

The New Worldwide Territoriality

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The New Worldwide Territoriality

Lay of the Land: Overview of Relevant US Tax Reform Changes

The Same, but Different: Continuing International Tax Rules

Between Two Pillars: International Adoption of Worldwide Territoriality?

Lay of the Land: Overview of Relevant Changes

Lay of the Land: Overview of US Changes

- US Tax Reform In a Nutshell:

Tax Base

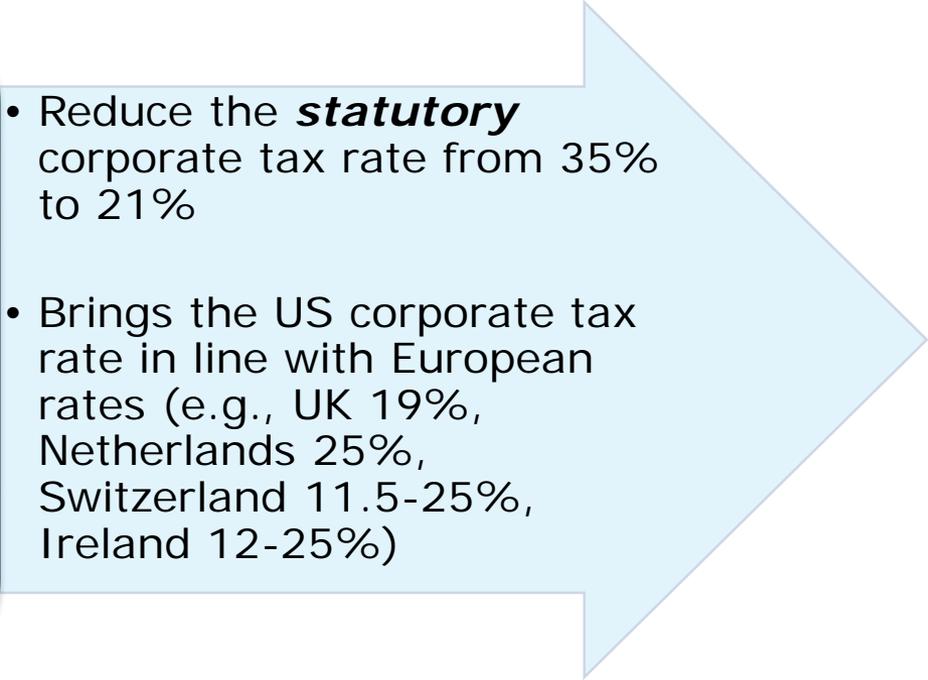
**Corporate
Tax Rate**

Lay of the Land: Overview of US Changes

- The Headline Rate (with European designer influences):



