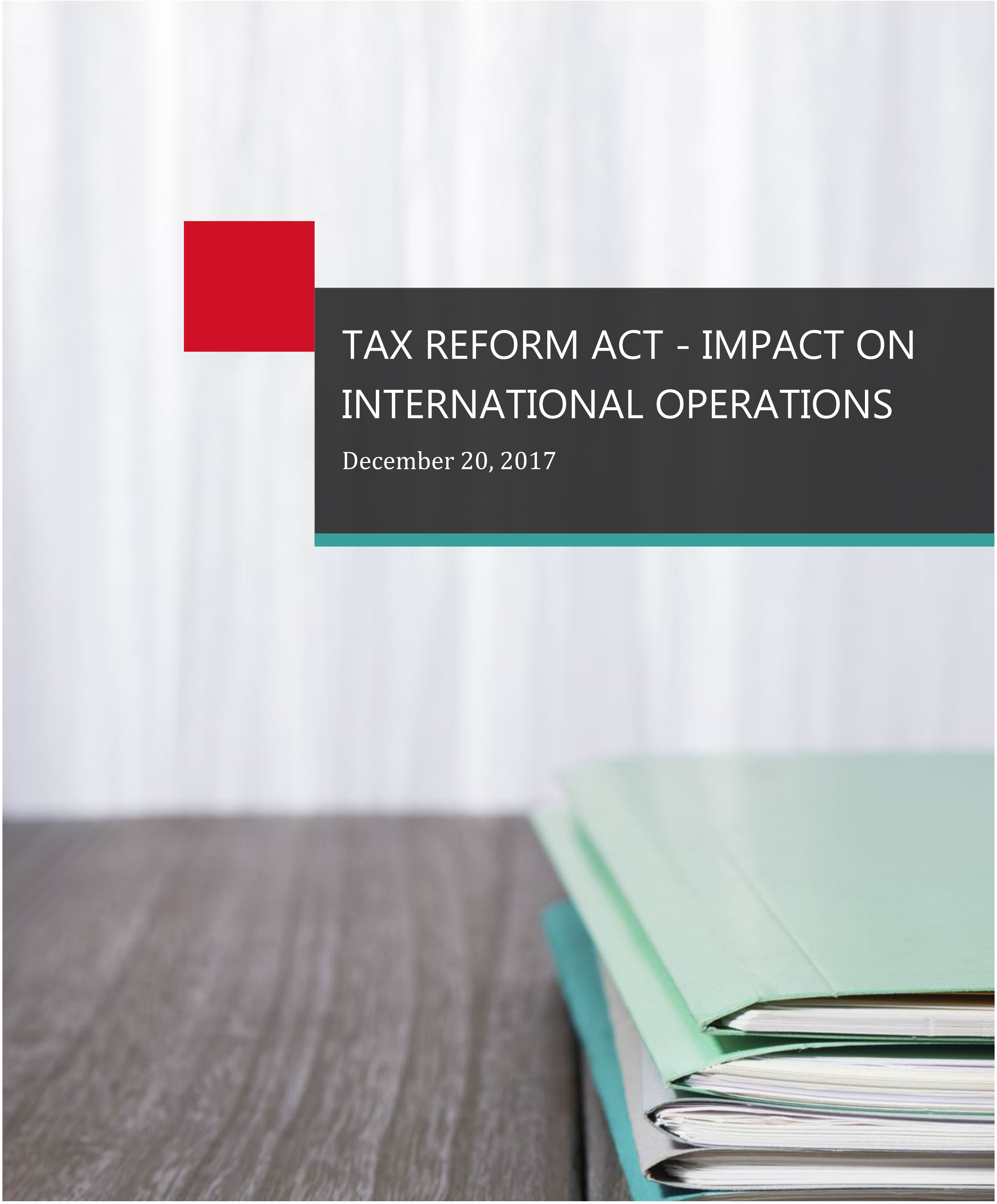

TAX REFORM ACT - IMPACT ON INTERNATIONAL OPERATIONS

December 20, 2017

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Tax Reform Act - Impact on Taxpayers with International Operations

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On December 20, 2017, the U.S. Congress passed the tax reform act (formerly known as the Tax Cuts and Jobs Act or the "Act"). President Trump is expected to sign the Act into law. The Act makes major changes to many areas of the Internal Revenue Code (the Code), including certain fundamental changes to the international tax provisions of the Code. This update summarizes the significant changes to the international tax rules.

