

INSIDE THE GLOBAL TAX PRACTICE

A SEMINAR ON U.S.
INTERNATIONAL TAX PLANNING

Fanny Karaman

Attorney at Law, Avocat à la Cour

Neha Rastogi

Law Clerk

Elizabeth V. Zanet

Attorney at Law

Michael Peggs

Transfer Pricing Economist

PROTECTING THE U.S. TAX BASE

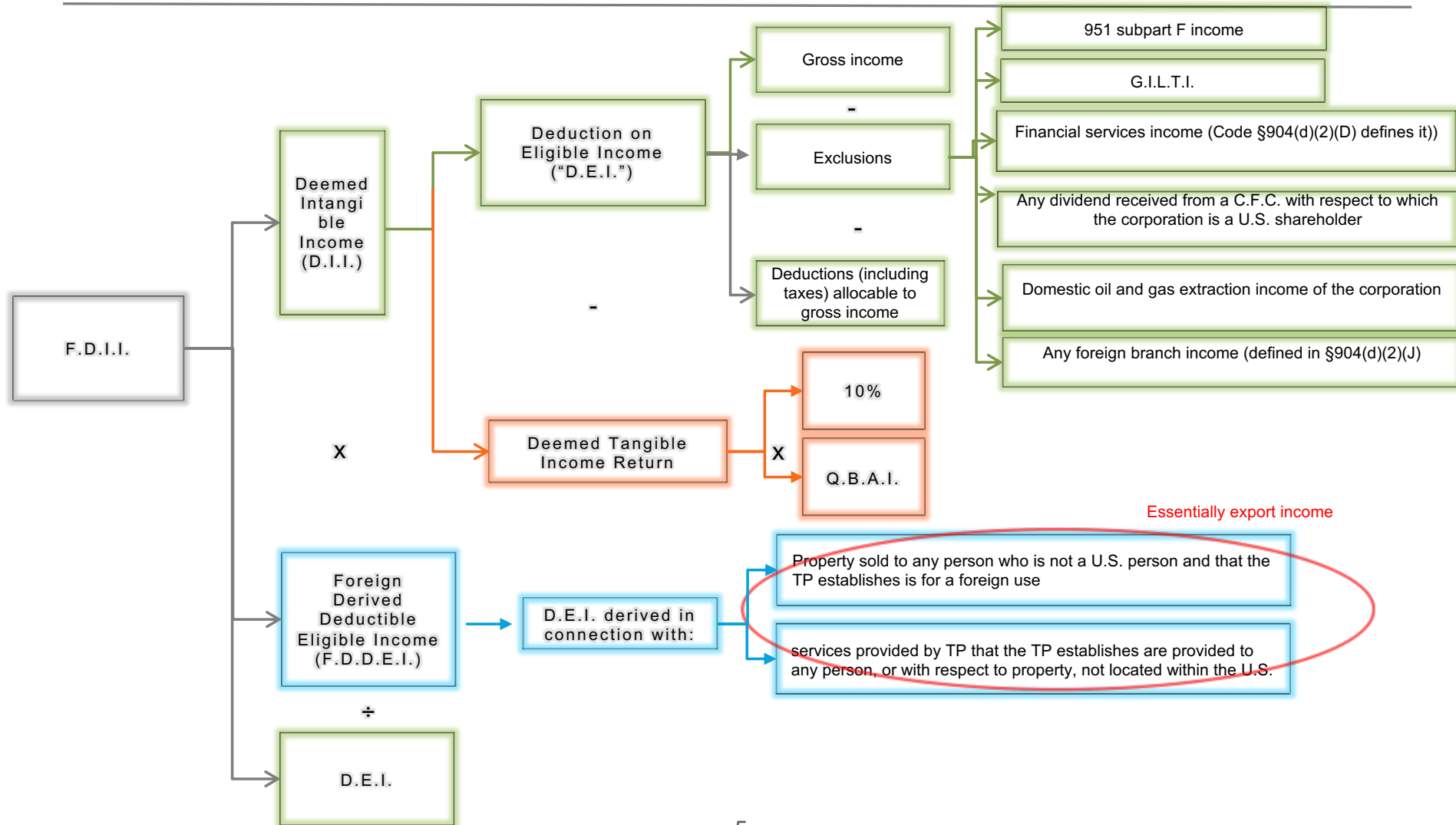
PART I – F.D.I.I.

Fanny Karaman

F.D.I.I.

