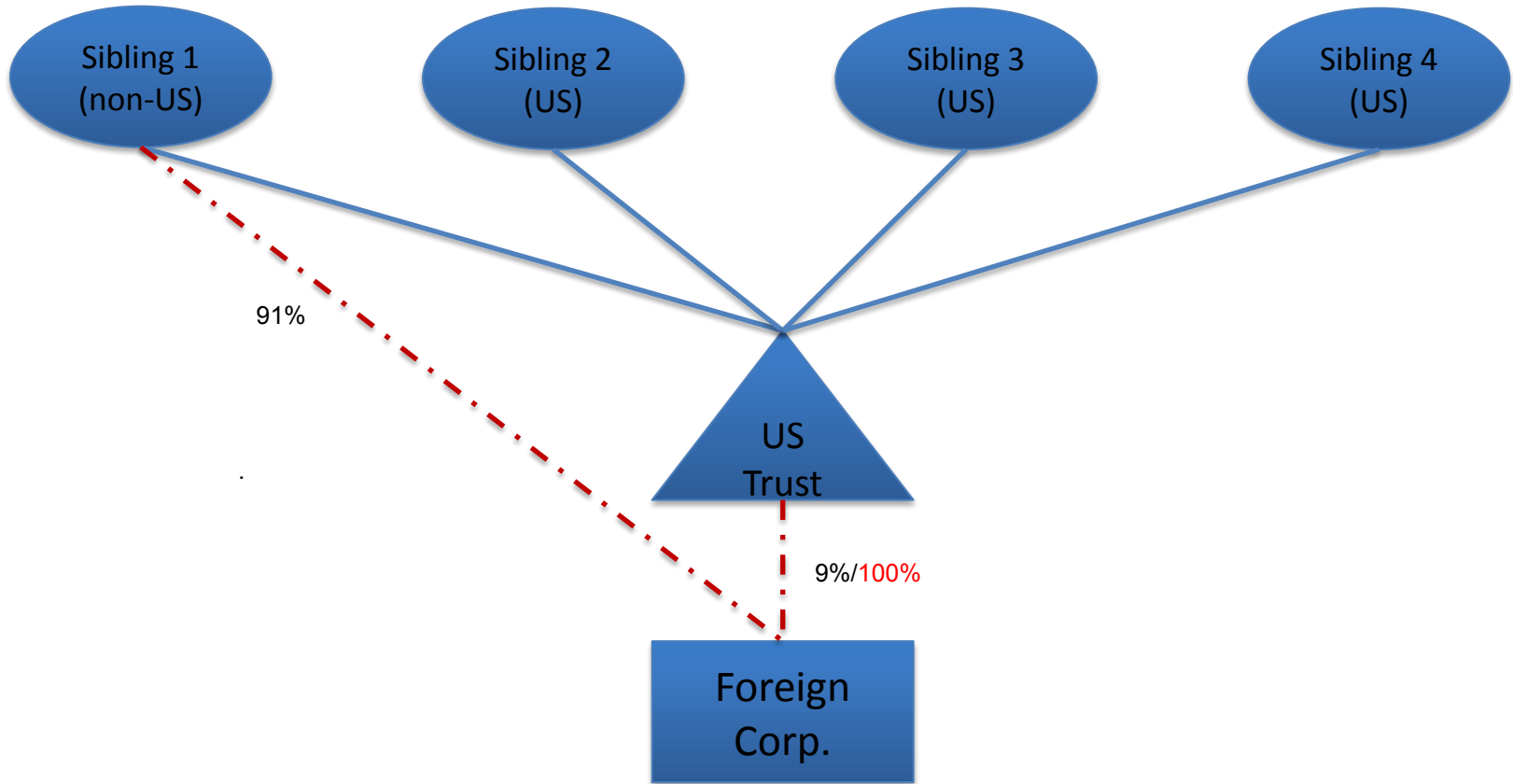
# Appendix A



# Appendix A



# Appendix A



US Persons	Indirect Percent	Constructive Percent	US Shareholder	Pro Rata Share
US Trust	9%	100%	Yes	9%
	9%	100% = CFC		



**United States Internal Revenue Service (IRS) Circular 230 disclosure:**  
**We are now Circular 230 Disclaimer Free**

However, the above presentation is based on the completeness and accuracy of facts and assumptions stated above. Any inaccuracy or incompleteness could have a material effect on the stated conclusions. We rely upon the relevant provisions of the Internal Revenue Code of 1986 as amended, the regulations thereunder, any applicable treaty, and the judicial and administrative interpretations thereof, which are subject to change or modification by subsequent legislative, regulatory, administrative, or judicial decisions. Any such changes also could have an effect on the validity of our conclusions. We do not update our advice for subsequent changes or modifications to the law and regulations or to the judicial and administrative interpretations thereof.

In addition, it should be understood that presentations of this nature are for purposes of discussion and necessarily involve simplification and compression. Descriptions of tax law in this presentation should be the subject of additional more detailed analysis before compliance or planning is implemented in reliance thereon.