Check-the-Box Elections for Foreign Subsidiaries and Branches: Achieving Optimal Tax Treatment Through Entity Selection

WEDNESDAY, APRIL 20, 2022, 1:00-2:50 pm Eastern

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Check-the-Box Elections for Foreign Subsidiaries and Branches: Achieving Optimal Tax Treatment Through Entity Selection

Planning Tips & Structuring Considerations including:

- US Entity Classification Regulations – Key Operating Rules and Default Categories
- Final Regulations governing the new GILTI High-Tax Exclusion;
- Outbound Transfers and the Foreign Branch Tax Credit Limit Basket;
- Anti-Hybrid Restrictions of § 267A;
- Disposition of Partnership Interests by Foreign Partners under § 864(c)(8)
- Preparing IRS Form 8832 and Late CTB Elections

Agenda

I. Overview of U.S. Tax Stakes for Foreign Entity Selection

II. Basic Entity Classification Rules of the United States

- A. Identifying when a de facto entity has been formed for U.S. tax purposes (state law not controlling)
- B. When entity selection becomes "relevant" and basic operating rules
- C. Domestic and foreign "default entity classification" rules

III. Key Anti-Tax-Deferral Regimes if Foreign Sub is classified as a "Corporation"

IV. Section 962 Election

V. GILTI Regime and the Final GILTI High-Tax Exclusion Regulations

VI. Other Considerations and Tax Strategies Relevant to Foreign Entity Selection

- A. Planning into Subpart F to avoid GILTI (and vice versa)
- B. Check-and-Sell Transactions
- C. CTB to flow-through treatment to combine QBAI or avoid Code § 59A BEAT
- D. Outbound transfers to foreign "corporations" vs. outbound transfers to foreign "partnerships"
- E. Disposition of partnership interests by foreign partners under Code § 864(c)(8)
- F. Final Anti-Hybrid Regulations issued under Code § 267A (brief overview)