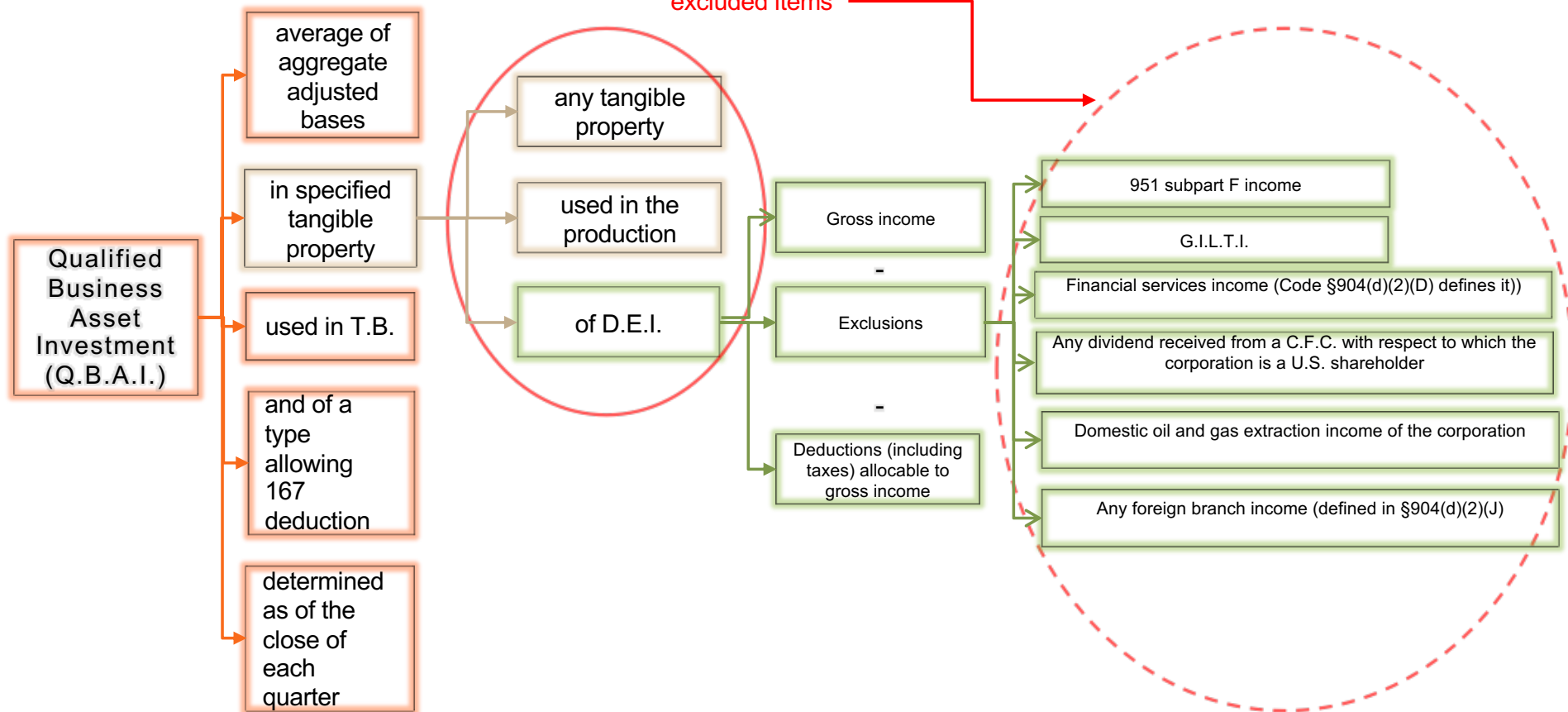
- F.D.I.I.: “Foreign Derived Intangible Income”
- Only available to U.S. C-corporations that are not R.I.C.'s or R.E.I.T.'s
- Effective for post 12/31/2017 tax years
- Corporate tax rate: Flat 21%
- 37.5% of F.D.I.I. is allowed as a deduction against F.D.I.I.
→ Reduced effective tax rate on F.D.I.I. = 13.125%
- For post-2025 taxable years, deduction decreases to 21.875%
- Limitation: if $F.D.I.I. + G.I.L.T.I. > \text{taxable income}$, pro-rata limitation applies

F.D.I.I.



F.D.I.I.

Essentially, property, plant and equipment not giving rise to these excluded items



F.D.I.I.