Territorial Corporate Tax System

The Act changes the taxation of domestic corporations from a worldwide tax system to a hybrid territorial tax system by establishing a limited participation exemption system. Such participation exemption will allow a domestic corporation to claim a 100% deduction for the foreign-source portion of a dividend (including deemed dividends arising under Section 1248 of the Code from the sale or exchange of stock) received by such domestic corporation from a "specified 10%-owned foreign corporation" in which such domestic corporation is a "United State shareholder." For this purpose, a "specified 10%-owned foreign corporation" is any foreign corporation (other than a passive foreign investment company (PFIC) that is not a controlled foreign corporation (CFC)) with respect to which any domestic corporation is a United States shareholder. As discussed below, the Act expands the current definition of United States shareholder to include not only United States persons that own (directly or constructively) stock of the foreign corporation representing 10% of the combined voting power of a foreign corporation but also United States persons that own (directly or constructively) stock of the foreign corporation representing 10% of the value of the foreign corporation. The deduction is allowed only to a C corporation that is not a regulated investment company or a real estate investment trust.

A domestic corporation may claim the deduction only if the dividend is paid on a share of stock that the domestic corporation has held for 366 days or more during the 731-day period beginning on the date that is 365 days before the date on which the share becomes ex-dividend with respect to such dividend. The holding period requirement will be satisfied only if the specified 10%-owned foreign corporation is a specified 10%-owned foreign corporation at all times during this period and the domestic corporation is a United States Shareholder with respect to such foreign corporation at all times during such period.

The deduction is not available if the dividend received from the specified 10%-owned foreign corporation is a "hybrid dividend," which is generally defined as any dividend for which the specified 10%-owned foreign corporation received a deduction in a foreign country.

No credit or deduction is allowed for any foreign income taxes paid or accrued with respect to any portion of a dividend that qualifies for the deduction.

This provision applies to distributions made after December 31, 2017.

Repeal of Active Trade or Business Exception Under Section 367(a)

The Act provides that, if a U.S. person transfers to a foreign corporation property that is used in the active conduct of a foreign trade or business, then such foreign corporation shall not be treated as a corporation for purposes of determining the extent to which gain is recognized on such transfer. The Act thus repeals the active trade or business exception under current law. This provision applies to transfers after December 31, 2017.

Loss Recapture on Transfer of a Foreign Branch to a Foreign Corporation

Under the Act, if a domestic corporation transfers substantially all of the assets of a foreign branch to a specified 10%-owned foreign corporation with respect to which it is a United States shareholder after the transfer, then the domestic corporation must recapture, as U.S. source income, any net branch losses incurred after December 31, 2017, and before the transfer and with respect to which the domestic corporation was allowed a deduction. This provision applies to transfers after December 31, 2017.

Deemed Repatriation of Deferred Foreign Earnings of 10%-Owned Foreign Corporations

The Act amends Section 965 to require a United States shareholder (which for this purpose includes domestic corporations, partnerships, trusts, estates, and U.S. individuals that own 10% of the voting power) of CFCs and other specified foreign corporations to include in income, for the last taxable year of such foreign corporation beginning before January 1, 2018, such shareholder's pro rata share of the deemed repatriation amount. Other specified foreign corporations are non-CFC, non-PFIC foreign corporations with a corporate United States shareholder (which for this purpose includes domestic corporations that own 10% of the voting power of such foreign corporation). The deemed repatriation amount is the greater of such foreign corporation's post-1986 deferred foreign income as of (i) November 2, 2017 or (ii) December 31, 2017 and that was not previously subject to U.S. tax (but excluding earnings and profits that were accumulated prior to the foreign corporation becoming a CFC or having a 10% U.S. shareholder). The deemed repatriation amount generally is unreduced by distributions made by the foreign corporation during the taxable year.