Lower
Corporate
Rate

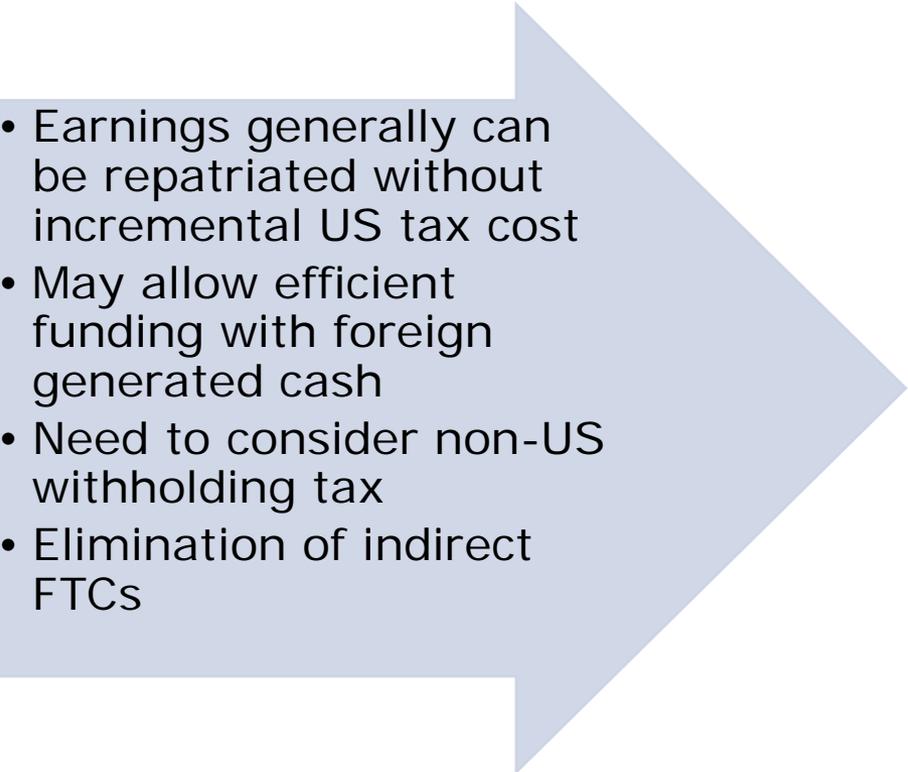
- 
- Reduce the **statutory** corporate tax rate from 35% to 21%
 - Brings the US corporate tax rate in line with European rates (e.g., UK 19%, Netherlands 25%, Switzerland 11.5-25%, Ireland 12-25%)

Lay of the Land: Overview of US Changes

- The shift *toward* territoriality . . .



Section 245A Foreign DRD

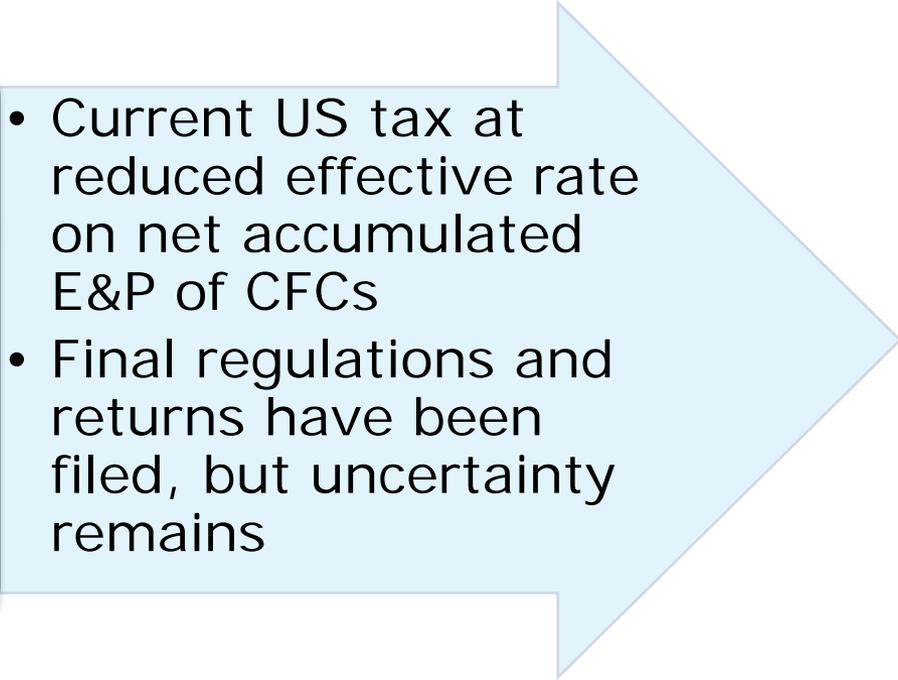
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- Earnings generally can be repatriated without incremental US tax cost
 - May allow efficient funding with foreign generated cash
 - Need to consider non-US withholding tax
 - Elimination of indirect FTCs

Lay of the Land: Overview of US Changes

- . . . that comes at a cost



Section 965 Transition Tax

- 
- Current US tax at reduced effective rate on net accumulated E&P of CFCs
 - Final regulations and returns have been filed, but uncertainty remains

Lay of the Land: Overview of US Changes

- “Intangible” income - worldwide territoriality?