- Summary:
 - F.D.I.I. is computed with regard to the U.S. corporation's income (not income of C.F.C. as in G.I.L.T.I.)
 - F.D.I.I. essentially is portion of U.S. C corp's net income (w/o G.I.L.T.I., sub F and other exclusions) exceeding a deemed rate of return on depreciable tangible assets and that is attributable to certain export-type income.
 - $F.D.I.I. = (D.E.I. - 10\% \times Q.B.A.I.) \times \text{certain export } D.E.I./D.E.I.$

PART II – B.E.A.T.

Elizabeth Zanet

B.E.A.T. – In Brief

- Applicable Taxpayers who make deductible payments to foreign affiliates and reduce their U.S. tax liability (i.e., erode their U.S. tax base) to an amount that is less than 10% of taxable income without the base erosion payments, pay the Base Erosion and Anti-abuse Tax (“B.E.A.T.”)
- The B.E.A.T. is an additional tax on top of any other tax applicable to the taxpayer
- So, an Applicable Taxpayer may be subject to U.S. corporate income tax and B.E.A.T.

B.E.A.T. – The Rule

- Applicable Taxpayers are required to pay a base erosion tax amount determined by reference to their modified taxable income
- To determine the modified taxable income, taxpayers must compute their taxable income without regard to tax benefits of base erosion payments (see later for definition)

B.E.A.T. – Definitions

- Applicable Taxpayer
- Definition: a corporation, other than a R.I.C., a R.E.I.T., or an S-corporation, that has:
 - Average annual gross receipts for the three tax year period ending with the preceding taxable year of at least \$500 million, and
 - A “base erosion percentage” (discussed in future slides) of 3% or higher

B.E.A.T. – Definitions

- Base Erosion Payment
- Definition: any amount paid or accrued to a foreign person that is a related party for which a deduction, depreciation, or amortization is allowed
- Some exceptions:
 - Payments that are a reduction to gross receipts (including for costs of good sold)
 - This is good for manufacturers
 - Payment for a service that is subject to the service cost method under U.S. transfer pricing rules

B.E.A.T. – Definitions

- Base Erosion Percentage
- Computation:

Aggregate amount of base erosion tax benefits*

Aggregate amount of all deductions allowable** in computing taxable income

- If Base Erosion Percentage is 3% or higher, taxpayer may be an Applicable Taxpayer

*Generally, all deductions, depreciation, and amortization allowed with respect to a base erosion payment

**Taking into account base erosion tax benefits but not taking into account certain other deductions, i.e., net operating losses, participation exemption and deductions for payments for services not treated as base erosion payments

B.E.A.T. – Definitions

- “Related Party”
 - Any 25% owner of the taxpayer
 - Any person related, under certain attribution rules and rules for transactions between partners/partnerships, to the taxpayer or to any 25% owner
 - Any person related to the taxpayer under the U.S. transfer pricing rules (Code §482)

B.E.A.T. – Tax Amount

- The B.E.A.T. - Tax Amount
- Computation:

10% of modified taxable income *minus* (regular tax liability *minus* tax credits *plus* research credits *plus* 80% of energy credits)

= B.E.A.T.

- Step-by-step:
 - ✓ Add back to taxable income all base erosion payments to related parties to compute modified taxable income and take 10% of modified taxable income
 - ✓ Take regular tax liability (21% of taxable income) and subtract credits, but not research credits, certain energy credits, this is the “floor” (i.e., lowest tax liability before have B.E.A.T. liability)
 - ✓ Compare 10% of modified taxable income with floor
 - ✓ If the result is positive, the result is the B.E.A.T.

*5.0% in 2018; 12.5% starting in 2026

B.E.A.T. – Example

- U.S. Corp has taxable income of \$100X which yields a regular tax liability for the tax year of \$21X
- U.S. Corp claims the following credits, totaling \$4.5X:
 - \$2X in research credits,
 - \$1X of renewable electricity production credits, and
 - \$1.5X of other tax credits.
- B.E.A.T. amount:
 - 10% of modified taxable income
 - minus
 - Regular tax liability (\$21X) reduced by the excess of all the credits (\$4.5X) minus the sum of the research credits and 80% of the energy credits ($\$4.5X - \$2X + 80\% * \$1X = \$19.3X$)
- U.S. Corp will owe B.E.A.T. to the extent that its modified taxable income exceeds \$193X (10% of \$193X is \$19.3X).
- Under these facts, with \$100X taxable income, U.S. Corp will pay B.E.A.T. if it deducts more than \$93X in base erosion tax payments.
- So, if modified taxable income is \$250X (because U.S. Corp had \$150X of base erosion tax payments), then $\$25X > \$19.3X$ and the B.E.A.T. is difference of \$5.7X
- U.S. Corp has a total tax liability of $\$16.5X + 5.7X = \$26.7X$

LIFE OF A FOREIGN STUDENT: U.S. TAX CONSEQUENCES & WORKING IN A U.S. FIRM

Neha Rastogi

You Are Special!

