Executive summary

On 2 November 2017, United States (US) House Ways and Means Committee Chairman Kevin Brady released a long-awaited tax reform bill entitled the Tax Cuts and Jobs Act of 2017 (H.R. 1), followed by a Chairman's Mark of H.R. 1 on 3 November 2017 (collectively referred to in this Alert as “the bill”). The bill seeks to reform the Internal Revenue Code, reducing the top corporate tax rate to 20%, reducing or restricting many corporate tax deductions and preferences, and substantially reforming the international tax provisions.

This Alert focuses on the bill's international tax provisions.

Detailed discussion

100% deduction for certain dividends received from foreign subsidiaries

The bill would add new Section 245A, which would provide a 100% deduction for the foreign-source portion of dividends received by a domestic corporation from a “specified 10%-owned foreign corporation,” which is a foreign corporation with respect to which the domestic corporation is a US shareholder as defined in Section 951(b), but not including a passive foreign investment.
company that is not a controlled foreign corporation (CFC). As proposed, new Section 245A would not apply to either foreign income directly earned by a domestic corporation through foreign branches or to capital gains recognized from the sale or exchange of stock in a specified 10%-owned foreign corporation. To the extent that Section 1248 treats any capital gain from the sale or exchange of CFC stock as a dividend, however, the 100% deduction should apply.

The foreign-source portion of a dividend is the amount that bears the same ratio to the dividend as the post-1986 undistributed foreign earnings of the specified 10%-owned foreign corporation bears to its total post-1986 undistributed earnings. Post-1986 undistributed earnings is the amount of earnings and profits (E&P) of the specified 10%-owned foreign corporation accumulated in tax years beginning after 31 December 1986, determined as of the close of the tax year of the specified 10%-owned foreign corporation in which the dividend is distributed and without diminution by reason of dividends distributed during such tax year.

Under Section 245A(a)(5), post-1986 undistributed foreign earnings is the portion of post-1986 undistributed earnings that is attributable to neither income effectively connected with the conduct of a trade or business in the United States and subject to US federal income tax, nor dividends received (directly or through a wholly-owned foreign corporation) from a domestic corporation at least 80% of the stock of which (by vote and value) is owned (directly or through such wholly-owned foreign corporation) by the specified 10%-owned foreign corporation.

Similar rules would apply to dividends of specified 10%-owned foreign corporations paid out of E&P accumulated in tax years beginning before 1 January 1987. An ordering rule would treat dividends as first paid out of post-1986 undistributed earnings. Additionally, the foreign source portion of a dividend in excess of post-1986 and pre-1987 undistributed earnings, a so-called nimble dividend, would also be entitled to the 100% deduction.

Credits and deductions for foreign taxes (including withholding taxes) paid or accrued with respect to any dividend benefiting from the 100% deduction would be disallowed. Additionally, for purposes of the foreign tax credit limitation under Section 904(a), the foreign-source income (and entire taxable income) of a US shareholder of a specified 10%-owned foreign corporation would be determined without regard to: (i) the foreign-source portion of any dividend received from such foreign corporation; and (ii) deductions properly allocated and apportioned to: (a) income with respect to stock of the specified 10%-owned foreign corporation (other than subpart F income and foreign high-return amounts); and (b) stock of the specified 10% foreign owned corporation (to the extent income with respect to such stock is not subpart F income or foreign high return amounts).

To be eligible for the 100% deduction, the domestic corporation must have held its stock in the specified 10%-owned foreign corporation for more than 180 days during the 361-day period that begins on the date that is 180 days before the ex-dividend date. For this purpose, a taxpayer is only treated as holding stock for any period if the specified 10%-owned foreign corporation is a specified 10%-owned foreign corporation for such period, and the taxpayer is a US shareholder with respect to such specified 10% foreign owned corporation for such period.

Effective date

The 100% deduction would apply to the distributions made after 31 December 2017.

Implications

The proposed move to a participation exemption system for the foreign-source portion of dividends from foreign corporations will be welcomed by domestic corporations, as will the elimination of the application of Section 956 to such domestic corporations. However, its non-application to foreign branches and capital gains, as well as the retention of subpart F and the introduction of the foreign high return amount, may temper some of that enthusiasm.