Section 250 FDII

- US federal income tax deduction for “foreign derived intangible income”
- Generally income from sales to foreign persons and services provided for foreign use, over tangible income return

Section 951A/250 GILTI

- Pro rata share of CFC income in excess of ten percent return on QBAI subject to current US tax
- Eligible for 50% deduction under Section 250
- Reduced foreign tax credits available in year of inclusion, subject to FTC limitations

Lay of the Land: Overview of US Changes

- Protecting (or broadening) the base

Section 163(j)

- General 30% limitation on interest deduction, with limited exceptions
- Under proposed regulations, also applies for purposes of GILTI

Section 59A BEAT

- Deductible payments to related persons potentially disfavored
- Impacts for integration planning

Lay of the Land: Overview of US Changes

- Protecting (or broadening) the base

Section 267A Anti-Hybrid

- Limits US tax deductions for interest on hybrid instruments and hybrid arrangements
- Consistent with OECD BEPS and EU anti-hybrid proposals
- Implications for CTB planning

Section 951/958 CFC Determinations

- Expanded US shareholder's to include ten percent of vote or value
- Expands CFC attribution to include through foreign corporations

The Same, but Different: Continuing International Tax Rules

The Same, but Different: Continuing International Tax Rules

- Whither Subpart F? Not so fast

Foreign Base Company Income

- Rules continue generally unchanged post-tax reform, although significance may be more limited in light of GILTI

High Tax Exception

- Subpart F income that is eligible for high tax exception is not included in GILTI
- Comments have requested a high tax exception to Section 951A GILTI
- Elimination of Section 902 pools and reduction in corporate rate may cause income that historically was not eligible to be high tax

Section 956

- Continues to apply, although proposed regulations generally would eliminate application to domestic corporations

The Same, but Different: Continuing International Tax Rules

- The continuing (or increasing) significance of Foreign Tax Credits

Section 902 Repeal

- Section 245A shift toward a territorial system eliminated the need for Section 902 baskets to associate foreign taxes with dividends received in the U.S.
- Elimination of tax pools has implications for foreign tax adjustments in pre-2017 tax years, as well as Section 965 inclusions
- Section 901 credits are still available, and FTCs with respect to Subpart F inclusions are addressed in Section 960

The Same, but Different: Continuing International Tax Rules

- The continuing (or increasing) significance of Foreign Tax Credits

GILTI Basket

- GILTI includes are eligible for an 80 % FTC in the year of the inclusion, resulting in 13.25% overall effective tax rate *assuming full utilization*
- Proposed regulations require allocation of expenses to GILTI basket income, which can result in effective tax rates on such income substantially in excess of 13.25%
- Allocation of R&D expenses is an open question under proposed regulations

The Same, but Different: Continuing International Tax Rules

- The Continuing (or increasing) significance of Foreign Tax Credits

Foreign Branch Basket

- New foreign branch basket applies with respect to income earned by foreign branches, including CTB entities
- Significant for FDII purposes as income in the foreign branch basket is not eligible for FDII
- Proposed regulations apply Section 367 principles to transactions between branch and the home office, which could significantly impact post-tax reform intangibles planning
- CTB restructuring to address application of BEAT introduces foreign branch basket considerations

The Same, but Different: Continuing International Tax Rules

- PTEP, the new and improved PTI

Section 965

- Section 965 inclusions result in substantial amounts of previously taxed earnings and profits
- But, significant limitations on ability to repatriate remain:
 - Section 965(a) versus Section 965(b) PTEP
 - Non-US withholding taxes that are not creditable
 - Accounting considerations – Designation of earnings as permanently reinvested