- You are a Nonresident alien
- Taxed only on U.S. source income (*earned in the U.S.*):
 - **F.D.A.P.**
Withholding Tax @ 30% on Gross amount of F.D.A.P.
 - Dividends from U.S. corporations
 - Rental income
 - Winnings from gambling/ lottery in the U.S.
 - **E.C.I.**
Taxed on Net basis at ordinary rates- range from 10% to 37%
 - Salary from working as a research assistant for a professor at your law school
 - Stipend from working as an intern in a law firm



You Are Special!


- **Foreign students are treated as being engaged in a U.S. Trade or Business**
 - Income earned from personal services is E.C.I. taxed on net basis at ordinary rates- highest marginal rate @ 37%
 - Reduced tax rate of 14% on certain items
- **Exempt from Social Security and Medicare Taxes @ 7.65%**

Scholarships

- Usually, scholarships granted by the U.S. educational institutions to pay for the tuition fees and books are not taxed in the U.S.
- Scholarship towards living expenses, i.e., accommodation, food or any other expense is not exempt. This amount is taxed at a reduced rate of 14% as opposed to 37%.
- The reduced rate of 14% is available only to foreign students.



Terms & Conditions Apply

- The non residential status is available to a foreign student only for 5 calendar years.
 - Presence in the U.S. for a part of the year is counted as 1 full year.
 - If you arrive in the U.S. on December 31, 2017, then 2017 will be counted as one full year. Therefore, you will be able to enjoy the non residential status for just another 4 years, i.e., 2018, 2019, 2020, and 2021.
- 
- Consequences after the expiry of 5 calendar years:
 - Worldwide income gets taxed in the U.S.
 - The reduced tax rate of 14% on non-qualified scholarships and exemption from Social Security and Medicare Taxes is not available after the expiry of 5-year period.

Terms & Conditions Apply

5 year-period is subject to an Exception

- Benefit extends beyond 5 calendar years if you can demonstrate that you have a closer connection with a foreign country than the U.S.
- Closer connection is demonstrated by showing that you do not have an intention to permanently reside in the U.S.
- Factors to show such intention:
 - Permanent home in a country outside of the U.S.
 - Family is located outside of the U.S.
 - Place where you regularly vote
 - Place where you keep your valuables
 - Place of future employment
 - Which country do you have the driving license of?

Don't Get Tempted!

- Some tax deductions and credits are available only to U.S. residents and citizens.
- A non resident student claiming such deductions or credits may be seen as waiving its non resident status.
- The I.R.S. may argue that none of the benefits that are otherwise available to a foreign student will be available to the student who claimed the deduction!



Don't Get Tempted!

EXAMPLE:

- American Opportunity Tax Credit and Lifetime Learning Credit are education credits that reduce the tax owed.
- These credits can reduce the taxes by \$2,500.
- Education Credits are only available to a U.S. resident or a U.S. citizen. If a nonresident student claims these credits, the I.R.S. may view it as waiving the non resident status.
- Thus, the tax benefits otherwise available to a non resident student will no longer be available.

Always Check The Tax Treaty

- A French student who comes to the U.S. to study is not taxed in the U.S. on the first \$5,000 earned from providing personal services in the U.S.
- The exemption increases to \$8,000 if the French individual is an employee of a French employer and he comes to the U.S. either to:
 - to acquire technical or professional experience OR
 - to study.