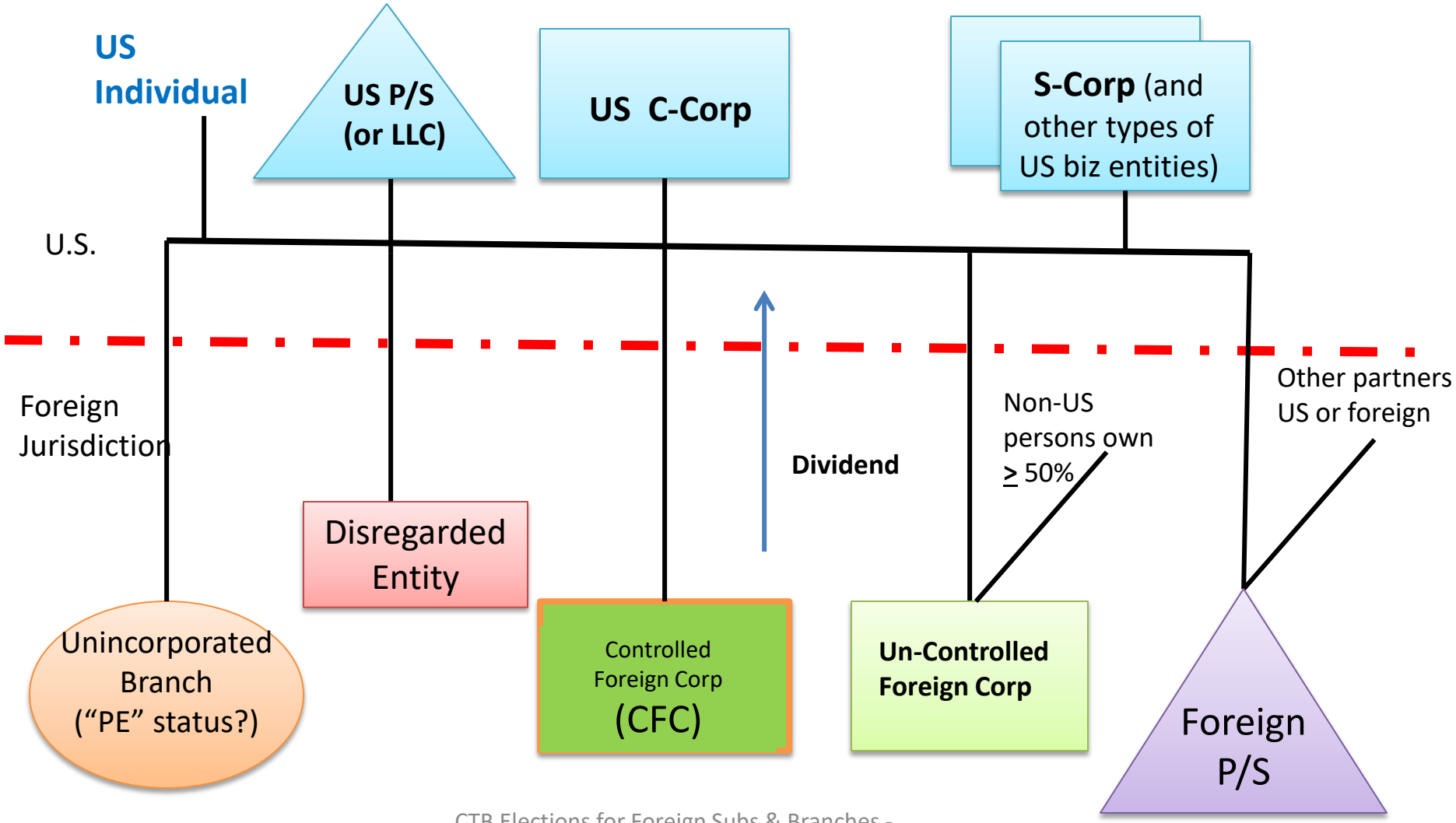
VII. Preparing IRS Form 8832, and Late Elections (Code § 9100 Relief)

VIII. Key Takeaways, Final Remarks, and Q&A

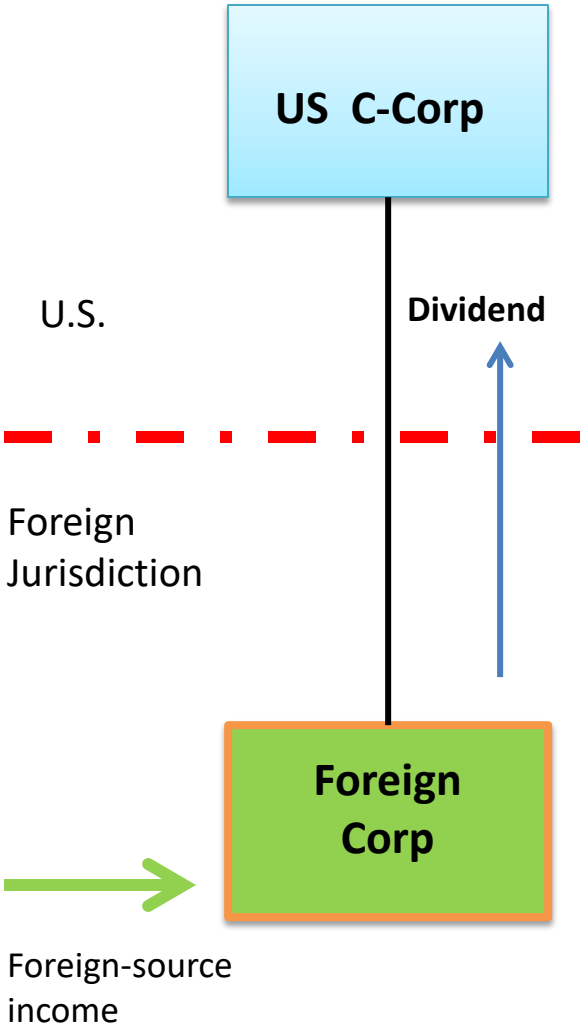
I. Overview of U.S. Tax Stakes in Foreign Entity Selection