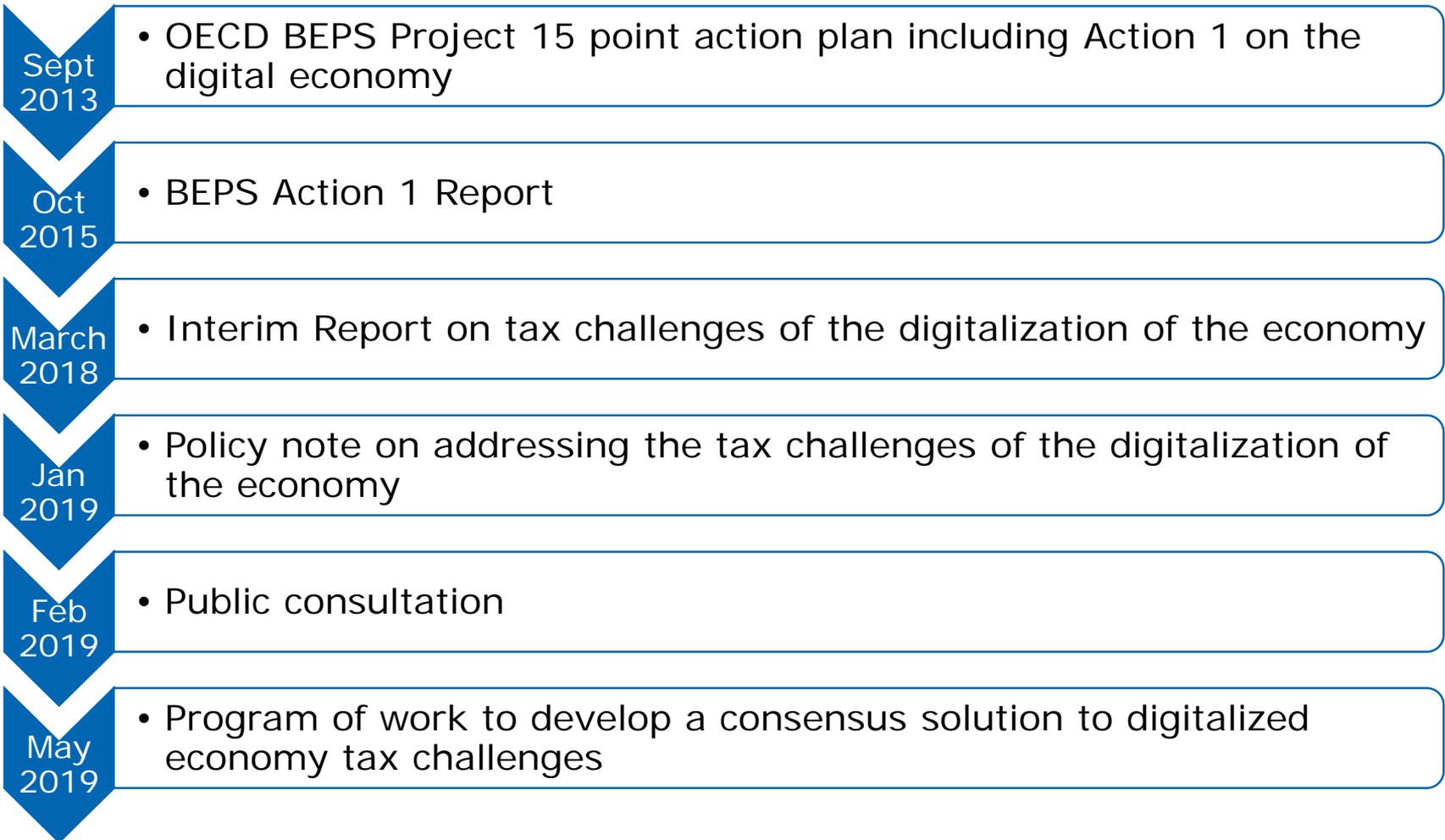
GILTI

- GILTI inclusions result in additional PTEP
- Taking into account GILTI, Section 245A DRD may have limited relevance to US taxpayers, at least in the near term

Between Two Pillars: International Adoption of Worldwide Territoriality?