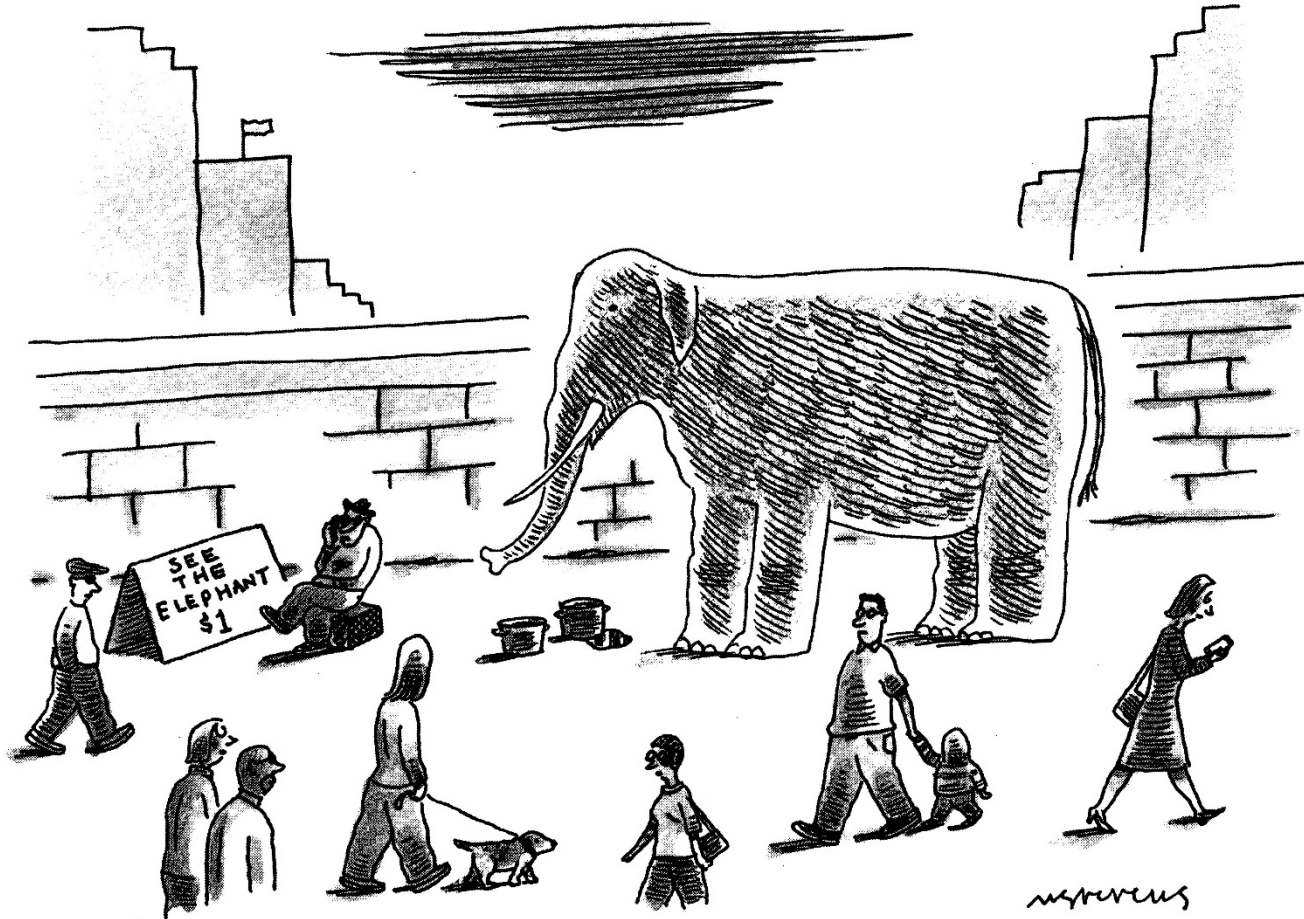
Remember To Report!!

- **If you earn income in the U.S.:**
 - Form 1040 NR
 - Form 8233 if claiming treaty benefits for personal services
 - Form 8833 if claiming treaty benefits for reduced withholding on other income, like dividends (taxed at 15% under the Treaty)
 - Form 8316 for refund of Social Security Tax if erroneously withheld on the Wages
 - Form 8843 to inform the I.R.S. about your nonresidential status
 - Must be filed even if no income in the U.S.



HOW TO MANAGE TRANSFER PRICING CONTROVERSY

Michael Peggs



"Business is terrible."

I.R.S. Audit Issues

- Inbound Distributor Campaign from LB&I – March 2017
- Renewed interest in best method selection – January 2018
- Training ground for new examiners
- Mid-sized companies viewed as non-compliant
- Companies benefit from the presence of long tenured management
- People and their business activities matter, so interview preparation is important

Managing a Transfer Pricing Audit

- Put a team together (accountant, attorney, economist)
- Manage communication with the exam team
- Keep the client up to date through uncertain periods
- Gauge involvement of client in meetings with the I.R.S.
- First-person information about the business and transaction conditions is viewed as relatively credible

Double Tax Case Resolution

- Cases often too small for APA program
- Not a priority for Competent Authority
- Cost of recovering double tax is high, so narrow down the issues and adjustments first
- Carefully consider taking the case to Appeals before Competent Authority

Important Notice

This presentation is not intended to be legal advice. Reading these materials does not create an attorney-client relationship. The outcome of each case stands on its own merits.