Overview of Tax Stakes in Business Entity Selection

General Rule: *When a foreign venture rises to the level of "permanent establishment" status, then foreign entity selection becomes more relevant, and an entity choice needs to be made. Traditionally—before the 2017 U.S. Tax Act (TCJA)--the choice was between primarily between "foreign E&P tax deferral" or "no deferral."*



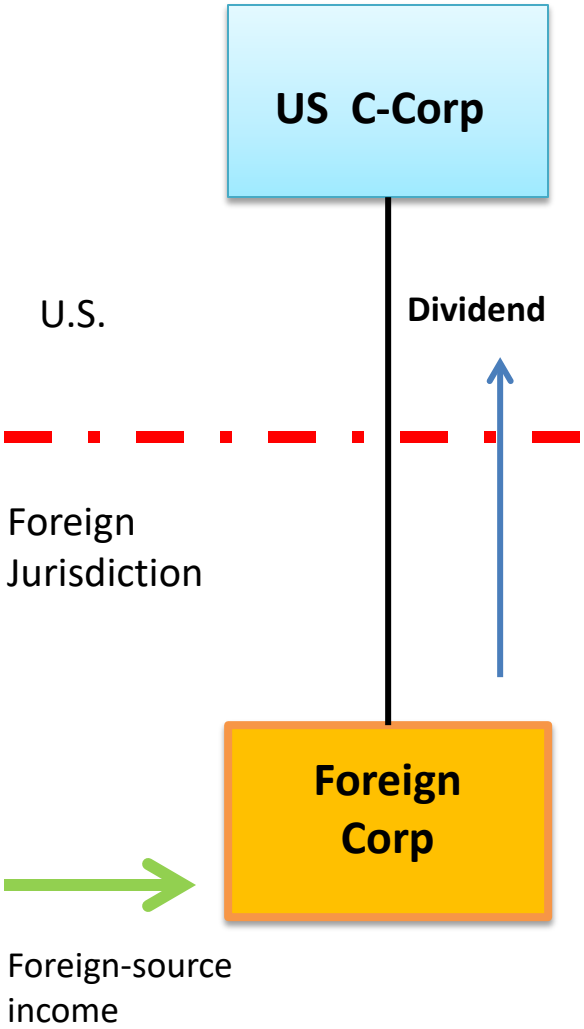
2017 TCJA Drastically Changed How a Foreign Sub's Income is Taxed



BEFORE the 2017 US Tax Act

- **General Rule:** United States generally taxes US corporations on a "worldwide" basis—*i.e.,* US corporations taxed currently on both US-source income and foreign source income they receive. (Contrast with a pure "territorial jurisdiction," which taxes its resident corporations only on income earned within its borders—not on foreign-source dividends and other foreign income).
- **Policy for Worldwide ("Residence-Based") System:** Belief that capital is allocated more efficiently when investors' choices about *where to invest* are not distorted by tax considerations. Economists believe it is more efficient if investments are made on the basis of pure economic fundamentals.
- **Deferral "Privilege" Exception:** **If a FOREIGN corporate Sub (of US corporate parent- as per diagram) earns foreign-source income, US corporate tax is not imposed on the foreign Sub's income unless and *until it is repatriated* to the US—in an actual or deemed dividend. (Indefinite tax deferral is tantamount to a complete tax exemption due to time-value of money.)**
- **Policy Rationale:** US-owned foreign Subs need a "level playing field" to compete and should not have to pay both foreign and US taxes when their competitors do not. Thus, U.S. tax deferral is allowed so long as the foreign Sub can be viewed as truly competing in an active trade/business in its relevant market abroad. However, to the extent the foreign Sub receives income that is either "passive" or looks like "conduit income" (i.e., earned through an low-tax branch/tax haven), the deferral "privilege" ends w/respect to that income, which is then taxed currently to its US shareholder(s) under one of several statutory anti-abuse regimes. Rationale: Foreign Sub is just there for tax advantages—not to compete in a foreign trade/business (i.e., "capital import neutrality" policy objective no longer being served).
- **Foreign Tax Credits**: The corporate income taxes imposed by U.S. upon actual or deemed repatriation of a foreign Sub's E&P may generally be offset with the foreign taxes already paid on that E&P via a tax credit (to extent it eliminates double juridical taxation).