Repeal of Section 956 for domestic corporations

Under current law, a US shareholder of a CFC must include in income annually its pro rata share of any United States property (as defined in Section 956(c)) held by a CFC for any tax year. The amount included in income by the US shareholder is determined based the CFC’s adjusted basis in the property, the untaxed E&P of the CFC and the length of time the CFC holds the US property during the tax year.

The bill would repeal Section 956 for domestic corporations effective for tax years of foreign corporations beginning after 31 December 2017. The bill would also authorize the US Treasury Department to issue regulations to address US partnerships with corporate partners.
Reduced transition tax on deferred foreign earnings

The bill would require a mandatory inclusion of the accumulated foreign earnings of a CFC and other foreign corporations with a 10% domestic corporate shareholder (a 10/50 company), collectively referred to as specified foreign corporations, or “SFCs.” The mandatory inclusion would be implemented by increasing the subpart F income of the specified foreign corporation (treating a 10/50 company as a CFC solely for this purpose) in its last tax year beginning before 1 January 2018, by its “accumulated post-1986 deferred foreign income” determined as of 2 November 2017, or 31 December 2017, whichever amount is greater. Each US shareholder of a specified foreign corporation would be required to include in gross income its pro rata share of the additional subpart F income, even though only domestic corporations would benefit from the 100% deduction for dividends received from certain foreign subsidiaries under the new territorial tax system also included in the bill.

The mandatory inclusion would be subject to tax at reduced rates: 12% for earnings held in cash or other specified assets, and 5% for the remainder. The two rates are achieved by allowing a deduction against the required inclusion, based on the US shareholder’s top marginal income tax rate in the inclusion year. The bill would allow a US shareholder to elect to pay the transition tax over eight years in eight equal installments. For a subchapter S corporation with a mandatory inclusion, however, the bill would permit each shareholder of the S corporation to elect to defer payment of its net tax liability with respect to the S corporation by reason of the mandatory inclusion until the tax year in which either of the following occurs first: the corporation ceases to be an S corporation; a liquidation or sale of substantially all of the S corporation’s assets; the S corporation ceases its business, ceases to exist, or any similar circumstance; or the shareholder transfers any share of stock in the S corporation.

Definition of accumulated post-1986 deferred foreign income

Accumulated post-1986 deferred foreign income of a specified foreign corporation means the E&P of the specified foreign corporation: (1) accumulated in tax years ending after 31 December 1986, and determined as of 2 November 2017, or 31 December 2017, whichever is greater, (2) without diminution by reason of any dividends distributed in its tax year that includes 2 November 2017, or 31 December, 2017, as relevant, (3) reduced by any such E&P previously subject to US tax (as effectively connected income or under subpart F of the Code), and (4) increased by certain qualified deficits of the specified foreign corporation.

The US shareholder’s mandatory inclusion would be determined by taking into account any E&P deficits of its specified foreign corporation, thus effectively requiring inclusion of the net positive amount of deferred foreign earnings. Prior proposals allowed an offset only for E&P deficits of specified foreign corporations owned directly or indirectly by the same US shareholder; however, the bill would permit a net E&P deficit attributable to one US shareholder to offset the net positive E&P of another US shareholder if both US shareholders were members of the same affiliated group.

Cash and other specified assets

The 12% transition rate would apply to an amount of the mandatory inclusion equal to a US shareholder’s aggregate foreign cash position, which means one-third of the US shareholder’s pro rata share of the cash position of its specified foreign corporations determined on: (1) 2 November 2017, (2) the last tax year of each specified foreign corporation that ended before 2 November 2017, and (3) at the end of the tax year preceding the last year of each specified foreign corporation that ended before 2 November 2017. So the cash positions of a CFC with a calendar tax year would be determined as of 2 November 2017; 31 December 2016; and 31 December 2015. If a specified foreign corporation did not exist as of the second or third measurement date, then such amount would be removed from the calculation.