This deemed repatriation generally will be taxed at a 15.5% rate to the extent the underlying foreign earnings are attributable to the U.S. shareholder's cash position and an 8% rate for all other amounts. The "cash position" is defined to include cash, net accounts receivable, and the fair market value of similarly liquid assets.

The Act provides that a United States shareholder that is required to include an amount in income under Section 965 is allowed a credit for approximately 44.3% of the foreign income taxes paid that are attributable to the cash position portion of the inclusion and approximately 22.9% of the foreign income taxes paid that are attributable to the remainder of the inclusion.

The Act provides that, in the case of a corporation that becomes an expatriated entity (within the meaning of Section 7874(a)(2)) at any point within the 10-year period following the enactment of the Act, a United States shareholder of such corporation is subject to U.S. tax at a 35% rate (with no reduction for foreign tax credits) on the entire amount of the deemed repatriation with respect to such corporation.

Current-Year Taxation for Global Intangible Low-Taxed Income ("GILTI") for U.S. Shareholders of CFCs

The Act adds to the Code new Section 951A, which requires a United States shareholder of a CFC to include in income, as a deemed dividend, the global intangible low-taxed income ("GILTI") of the CFC. After factoring in a deduction that a domestic corporation will be entitled to claim with respect to such income inclusion, a domestic corporation will be subject to U.S. tax on GILTI at an effective rate of 10.5% (that is, 50% of the U.S. corporate tax rate of 21%).

For purposes of this rule, "GILTI" is defined as the excess of the U.S. shareholder's net CFC tested income over a net deemed tangible income return. "Net CFC tested income" generally means a CFC's gross income, other than income that is subject to U.S. tax as effectively connected income, Subpart F income (including income that would be Subpart F income but for the application of certain exceptions), and foreign oil and gas extraction income, less allocable deductions. The "net deemed tangible income return" generally is an amount equal to (i) 10% of the aggregate of the United States shareholder's pro rata share of a CFC's qualified business asset investment (generally, a quarterly average of the CFC's tax basis in depreciable property used in its trade or business) over (ii) the amount of interest expense taken into account to determine such U.S. shareholder's net CFC tested income.

Under the Act, a domestic corporation is entitled to a credit for 80% of its pro rata share of the foreign income taxes attributable to the income of the CFC that is taken into account in computing its net CFC tested income. The foreign tax credit limitation rules apply separately to such taxes, and any taxes that are deemed paid under these rules may not be carried back or forward to other tax years.

This provision is effective for taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of United States shareholders in which or with which such taxable years of foreign corporations end.

Effective 13.125% Tax Rate on Foreign-Derived Intangible Income of a Domestic Corporation

The Act adds to the Code new Section 250, which allows a domestic corporation to claim a deduction (for tax years from 2018 through 2025) for an amount equal to 37.5% of its foreign-derived intangible income (reduced to 21.875% for tax years beginning after December 31, 2025). Thus, a domestic corporation is subject to U.S. tax on foreign-derived intangible income at a rate of 13.125%.

In general, a domestic corporation's "foreign-derived intangible income" is calculated by applying a complex series of formulas and definitions that ultimately measure the extent to which the domestic corporation's income in excess of a 10% return on its U.S. depreciable assets (increased to 15.625% for tax years beginning after December 31, 2025) is attributable to (i) the sale of property to foreign persons for use outside the United States or (ii) the performance of services for foreign persons, or with respect to property located, outside the United States. Income of the domestic corporation is not taken into account for this purpose to the extent it is Subpart F income, GILTI, financial services income, a dividend received from a CFC in which the domestic corporation is a United States shareholder, domestic oil and gas extraction income, and foreign branch income. Special rules apply to transactions involving intermediaries and related parties.

This provision is effective for taxable years beginning after December 31, 2017.