Post – 2017 TCJA: Generally, no more U.S. tax deferral – foreign sub's E&P is either taxed currently or exempted



AFTER the 2017 US Tax Act

- **General Rule:** United States still generally taxes its US corporations on a "worldwide" basis—*but* at a much lower rate—i.e., 21% (down from 35%). However, the corporate tax base is broader with more foreign Subs' E&P subject to US tax. Also, there is some foreign-source income that is completely exempt from U.S. corporate taxation . Thus, new system is still a "hybrid system" exhibiting attributes of both a residence-based AND territorial system.

- **"Deferral Privilege" Exception is formally eliminated:** Now, all income of a foreign subsidiary owned by a U.S. corporation will be either:

  - **Taxed currently by US** (either under one of the pre-existing anti-abuse regimes (PFIC or expanded Subpart F) **OR** under the new very broad category of §951A "GILTI" income (*Global Intangible Low-Taxed Income*), which functions as a minimum tax , which can reach a foreign Sub's income even if it's not passive or conduit income; **OR**

  - **EXEMPT from U.S. corporate taxation (forever).**

Three categories of foreign-source income of foreign Subs are now EXEMPT . *But these may not amount to much due to the breadth of the new GILTI minimum tax.* They include:

1. CFC's earnings attributable to the 10% notional return in the GILTI regime (QBAI), which qualifies for the § 245A DRD when repatriated:
2. Income of 10% corporate "US Shareholders" of foreign Subs that do not qualify as CFCs (but do qualify as "specified foreign corporations" and so get the § 245A DRD); and
3. Pre-1987 E&P accumulated by foreign Subs, but only to extent of the pro rata share owned by 10% U.S. CORPORATE shareholders, since the §965 Transition Tax does not apply to those earnings and the §245A DRD applies when repatriated.

- **In Sum**: U.S. still has a "hybrid system" –i.e., part Residence-based (perhaps more so now) and part Territorial. Despite its new territorial attributes, the purview of US corporate tax is probably greatly expanded… but at a much LOWER rate—21% (vs. the former 35%).

Overview of U.S. Tax Stakes for Foreign Entity Selection: Comparing U.S. statutory tax rates and limits on foreign tax credit utilization

	Offshore				Onshore		
	§245A DRD	§951(a) Subpart F	§951A GILTI	Foreign branch	§956 Invest US property	§250 FDII	Non-FDII
Effective rates (%)	0	21	10.5	21	21	13.125	21
Foreign tax credits (%)	None	100%	80%	100%	100%	100%	100%
FTC Carryforward	None	10-yrs	None	10-yrs	10-yrs	10-yrs	10-yrs
Other	Creates exempt income/ partially exempt asset For corps, PTI generally means little 245A	GL or passive	**"New" Separate Basket**	**"New" Separate Basket**	Converts Exempt Income Multiple year FTCs?	Most income U.S. source – no FTCs	Most income U.S. source – no FTCs Avoid/ get in FDII

II. Basic Entity Classification Rules of the United States

- Background and Historical Context
- Identifying when a de facto entity has been formed for U.S. tax purposes (state law not controlling)
- When does entity categorization becomes “relevant” (and why do you need to pay attention to this)?
- Key operating rules of the “Check-the-Box” Regulations, including the domestic and foreign “default entity classification” rules
- Expansion of Subpart F’s CFC regime; downward attribution rules

