V. Foreign-Related Changes

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Deduction for Foreign-Source Portion of Dividends Received by Domestic Corporations from Specified 10-Percent Owned Foreign Corporations

TCJA enacts new Code Sec. 245A, which provides for an exemption for certain foreign income. This exemption is provided for by means of a 100-percent deduction for the foreign-source portion of dividends received from specified 10-percent owned foreign corporations by domestic corporations that are United States shareholders of those foreign corporations within the meaning of Code Sec. 951(b) (referred to as "DRD"). The provision is effective for distributions made (and, for purposes of determining a taxpayer's foreign tax credit limitation under Code Sec. 904, deductions in tax years beginning) after December 31, 2017. (return to Foreign-Related Changes)

Special Rules Relating to Sales or Transfers Involving Specified 10-Percent Owned Foreign Corporations

TCJA provides that, in the case of the sale or exchange by a domestic corporation of stock in a foreign corporation held for one year or more, any amount received by the domestic corporation which is treated as a dividend for purposes of Code Sec. 1248, is treated as a dividend for purposes of applying the provision.

Solely for the purpose of determining a loss, TCJA provides that a domestic corporate shareholder's adjusted basis in the stock of a specified 10-percent owned foreign corporation (as defined in this provision) is reduced by an amount equal to the portion of any dividend received with respect to such stock from such foreign corporation that was not taxed by reason of a dividends received deduction allowable under Code Sec. 245A in any tax year of such domestic corporation. This rule applies in coordination with Code Sec. 1059, such that any reduction in basis required pursuant to this provision will be disregarded, to the extent the basis in the specified 10-percent owned foreign corporation's stock has already been reduced pursuant to Code Sec. 1059.

TCJA also provides that, if for any tax year of a controlled foreign corporation (CFC) beginning after December 31, 2017, an amount is treated as a dividend under Code Sec. 964(e)(1) because of a sale or exchange by the CFC of stock in another foreign corporation held for a year or more, then: (1) the foreign-source portion of the dividend is treated as subpart F income of the selling CFC for purposes of Code Sec. 951(a)(1)(A), (2) a United States shareholder with respect to the selling CFC includes in gross income for the tax year of the shareholder with or within the tax year of the CFC ends, an amount equal to the shareholder's pro rata share (determined in the same manner as under Code Sec. 951(a)(2)) of the amount treated as subpart F income under (1), and (3) the deduction under Code Sec. 245A(a) is allowable to the U.S. shareholder with respect to the subpart F income included in gross income under (2) in the same manner as if the subpart F income were a dividend received by the shareholder from the selling CFC.

In the case of a sale or exchange by a CFC of stock in another corporation in a tax year of the selling CFC beginning after December 31, 2017, to which this provision applies if gain were recognized, rules similar to Code Sec. 961(d) apply.

Code Sec. 367 is amended to provide that in connection with any exchange described in Code Secs. 332, 351, 354, 356, or 361, if a U.S. person transfers property used in the active conduct of a trade or business to a foreign corporation, such foreign corporation is not, for purposes of determining the extent to which gain is recognized on such transfer, be considered to be a corporation.
Under TCJA, if a domestic corporation transfers substantially all of the assets of a foreign branch (within the meaning of Code Sec. 367(a)(3)(C), as in effect before the date of enactment of TCJA) to a specified 10-percent owned foreign corporation with respect to which it is a U.S. shareholder after the transfer, the domestic corporation includes in gross income an amount equal to the transferred loss amount, subject to certain limitations.

The provisions relating to sales or exchanges of stock apply to sales or exchanges after December 31, 2017. The provision relating to reduction of basis in certain foreign stock for the purposes of determining a loss is effective for distributions made after December 31, 2017. The provisions relating to transfer of loss amounts from foreign branches to certain foreign corporations and to the repeal of the active trade or business is effective for transfers after December 31, 2017. (return to Foreign-Related Changes)

Treatment of Deferred Foreign Income Upon Transition to Participation Exemption System of Taxation
TCJA generally requires that, for the last tax year beginning before January 1, 2018, any U.S. shareholder of a controlled foreign corporation, as well as all foreign corporations (other than PFICs) in which a U.S. person owns a 10-percent voting interest, must include in income its pro rata share of the undistributed, non-previously-taxed post-1986 foreign earnings of the corporation ("mandatory inclusion"). A special rule permits deferral of the transition net tax liability for shareholders of a U.S. shareholder that are an S corporation. The provision is effective for the last tax year of a foreign corporation that begins before January 1, 2018, and with respect to U.S. shareholders, for the tax years in which or with which such tax years of the foreign corporations end. (return to Foreign-Related Changes)

Current Year Inclusion of Global Intangible Low-Taxed Income by U.S. Shareholders
Under TCJA, a U.S. shareholder of any CFC must include in gross income for a tax year its global intangible low-taxed income (GILTI) in a manner generally similar to inclusions of subpart F income. GILTI, which is defined in new Code Sec. 951A, means, with respect to any U.S. shareholder for the shareholder's tax year, the excess (if any) of the shareholder's net CFC tested income over the shareholder's net deemed tangible income return. The shareholder's net deemed tangible income return is an amount equal to 10 percent of the aggregate of the shareholder's pro rata share of the qualified business asset investment (QBAI) of each CFC with respect to which it is a U.S. shareholder. The provision is effective for tax years of foreign corporations beginning after December 31, 2017, and for tax years of U.S. shareholders in which or with which such tax years of foreign corporations end. (return to Foreign-Related Changes)