International Adoption of Worldwide Territoriality

OECD BEPS Action 1



The OECD digital tax Program of Work

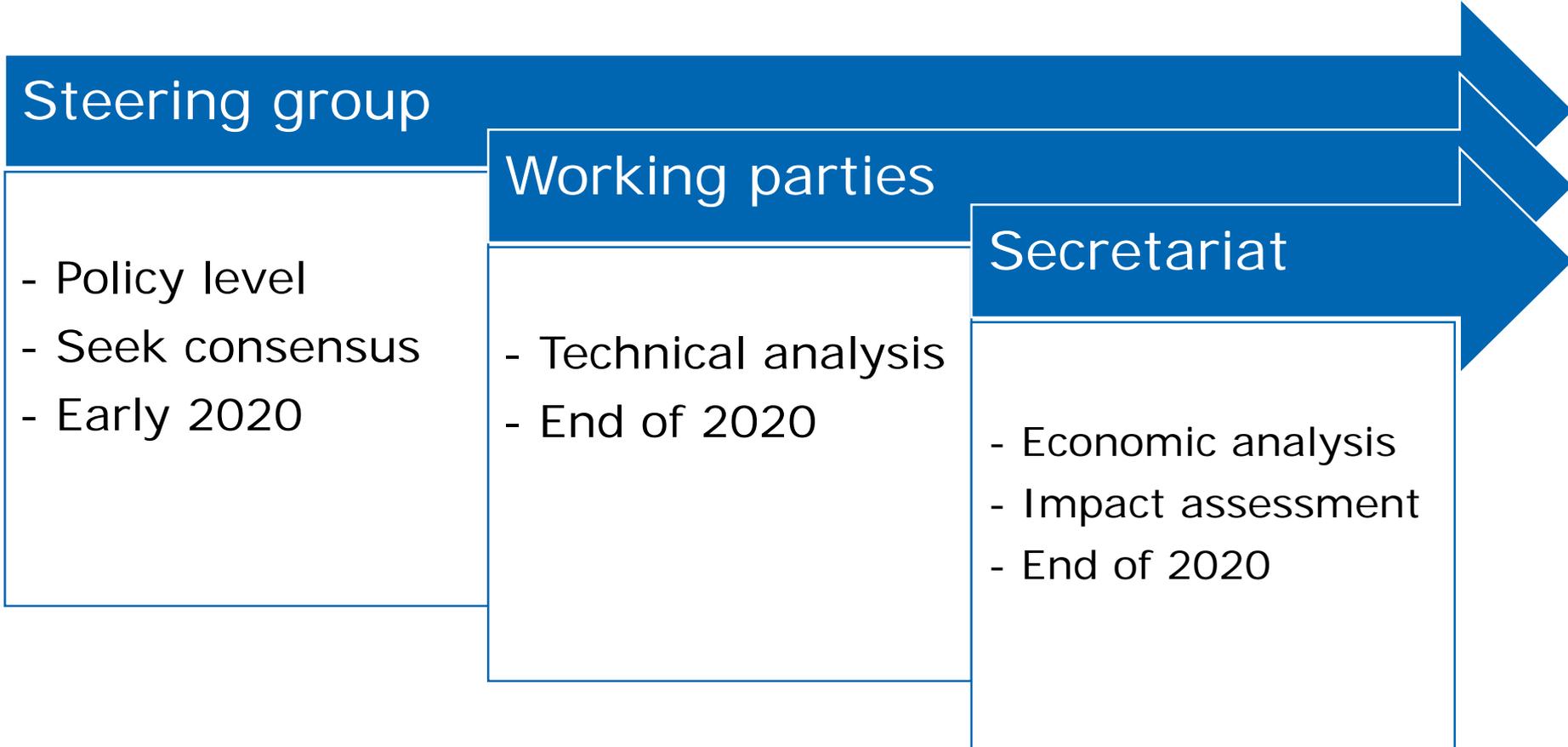
Pillar 1

- Profit allocation to market jurisdictions
- New nexus rule – remote taxable presence