In addition to cash, a specified foreign corporation’s cash position would include its net accounts receivable, the fair market value of actively traded personal property for which there is an established financial market; commercial paper; certificates of deposit; federal, state and foreign government securities; foreign currency; obligations with a term less than a year, and any asset identified by the Treasury Department as economically equivalent to the specified assets. To prevent double counting, the bill provides rules to exclude certain accounts receivable, equity interest, and obligations with a term of less than one year, respectively, from other specified foreign corporations of the same US shareholder. Further, any block assets would also be excluded and the Treasury Department could disregard transactions with the principal purpose of reducing the aggregate cash position of a specified foreign corporation.
Use of tax attributes to reduce the transition tax

Any foreign income taxes deemed paid by the US shareholder under Section 960 would be reduced based on the same ratios applied to determine the allowable deduction against the mandatory inclusion. A gross-up under Section 78 would be required only for the reduced amount. The reduced amount could be claimed as a credit against the transition tax liability, subject to the normal limitations under Section 904. The bill would also not limit the use of a foreign tax credit carryforward, or any other attributes, of the US shareholder to offset the transition tax. Further, the bill would turn off recapture under Sections 904(f) and 907(c)(4), and extend the carryforward period for any foreign taxes deemed paid with respect to the mandatory inclusion not used in the year of the inclusion to 20 years.

Implications

Unlike previous proposals, the bill provides a date certain (2 November 2017, or 31 December 2017) to determine the accumulated deferred foreign earnings that would be subject to the one-time transition tax. The bill does not specify, however, how that amount is to be “determined” on those dates, although any issues related to this determination would be limited to current E&P for the specified foreign corporation’s tax year in which the relevant date occurs. Nonetheless, US shareholders should begin considering E&P studies, at least for their most relevant specified corporations, gathering documentation for their foreign tax pool balances and determining their aggregate foreign cash position.

By increasing the subpart F income of a specified foreign corporation in the transition year, a US shareholder could be required to pay transition tax on foreign earnings accumulated before acquiring its ownership in the specified foreign corporation, including possibly E&P not included in “post-1986 undistributed earnings” for purposes of Section 902. The House Ways & Means staff appear to have rejected requests for these issues to be addressed.

New category of subpart F income: foreign high return amounts

The bill would add new Section 951A, which would require a US person that is a US shareholder of any CFC for any tax year to include in gross income 50% of its “foreign high return amount” determined for that tax year. A US shareholder’s foreign high return amount is the excess, if any, of the US shareholder’s “net CFC tested income” for that tax year over the excess, if any, of: (1) the US shareholder’s “applicable percentage” of its aggregate pro rata share of the “qualified business asset investment” of each CFC with respect to which it is a US shareholder in that tax year, over (2) any interest expense taken into account in determining the US shareholder’s net CFC tested income for that tax year. Effectively, the bill is identifying an amount of income earned by the US shareholder’s CFCs that it considers “excessive.”

A US shareholder’s net CFC tested income is the excess, if any, of its aggregate pro rata share of any tested income of each CFC, over its aggregate pro rata share of any tested loss of each CFC. A CFC’s tested income is the excess, if any, of: (1) its gross income (other than ECI, subpart F gross income, amounts excluded from foreign personal holding company income under Section 954(c)(6) that do not reduce a US shareholder’s foreign high return amount, active insurance and financing income, amounts excluded from foreign base company income under Section 954(b)(4), commodities income (as defined), and related-party dividends) over (2) deductions (including taxes) properly allocable to such gross income under rules similar to those of Section 954(b)(5). Tested loss is the excess of: (1) properly allocated and apportioned deductions; over (2) gross income taken into account in determining tested income. So for any tax year a CFC would have either tested income or tested loss, but not both.

The applicable percentage for any tax year would equal the federal short-term rate (determined under Section 1274(d)) for the month in which or with which such tax year ends, plus seven percentage points. A CFC’s qualified business asset investment is the aggregate of its adjusted bases in tangible property that is: (1) used in a trade or business of the CFC, (2) of a type with respect to which a deduction is allowed under Section 168, and (3) used in the production of tested income or tested loss.

The bill would amend current Section 960 to treat a US corporation that includes a foreign high return amount in income as paying a portion of any foreign income taxes paid or accrued by its CFCs with respect to gross income taken into account in determining tested income or tested loss. Specifically, under new Section 960(d), the US corporation would be treated as paying foreign income taxes equal to 80% of “foreign high return percentage,” multiplied by the aggregate foreign income taxes paid or accrued by its CFCs that are properly attributable to gross income taken into account in determining tested income or tested loss (defined as “tested foreign income taxes”). For any tax year, the US corporation’s foreign high return percentage would be the ratio of its foreign high return amount to its aggregate tested income. The bill would create a new Section 904(d) limitation
category for foreign high return amounts but any foreign income taxes not claimed as a credit in a tax year could not be carried back or forward.