Deduction for Foreign-Derived Intangible Income and Global Intangible Low-Taxed Income
TCJA provides domestic corporations with reduced rates of U.S. tax on their foreign-derived intangible income ("FDII") and GILTI (defined above). A domestic corporation's FDII is the portion of its intangible income, determined on a formulaic basis that is derived from serving foreign markets. For tax years beginning after December 31, 2017, and before January 1, 2019, the effective tax rate on FDII is 21.875 percent and the effective U.S. tax rate on GILTI is 17.5 percent. For tax years beginning after December 31, 2018, and before January 1, 2026, the effective tax rate on FDII is 12.5 percent and the effective U.S. tax rate on GILTI is 10 percent. For tax years beginning after December 31, 2025, the effective tax rate on FDII is 15.625 percent and the effective U.S. tax rate on GILTI is 12.5 percent. The provision is effective for tax years beginning after December 31, 2017. (return to Foreign-Related Changes)

Modifications of Subpart F Provisions
TCJA makes the following modifications –
- eliminates the inclusion of foreign base company oil related income as a category of foreign base company income;
- repeals Code Sec. 955;
- amends the ownership attribution rules of Code Sec. 958(b);
- modifies the definition of U.S. shareholder;
- eliminates the requirement that a corporation must be controlled for 30 days before subpart F inclusions apply;
- makes permanent the exclusion from foreign personal holding company income for certain dividends, interest (including factoring income that is treated as equivalent to interest under Code Sec. 954(c)(1)(E)), rents, and royalties received or accrued by one CFC from a related CFC; and
- amends the requirement in subpart F that U.S. shareholders recognize income when earnings are repatriated in the form of increases in investment by a CFC in U.S. property to provide an exception for domestic corporations that are U.S. shareholders in the CFC either directly or through a domestic partnership. (return to Foreign-Related Changes)

Prevention of Base Erosion
TCJA makes the following modifications -
- places limitations on income shifting through intangible property transfers;
- denies a deduction for any disqualified related party amount paid or accrued pursuant to a hybrid transaction or by, or to, a hybrid entity;
- provides rules that surrogate foreign corporations are not eligible for reduced rate on dividends; and
- modifies the tax rate on base erosion payments of taxpayers with substantial gross receipts. (return to Foreign-Related Changes)

Modifications Related to Foreign Tax Credit System
TCJA makes the following modifications: (1) repeals the Code Sec. 902 indirect foreign tax credits and provide for the determination of Code Sec. 960 credit on current year basis; (2) requires foreign branch income to be allocated to a specific foreign tax credit basket; (3) accelerates the effective date of the worldwide interest allocation rules to apply to tax years beginning after December 31, 2017, rather than to tax years beginning after December 31, 2020; and (4) allocates and apportion gains, profits, and income from the sale or exchange of inventory property produced partly in, and partly outside, the United States on the basis of the location of production with respect to the property. (return to Foreign-Related Changes)

Inbound Provisions
Under TCJA, an applicable taxpayer is required to pay a tax equal to the base erosion minimum tax amount for the tax year. The base erosion minimum tax amount means, with respect to an applicable taxpayer for any tax year, the excess of 10-percent of the modified taxable income of the taxpayer for the tax year over an amount equal to the regular tax liability of the taxpayer for the tax year reduced (but not below zero) by the excess (if any) of credits allowed under Chapter 1 against such regular tax liability over the sum of: (1) the credit allowed under Code Sec. 38 for the tax year which is properly allocable to the research credit determined under Code Sec. 41(a), plus (2) the portion of the applicable Code Sec. 38 credits not in excess of 80 percent of the lesser of the amount of such credits or the base erosion minimum tax amount (determined without regard to this clause (2)).

For tax years beginning after December 31, 2025, two changes have been made, (i) the 10-percent provided for above is changed to 12.5-percent, and (ii) the regular tax liability is reduced by the aggregate amount of the credits allowed under Chapter 1 (and no other adjustment made). (return to Foreign-Related Changes)

Modification of Insurance Exception to the Passive Foreign Investment Company Rules
TCJA modifies the requirements for a corporation the income of which is not included in passive income for purposes of the PFIC rules. The provision replaces the test based on whether a corporation is predominantly engaged in an insurance business with a test based on the corporation's insurance liabilities. The requirement that the foreign corporation is subject to tax under subchapter L if it were a domestic corporation is retained. (return to Foreign-Related Changes)

Repeal of Fair Market Value of Interest Expense Apportionment
TCJA prohibits members of a U.S. affiliated group from allocating interest expense on the basis of the fair market value of assets for purposes of Code Sec. 864(e). Instead, the members must allocate interest expense based on the adjusted tax basis of assets. The provision is effective for tax years beginning after December 31, 2017. (return to Foreign-Related Changes)