Other Changes to Subpart F Rules

Expansion of Stock Attribution Rules for Determining CFC Status

The Act repeals Section 954(b)(4), which provides that stock in a foreign corporation is not attributed "downward" from a foreign person to a related U.S. person for purposes of determining whether such U.S. person is a United States shareholder of such foreign corporation (and, thus, whether such foreign corporation is a CFC). This provision apparently is intended to render ineffective "de-control transactions" in which a foreign parent acquires a greater than 50% interest in a CFC of its U.S. subsidiary and, thus, causes the CFC to be a non-CFC.

This provision is effective for the last taxable year of foreign corporations beginning before January 1, 2018, and each subsequent year of such foreign corporations and for the taxable years of United States shareholders in which or with which such taxable years of foreign corporations end.

Expansion of Definition of United States Shareholder

Under current law, a United States shareholder is defined as any U.S. person that owns 10% of the voting stock in a foreign corporation. The Act expands this definition to also include any U.S. person that owns 10% of the value of the stock in a foreign corporation. This change accordingly expands the circumstances in which a foreign corporation will be treated as a CFC (including in situations where a U.S. person owns "low vote" stock that represents at least 10% of the value of the foreign corporation).

This provision is effective for taxable years of foreign corporations beginning after December 31, 2017, and for taxable years of United States shareholders in which or with which such taxable years of foreign corporations end.

Elimination of 30-Day Requirement for Subpart F Inclusions

Under current law, a United States shareholder of a foreign corporation is required to include amounts in income under Subpart F for a particular tax year only if such foreign corporation has been a CFC for at least 30 consecutive days for such year. The Act eliminates this 30-day requirement. This provision is effective for taxable years of foreign corporations beginning after December 31, 2017, and for taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

Repeal of Treatment of Foreign Base Company Oil-Related Income as Subpart F Income

The Act repeals Section 954(g), which includes foreign base company oil-related income as one of the categories of foreign base company income. This provision is effective for taxable years of foreign corporations beginning after December 31, 2017, and for taxable years of United States shareholders in which or with which such taxable years of foreign corporations end.

Repeal of Inclusion Based on Withdrawal of Previously Excluded Subpart F Income from Investment in Qualified Shipping Operations

The Act repeals Section 955, which requires a United States shareholder of a CFC to include in income any previously excluded Subpart F income that such CFC withdraws from investment in certain qualified shipping operations. This provision is effective for taxable years of foreign corporations beginning after December 31, 2017, and for taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

Anti-Base Erosion Rules

Expansion of the Definition of Intangible Property for Outbound Transfers

The Act expands the definition of "intangible property" under Section 936(h)(3)(B) to include goodwill, going concern value, workforce in place and any other item the value or potential value of which is not attributable to tangible property or the services of an individual. This provision legislatively overturns several recent Tax Court cases holding that assets such as workforce in place and goodwill are beyond the scope of the statutory definition of "intangible property." In addition, the Act removes the qualification that intangible property under Section 936(h)(3)(B) must have substantial value independent of the services of an individual. As a result, certain transfers of such assets by a U.S. person to a foreign corporation will be subject to Section 367(d) or 482.

The Act also requires Treasury to issue regulations that would, for purposes of applying the outbound transfer rules under Section 367(d) or the transfer pricing rules under Section 482, require the valuation of intangible properties on an aggregate basis or on the basis of realistic alternatives to such transfers, in each case, if Treasury determines that such a basis is the most reliable means of valuation.

These provisions apply to transfers in taxable years beginning after December 31, 2017. However, the Act expressly provides that the changes to Section 936(h)(3)(B) are not to be construed as creating an inference as to the application of the prior version of the section.

Certain Related Party Amounts Paid or Accrued in Hybrid Transactions or with Respect to Hybrid Entities

The Act adds new Section 267A, which disallows a deduction for interest or royalties paid or accrued to a related party pursuant to a "hybrid transaction" or by or to a "hybrid entity" if such amount is not included in the income of such party under the local tax laws of the country of which such related party is a resident or if such party is entitled to a deduction with respect to such payments under the local tax laws of such country.