Effective date
New Section 951A would apply to tax years of foreign corporations beginning after 31 December 2017, and to tax years of US shareholders in which or within which such tax years of a foreign corporation end.

Implications
Although some form of anti-base erosion provision was expected as part of US tax reform, new Section 951A is more far-reaching than most anticipated. It would effectively establish a global minimum tax on foreign earnings. Because intangible property would not be treated as a qualified business asset investment, Section 951A will be particularly significant for US taxpayers with considerable offshore intangible property. Further, because the bill would also repeal current Section 958(b)(4), which does not prevent stock owned by a foreign person to be attributed downward to a domestic subsidiary, the provision would also affect foreign-parented groups with US subsidiaries that partially own non-US subsidiaries that would become CFCs because of the repeal.

New excise tax on certain payments from a domestic corporation to a foreign affiliate

Current law
Under current law, a foreign corporation is generally subject to US taxation on a net basis on ECI under Section 882, or on a gross basis (30% statutory rate subject to reduction under a US tax treaty) on certain non-ECI income that is fixed or determinable annual or periodical (FDAP) under Section 881.

New Section 4491
New Section 4491 would impose on each “specified amount” paid or incurred by a domestic corporation to a foreign corporation that is a member of the same international financial reporting group (IFRG) a tax equal to the highest rate of tax imposed under Section 11 for the tax year in which the specified amount is paid. This new “excise tax” would be imposed on the domestic corporation and would not be deductible for US federal tax purpose. For this purpose, a specified amount paid, incurred or received by a partnership that is a member of an IFRG would be treated as paid, incurred or received by its partners, and a specified amount paid, incurred or received by a foreign corporation in connection with a US trade or business would be treated as paid, incurred or received by a domestic corporation.

A specified amount for this purpose means any amount that is, with respect to the payor, deductible or includible in cost of goods sold (COGS), inventory or the basis of a depreciable or amortizable asset for the payor. However, a specified amount does not include interest, amounts paid or incurred for the acquisition of certain commodities, FDAP payments subject to withholding tax under Section 881, or service fees not subject to a markup to the extent the payor elects the services cost method for Section 482 purposes. For FDAP amounts, however, the provision would only exclude the portion of such amount in proportion to the actual rate of tax imposed under Section 881(a) to 30%. Thus, for example, it would appear that, if US$1,100 of a FDAP royalty payment were subject to a treaty-reduced withholding tax rate of 10% under Section 881(a), only 1/3 of that amount would be excluded from treatment as a specified amount.

An IFRG for this purposes is any group of entities, with respect to any specified amount, if the specified amount is paid or incurred during a reporting year of such group with respect to which it prepares consolidated financial statements (within the meaning of Section 163(n)(4)) and the average annual aggregate payment of specified amounts of such group for the three-reporting-year period ending with such reporting year exceeds $100 million.

Election to treat specified amounts as ECI
In lieu of the domestic corporation incurring an excise tax on a specified amount, the foreign corporation that receives the payment would be permitted to elect to take the specified amount into account as if were engaged in a USTB and had a US permanent establishment (PE) during the tax year in which the amount was received, and as if such amount were ECI and attributable to the US PE (the ECI election). Once made, the ECI election could be revoked only with Internal Revenue Service consent. Importantly, for any underpayment, penalties, additions to tax or additional amounts, the provision would place joint and several liability on each domestic corporation that is a member of the IFRG.

If the ECI election were made, the foreign corporation would be allowed a deduction against the specified amount for a “deemed expenses” amount. The deemed expenses with respect to a specified amount received by the foreign corporation during a reporting year is the amount of expenses required so that the foreign corporation’s net income ratio (i.e., the ratio of the net income determined without regard to interest income, interest expense, and income taxes, divided by revenues) with respect to the specified amount equals the IFRG’s net income ratio with
respect to the product line to which the specified amount relates. The amounts required to determine the net income ratio would be determined on the basis of the IFRG’s consolidated financial statements and the books and records of the IFRG members used to prepare those statements.