Pillar 2

- Income inclusion – a global minimum tax
- Tax on base eroding payments

Program of Work - timetable



European Commission digital tax proposals

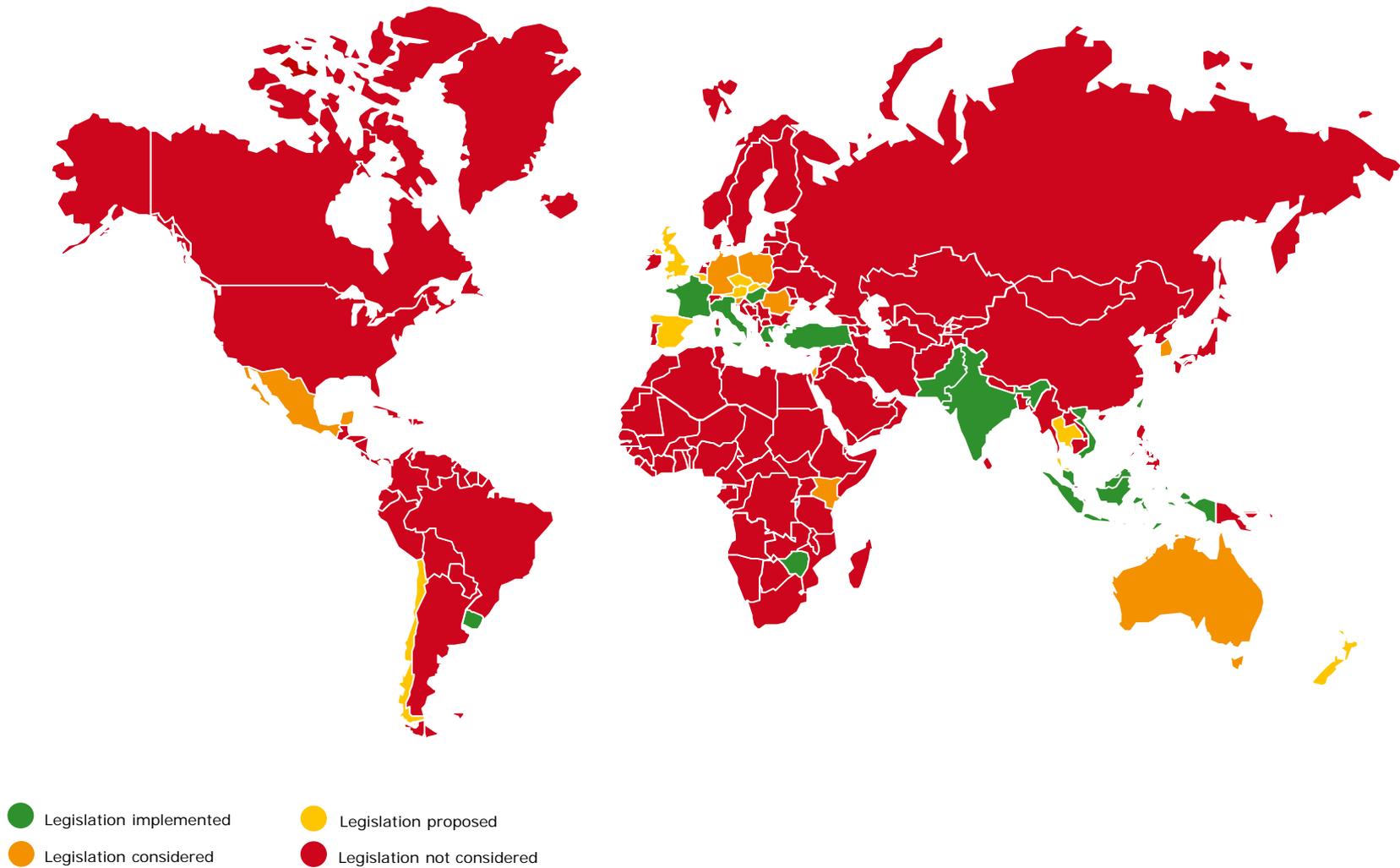
EC proposals

Taxable digital presence

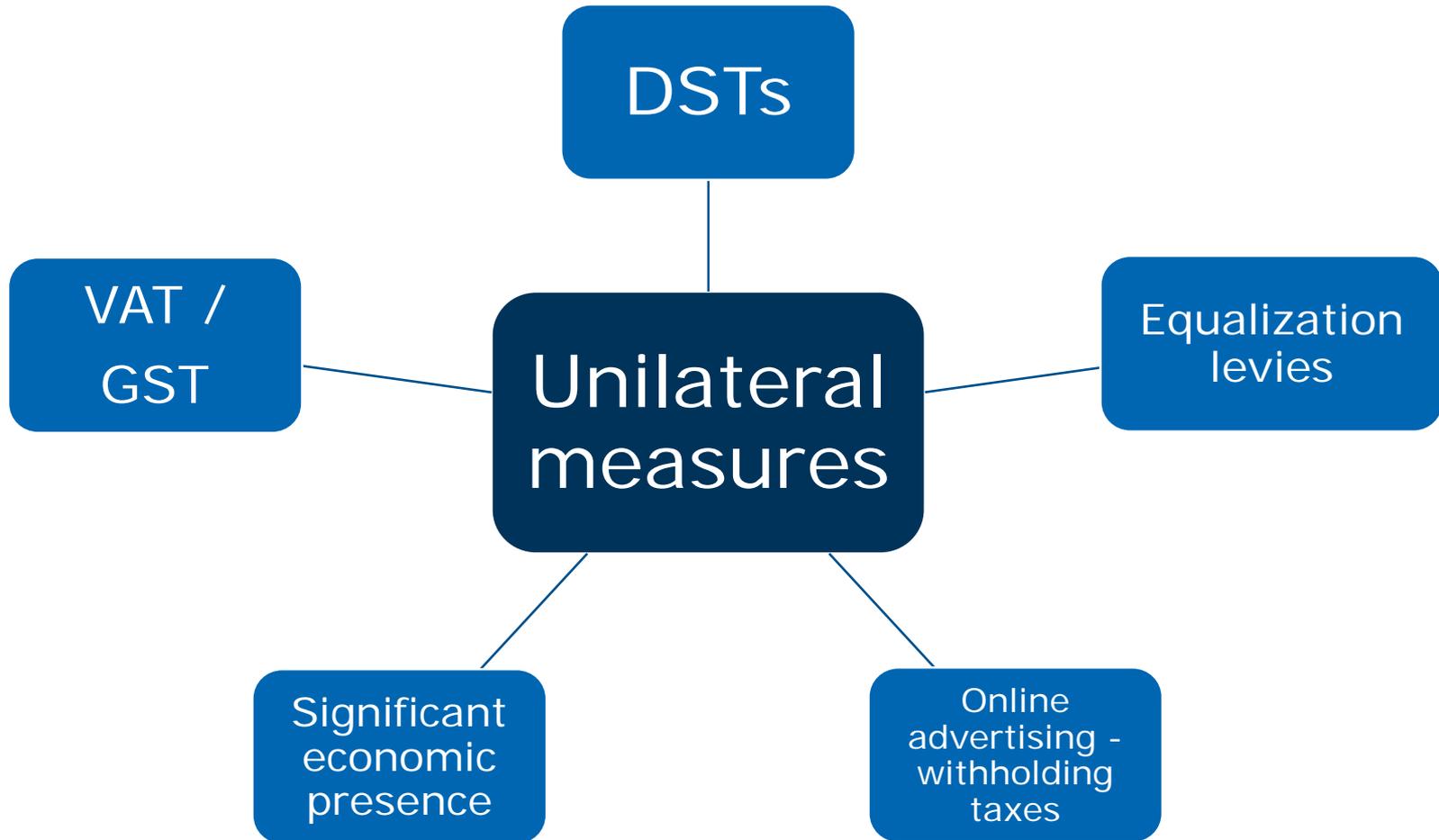
Digital services tax

April 2019 - EC plans blocked and put on hold

Unilateral, domestic digital tax proposals



Range of unilateral digital tax measures



The US perspective

OECD

- Engage to ensure broad focus to reform
- Ensure certain digital businesses not unfairly targeted

EC

- Strongly objects to DSTs
- Treasury and Senate criticism

Unilateral

- Strong objections
- OECD represents the best route
- Trade challenges – e.g., French DST

The OECD Public Consultation

- **Pillar One**: Focuses on the allocation of taxing rights between jurisdictions and seeks to review the profit allocation and nexus rules in the context of the digital economy
 - **Not Just Digital Business**: Notwithstanding this stated objective, under public consultation paper applies to all “consumer-facing businesses,” not just highly digital businesses
 - **Economic Nexus**: The new nexus rule proposed in the consultation paper seeks to address the issue of nexus by creating a taxing right in all cases where a business “*has a sustained and significant involvement in the economy of a market jurisdiction, such as through consumer interaction and engagement, irrespective of its physical presence in that jurisdiction*”