For purposes of this rule, a "hybrid transaction" is any transaction, series of transactions, or instrument one or more payments with respect to which are treated as interest or royalties for U.S. tax purposes but not so treated under the local tax laws of the country of which the recipient is a resident. A "hybrid entity" is an entity that is treated as fiscally transparent under U.S. tax law but not so treated under the local tax laws of the country of which the recipient is a resident, or vice versa.

This provision is effective for taxable years beginning after December 31, 2017.

Changes to Foreign Tax Credit System

Changes to Indirect Foreign Tax Credit Rules

The Act repeals Section 902, which allows a domestic corporation to claim an indirect foreign tax credit with respect to dividends it receives from a foreign corporation in which it owns 10% of the voting stock.

The Act modifies Section 960, which allows a domestic corporation to claim an indirect foreign tax credit with respect to Subpart F inclusions. Under the Act, the foreign tax credit is calculated based on current-year foreign taxes paid (rather than a cumulative foreign tax pool) with respect to the relevant item of Subpart F income. The Act also includes provisions addressing distributions of previously taxed income by a CFC to a domestic corporation (or by a lower-tier CFC to an upper-tier CFC).

These provisions apply to taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of United States shareholders in which or with which such taxable years of foreign corporations end.

Separate Foreign Tax Credit Limitation Basket for Foreign Branch Income

In general, under Section 904, a taxpayer is permitted to claim a foreign tax credit in an amount equal to the U.S. tax imposed on such taxpayer's foreign source income. This limitation applies separately to the taxpayer's "general basket" and "passive basket" income.

The Act adds as a new basket "foreign branch income," which is defined as the business profits of a U.S. person that are attributable to one or more qualified business units in one or more foreign countries. However, foreign branch income does not include any income that is otherwise treated as passive basket income.

This provision is effective for taxable years beginning after December 31, 2017.

Source of Income from Sales of Inventory Produced by the Taxpayer

Under current law, the source of a taxpayer's income from the sale or exchange of inventory property produced (in whole or in part) by the taxpayer in the United States and sold outside the United States (or vice versa) is generally sourced 50% to the place of production and 50% to the place of sale (based on title passage rule).

The Act modifies these rules and provides that the source of such income is determined solely based on the location of production with respect to such inventory property.

This provision is effective for taxable years beginning after December 31, 2017.

Election to Increase Percentage of ODL Recapture as Foreign Source Income

Under current law, Section 904(g) allows a taxpayer with an overall domestic loss (ODL) to recapture such ODL by recharacterizing U.S. source income earned in succeeding taxable years as foreign source to the extent of the lesser of the ODL or 50% of the taxpayer's U.S. source income in such year.

The Act amends Section 904(g) to allow a taxpayer to elect a percentage between 50% and 100% with respect to ODLs that arose prior to January 1, 2018 in determining the amount of U.S. source income earned in a succeeding year that it may recharacterize as foreign source income.

This provision is effective for ODLs in existence prior to January 1, 2018, and the election may only be made during taxable years beginning after December 31, 2017, and before January 1, 2028.

The Base Erosion Anti-Abuse Tax (BEAT)

BEAT is a minimum tax on multinational corporations that have at least $500 million of annual domestic gross receipts (averaged over a 3-year period) and a "base erosion percentage" of 3% or higher (2% or higher for certain banks and registered security dealers) for the taxable year. BEAT generally is the excess of

- 10% (5% for taxable years beginning during 2018) of the taxpayer's modified taxable income (generally, its taxable income plus the base erosion tax benefit amount (including the base erosion percentage of an NOL deduction)) over
- an amount equal to the taxpayer's regular tax liability reduced by certain credits, except for certain business tax credits, including up to 80% of the value of production tax credits under Section 45 of the Code and investment tax credits under Section 48 of the Code.

For taxable years beginning after 2025, the 10% limit is increased to 12.5% and certain credits are treated differently for purposes of determining a taxpayer's regular tax liability. For example, after 2025, production tax credits and investment tax credits will no longer offset any portion of the BEAT.