Any ECI amount resulting from the ECI election would be treated as such for all purposes of the Code. Thus, as explained in the Joint Committee on Taxation’s Explanation, it is subject to the branch profits tax and is not subject to the excise tax under Section 4371. For purposes of Section 245 and new Section 245A, however, these amounts would not be treated as ECI. Thus, a distribution of earnings attributable to the amounts described in this proposal would be eligible for the participation Dividends Received Deduction under new Section 245A. No foreign tax credit or deduction would be allowed for any taxes (including withholding taxes) paid or accrued with respect to any amount to which this proposal applies.

Effective date
The provision would apply to amounts paid or accrued after 31 December 2018.

Implications
This provision would be a significant change to the long-standing rules (general principles) concerning the US federal taxation of cross-border payments, but would apply equally to US- and foreign-parented multinational groups. The gross basis (and non-deductible nature) of the excise tax makes clear the provision intended to encourage foreign corporations to make the ECI Election for specified amounts. Because the deemed ECI amount could also be subject to the branch profits tax provisions of Section 884, however, the choice may not be obvious in all cases. IFRGs will have to model both options to determine whether the irrevocable ECI Election should be made.

Changes to the foreign tax credit regime
Section 902. As a result of allowing a 100% deduction for the foreign-source portion of dividends received by a domestic corporation from certain foreign subsidiaries, the bill would repeal current Section 902, which applies to deem a domestic corporation or certain foreign corporations as paying foreign taxes actually paid by a foreign corporation from which a dividend is received.

Section 960. The bill would amend Section 960(a) to deem a US corporation that has a subpart F income inclusion with respect to a CFC as paying only the CFC’s foreign income taxes “properly attributable” to the items included in gross income by the domestic corporation. New Section 960(b) would treat a US corporation that receives distributions of previously-taxed E&P as paying foreign income taxes paid by the CFC with respect to the PTI that are “properly attributable” to the PTI, and that have not been previously treated as paid by the domestic corporation (e.g., withholding taxed paid by an upper-tier CFC on the receipt of previously-taxed E&P from a lower-tier CFC).

Effective date
The amendments would be effective for tax years beginning after 31 December 2017.

Implications
The repeal of Section 902 would be a simplifying consequence of the proposed dividend-exemption system. Because Section 954(c)(6)’s “look-through” exception does not apply to dividends received by a CFC from a 10/50 company, however, repealing Section 902(b) would result in immediate US taxation on any such dividends without offset for any foreign income taxes paid or accrued by the payor 10/50 company, which is not consistent with long-standing US tax policy. It’s unclear whether this result is intended. New Section 960(b) is a thoughtful clarification of current Section 960(a)(3), especially insofar as the new section would apply explicitly to distributions of previously-taxed E&P subject to Section 959(b).

Limitation on interest expense deductions by domestic corporations that are members of an IFRG
Current law
Current Section 163(j) can apply to limit a US corporation deduction for interest payments made to a related party. Specifically, if the US corporation’s debt-to-equity ratio exceeds 1.5 to 1 for a tax year, Section 163(j) limits the deduction for interest paid to certain related parties that are not subject to US tax, if the taxpayer incurs net interest expense that exceeds 50% of the taxpayer’s adjusted taxable income (defined as taxable income without regard to net interest expense, net operating losses, certain cost recoveries and domestic production activities). Any disallowed interest deductions are carried forward indefinitely, while any “excess limitation” (the excess of 50% of the corporation’s adjusted taxable income over its net interest expense) may be carried forward three years. Under Section 163(j)(6)(C) and (j)(7), all members of the same affiliated group, as that term is defined under Section 1504(a), are treated as a single taxpayer.
Amended Section 163(j). The bill would amend Section 163(j) to limit the deduction of any taxpayer for any tax year for business interest to the sum of any business interest income for such tax year, and 30% of the taxpayer’s adjusted taxable income for that year. This limitation would apply to all taxpayers, regardless of their form and regardless of whether interest were paid to related parties (foreign or domestic). Small businesses (as defined) would be excluded, however. A taxpayer’s adjusted taxable income for this purpose means its taxable income determined without regard to any items not properly allocable to a trade or business, any business interest expense or income, any net operating loss deduction, and any deduction for depreciation, amortization or depletion. Amended Section 163(j) would permit a carryforward of any disallowed business interest for five years, and would also provide rules for the treatment of carryforward business interest for certain corporate acquisitions.