The OECD Public Consultation

- **Pillar One**: (cont.)
 - **Profit Allocation**: Assuming the nexus threshold is satisfied:
 - **A** – a profit allocation is conducted by determining the deemed residual profit and allocating it to market jurisdictions
 - **B** – a separate allocation is made to jurisdictions where the entity has a physical taxable presence under traditional standards, and a fixed return is established for such activities
 - **C** – an amount of additional profit to be allocated to marketing and distribution jurisdictions based on agreement of taxing authorities

The OECD Public Consultation

- **Pillar Two**: Global anti-Base Erosion proposal or (“GloBE”) addresses, on a “without prejudice” basis, taxing rights that would “strengthen the ability of jurisdictions to tax profits where the other jurisdiction with taxing rights applies a low effective rate of tax to those profits
- The Consultation paper leaves many questions unanswered, but proposes exploring:
 - **Income Inclusion Rule**—i.e., taxing the income of a foreign branch or a controlled entity if that income was subject to tax at an effective rate that is below a minimum rate
 - **Undertaxed Payments Rule**—i.e., denying deductions of or imposing source-based taxation (including withholding tax) on payments to related parties if such payments were not subject to tax at or above a minimum rate

The OECD Public Consultation

- Pillar Two: (cont.)
 - The Consultation paper leaves many questions unanswered, but proposes exploring:
 - **Switch-Over Rule**—i.e., permitting residence jurisdictions (by revising applicable tax treaties) to switch from an exemption to a credit method where the profits attributable to a permanent establishment (“PE”) or derived from immovable property (which is not part of a PE) were subject to an effective rate below the minimum rate
 - **Subject to Tax Rule**—i.e., complementing the Undertaxed Payments Rule by subjecting payments to withholding or other taxes at source and adjusting eligibility for treaty benefits on certain items of income where such payments were not subject to tax at a minimum rate

The OECD Public Consultation

- Pillar Two: (cont.)
 - Proposes using financial accounting rules as a base for determining effective rates of tax and applying minimum tax thresholds
 - Decisions must be made as to blending of taxes (e.g., same basic question that IRS is wrestling with on GILTI high-tax)
 - Recognition that for administrability purposes there may need to be certain carve-outs

Questions?



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