For this purpose, a corporation's "base erosion percentage" generally equals the aggregate amount of "base erosion tax benefits" of the corporation for the taxable year, divided by the aggregate amount of deductions allowable to the corporation for the taxable year. A "base erosion tax benefit" generally means (i) any deduction allowed with respect to a base erosion payment, (ii) in the case of a base erosion payment with respect to the purchase of depreciable property, any deduction allowed for depreciation (or amortization in lieu of depreciation) with respect to the property acquired with such payment, or (iii) any reduction in gross receipts with respect to a payment described above made to a related foreign corporation that became a surrogate foreign corporation after November 9, 2017 or made to a member of an expanded affiliated group that includes such surrogate foreign corporation. A "base erosion payment" generally is a deductible payment by the corporation to a foreign related party (subject to certain exceptions).

This provision is effective for payments paid or accrued in taxable years beginning after December 31, 2017.

Shareholders Not Eligible for Preferential Tax Rate on Dividends from Inverted Companies

Certain dividends from "qualified foreign corporations" are subject to a reduced rate of tax. Such qualified foreign corporations include corporations incorporated in a U.S. possession and certain corporations that are eligible for benefits of an income tax treaty with the United States and is approved by Treasury as satisfactorily providing for an exchange of information.

The Act provides that dividends from a surrogate foreign corporation (as defined under Section 7874) are not eligible for reduced tax rates unless such corporation is deemed to be a domestic corporation under Section 7874.

This provision is effective for dividends paid after the date of enactment of the Act and will apply only to dividends from foreign corporations that became surrogate foreign corporations after the date of enactment of the Act.

Sale of a Partnership Interest by a Foreign Person

Under the Act, gain or loss realized by a foreign corporation or a foreign individual from the sale or exchange of an interest in a partnership engaged in a U.S. trade or business is treated as effectively connected with a U.S. trade or business to the extent that the sale of all the partnership assets would have produced effectively connected gain or loss. This provision applies to sales, exchanges, and dispositions occurring on or after November 27, 2017. This provision repeals the result in *Grecian Magnesite Mining v. Commissioner*, 149 T.C. No. 3 (2017), where the Tax Court held that a foreign partner was not subject to U.S. tax on sale of a partnership interest, rejecting the holding of Rev. Rul. 91-32 to the contrary.

The Act also amends Section 1446 to require the transferee of a partnership interest to withhold 10% of the amount realized on the sale or exchange of a partnership interest unless the transferor certifies that it is not a nonresident alien individual or foreign corporation. This provision is effective for transfers occurring after December 31, 2017.

Repeal of Fair Market Value Method of Interest Expense Apportionment

Under current law, members of a U.S. affiliated group may elect to allocate and apportion their interest expense among U.S. source income and foreign source income based on either the adjusted tax basis or fair market value of their assets.

The Act now provides that interest expense must be allocated and apportioned based on the adjusted tax basis of their assets. This provision is effective for taxable years beginning after December 31, 2017.

Restriction on Insurance Business Exception to PFIC Rules

For purposes of determining whether a corporation is a PFIC, current law excludes certain investment income derived from the active conduct of an insurance business from being treated as passive income. The Act narrows this exception to generally apply only to a foreign corporation whose applicable insurance liabilities constitute more than 25% of its total assets determined on the basis of such corporation's applicable financial statement for the last year ending with or within the taxable year.

The Act provides potential relief to a foreign corporation that cannot meet the 25% test by giving the IRS regulatory authority to allow a U.S. person owning stock of such a foreign corporation to elect to treat it as a qualifying insurance company if its applicable insurance liabilities equal at least 10% of its assets, the foreign corporation is predominantly engaged in an insurance business, and the failure to satisfy the greater than 25% threshold is due solely to run-off-related or rating-related circumstances involving such insurance business.

This provision is effective for taxable years beginning after December 31, 2017.

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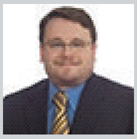

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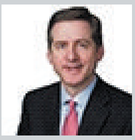

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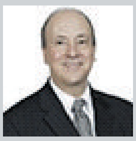

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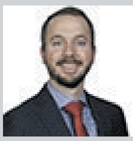

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