New Section 163(n). The bill would add new Section 163(n) to limit the deduction for interest paid by a domestic corporation that is a member of an IFRG. For this purpose, an IFRG means, for any reporting year, any group of entities that: (1) includes at least one foreign corporation engaged in a US trade or business, or at least one domestic corporation and one foreign corporation; (2) prepares consolidated financial statements, and (3) has average annual global gross receipts of more than $100 million for the three-year reporting period ending with the reporting year.

If Section 163(n) applied, the domestic corporation’s deduction for interest expense paid or accrued during the tax year could not exceed the sum of the domestic corporation’s “allowable percentage” of 110% of its net interest expense, plus any interest income of the domestic corporation for that tax year. A domestic corporation’s allowable percentage for a tax year is the ratio of its allocable share of the IFRG’s net interest expense for the reporting year that ends in or with such tax year over its reported net interest expense for such reporting year of the IFRG. A domestic corporation’s allocable share of an IFRG’s net interest expense for any reporting year is the portion of such expense that bears the same ratio as the domestic corporation’s earnings before interest, taxes, depreciation and amortization (EBITDA) bears to the IFRG’s EBITDA, as determined for that reporting year. Any disallowed interest expense could be carried forward for up to five years.

For this purpose, an affiliated group that files (or is required to file) a consolidated return would be treated as a single corporation. In the case of a partnership, Section 163(n) would apply at the partner level, and it would also apply to a foreign corporation engaged in a US trade or business.

Taxpayers would apply amended 163(j) or new Section 163(n), whichever denies a greater deduction for interest.

Effective date
Amended Section 163(j) and new Section 163(n) would apply for tax years beginning after December 31, 2017.

Limitation on losses with respect to specified 10%-owned foreign corporations
As a corollary to the 100% deduction allowable against foreign-source dividends received by a domestic corporation from certain foreign subsidiaries, the bill would add new Section 961(d) to require — solely for purposes of determining loss on a disposition of stock of a foreign corporation — the domestic corporation to reduce its adjusted basis in such stock (but not below zero) by the amount of any such deduction claimed by the domestic corporation for dividends received with respect to such stock. A reduction, however, would not be required to the extent the adjusted basis of the stock were reduced under Section 1059. This provision would apply for distributions made after 31 December 2017.

Recapture of foreign branch losses
The bill would add new Section 91 to require a domestic corporation that transfers substantially all of the assets of a foreign branch (within the meaning of Section 367(a)(3)(C)) to a specified 10%-owned foreign corporation with respect to which the domestic corporation is a US shareholder after the transfer, to include in gross income the “transferred loss amount” with respect to such transfer. The transferred loss amount would equal the excess of losses incurred by the foreign branch after 31 December 2017, and before the transfer, for which a deduction was allowed to the domestic corporation, over the sum of taxable income earned by the foreign branch in tax years after the loss was incurred and through the close of the tax year of the transfer and any amount recognized under Section 904(f)(3) as a result of the transfer. For a transfer described in Section 367(a)(3)(C), the transferred loss amount would not exceed the accumulated branch losses not recaptured under Section 367(a)(3)(C).
For a transfer not described in Section 367(a)(3)(C), the transferred loss amount would be reduced (but not below zero) by any gain recognized on the transfer (other than gain amounts recognized under the branch loss recapture rules). Any amounts included in gross income under this provision and under Section 367(a)(3)(C) would be treated US-source. New Section 91 and amended Section 367(a)(3)(C) would apply to transfers occurring after 31 December 2017.

**Source of income from inventory sales**

Current law

Current Section 863(b) provides special rules that source income derived from the sale of inventory produced within the US and sold outside of the US (or vice versa) (a Section 863(b) sale) as partly from US sources and partly from foreign sources.

H.R. 1 provision

The bill would amend Section 863(b) to require income from a Section 863 Sale to be apportioned between US and foreign sources solely on the basis of the production activities with respect to the inventory sold.

Effective date

Amended Section 863(b) would apply to tax years beginning after 31 December 2017.

Implications

Under current law, the place of sale of inventory for purposes of Section 863(b)(2) is determined under the “title passage rule.” This rule effectively permits a taxpayer to elect whether a sale of inventory constitutes a Section 863 Sale – and therefore whether the associated income is sourced as partly within and partly outside the US. Amended Section 863(b) would eliminate this bifurcation, and thus would generally be unfavorable.

**Other changes to subpart F**

Expanded stock attribution rules to determine CFC status. The bill would repeal current Section 958(b)(4), which generally prevents stock owned by a foreign shareholder from being attributed downward to a domestic subsidiary. For foreign-parented groups, this rule could prevent CFC status for any foreign subsidiaries jointly owned, for example, by the foreign parent corporation and US subsidiary. For example, if the foreign parent owned 51% of the foreign subsidiary and the US subsidiary owned the remaining 49%, the foreign subsidiary would not be a CFC because Section 958(b)(4) prevents the US subsidiary from being treated as owning the foreign parent’s 51% interest. The bill would repeal this limitation. Thus, under these assumed facts, the US subsidiary would, for purposes of determining US shareholder and CFC status, be treated as owning all of the stock of the foreign subsidiary, causing it to become a CFC. The US subsidiary’s inclusion of any subpart F income, however, would still be limited to its directly held stock, and any stock indirectly held through foreign entities as determined under Section 958(a). The repeal of Section 958(b)(4) would greatly expand the application of subpart F, including the new foreign high return provisions of Section 951A included in the bill. Foreign-parented groups should evaluate their corporate structure in light of this proposed change. US shareholders owning a 10% voting interest in a foreign-parented group should also evaluate this proposed change.

**Elimination of the 30-day rule.** Current Section 951(a) requires a subpart F income inclusion with respect to a foreign corporation for any tax year only if the foreign corporation is a CFC for at least 30 consecutive days during that tax year. The bill would repeal this “30-day rule.”

Section 954(c)(6) made permanent. The bill would make permanent Section 954(c)(6), which excludes from foreign personal holding company (as defined in Section 954(c)) certain dividends, interest, rents and royalties, received by CFC by a related CFC. Current Section 954(c)(6) would not apply to tax years of a CFC beginning after 31 December 2019.

De minimis exception indexed for inflation. The bill would index for inflation the existing subpart F de minimis exception.

Repeal of FBCOR rules. The bill would repeal Section 954(g), providing rules that treat as subpart F income certain foreign oil-related income earned by a CFC.

Repeal of inclusion based on withdrawal of qualified shipping investment. Foreign shipping income earned by a CFC between 1976 and 1986 was not treated as subpart F income to the extent reinvested in certain qualified shipping investments. Under current law, such income is subject to US tax to the extent there is a net decrease to a CFC’s qualified shipping investments in any tax year. The bill would repeal this income inclusion requirement.

These amendments to subpart F would apply to tax years of foreign corporations beginning after 31 December 2017, and to tax years of the US shareholders in which or with which such tax years of foreign corporations end.
Impact

The bill would fundamentally change the US taxation of foreign earnings by providing a 100% deduction for foreign-source earnings repatriated as dividends to domestic corporations from their specified 10%-owned foreign subsidiaries. The benefit of this territorial regime, however, would be limited by Section 951A, which would impose a minimum tax on foreign earnings by taxing currently half of a US shareholder’s “foreign high return amount.” Because this amount would be determined on an aggregate basis (i.e., all CFCs effectively treated as one), high-taxed and low-taxed income would be blended, increasing the likelihood of residual US tax being paid with respect to the inclusion. The additional limitations of the deduction of net interest expense would likely require multinationals to reevaluate their capital structures. Finally, the proposed excise tax on certain payments made by domestic corporations to foreign affiliates would negatively affect all multinationals, whether foreign- or US-parented, likely requiring supply chain restructuring and possibly unwinding of other internal restructurings. Significant hurdles remain for its enactment, but the bill represents a significant step forward towards fundamental US tax reform.

Endnote

1. Currency references in this Alert are to US$. 
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