Background

- In late 1996, IRS and U.S. Treasury issued final so-called "Check-the-Box Regulations" under Treas. Reg. § 301.7701.
- Final Regs allowed any "eligible entity" (as defined) to ELECT its federal income tax classification—*i.e.*, as either a "corporation" or "partnership"
- Stated policy reasons for elective entity classification system:
  - **Simplification of pre-1997 classification system,** which required taxpayers or their advisors to examine the entity's organizational documents and the law in which the entity was organized, and to continually monitor the entity and the law for changes so as to avoid inadvertent classifications.
  - **Fairness**. Pre-1997 classification system heavily favored well-advised taxpayers who had the resources to pay for sound tax advice. (This policy argument may not be as true in the international context because wealthier taxpayers are the ones that usually have cross-border issues.)
  - **Efficiency.** New classification system seen as reducing transaction costs.

Entity's classification is critical for both legal and tax reasons

- "Corporation" (Subchapter C applies – i.e., §§ 301--385)
  - ***Shareholders are not liable on entity's debts*** --instead they are insulated and creditors generally cannot reach beyond the corporate veil to their personal assets. (This is a KEY reason why some kind of "limited liability" entity needs to be formed).
  - ***But two-levels of tax:*** Income tax is imposed once at corporate level (§11) and again at the shareholder level (§ 301(a)) when that income is distributed as a §316 dividend. (Exception: S-Corps, which are not taxed at entity level and which require a separate "S-election.")
- "Partnership" (Subchapter K applies – i.e., §§ 701--777).
  - ***Partners (at least the GP) are personally liable***. (Exception: limited liability partnerships (LLPs) which emerged in US States in 1990s, along with LLCs.)
  - ***Income is not taxed at entity level***. Instead, income, profits, and losses are treated as "flowing thru" to the partners who are taxable on that income, whether or not the profits are actually distributed. However, income & tax attributes are often computed & characterized at the level of the partnership entity. (Exception: publicly traded partnerships are taxed like C-Corps.)

Pre-1997 Entity Classification Rules

- From 1960 until final adoption of CTB Regs, an entity's classification as either a "corporation" or "partnership" was determined by the multi-factor **"Kintner Regs"** (named in response to a 9th Circuit Court decision, *U.S. v. Kintner*, 216 F.2d 418 (9th Cir. 1954).

- Pre-CTB "Kintner Regs" enumerated 6 attributes of a corporate venture:

  1. Presence of associates **
  2. Objective to carry on business **
  3. Continuity of Life
  4. Centralized management of the business
  5. Limited liability of the owners of the entity
  6. Free transferability of interests. *

- Factors No. 1 and No. 2 were generally ignored because they are not helpful since they are common to both corporations and partnerships.
- An entity possessing 3 or more of remaining factors--i.e., No. 4 through No. 6--was a "corporation" for U.S. tax purposes
- Entity possessing 2 or fewer of remaining factors was a "partnership" for U.S. tax purposes

* *See* Treas. Reg. § 301.7701-2 (prior to 1996 amendment).

Policy Problems motivated the final 1997 adoption of the CTB Regs

- Although the former multi-factor, *Kintner* test seemed theoretically simple, they were in practice:
  - **Complex and expensive to apply** (and to continually monitor for changed circumstances and amended law)
  - **Uncertain** (often requiring an investigation into foreign company law)
  - **Vulnerable to Manipulation**
  - **Unfair** (Wealthier taxpayers had more opportunity to pay advisors to manipulate the factors.)
  - **Distortive of economic reality** (Transaction structures and locations, as well as organizing documents were designed to meet the desired tax classification—rather than economic needs of the business). *

* *See* Staff of Joint Committee on Taxation, "Review of Selected Entity Classification and Partnership Tax Issues, " JCS-6-97, 1 (Apr. 8, 1997) (hereinafter "JCT Study").

New LLC and LLP entity statutes rendered the multi-factor test obsolete

- In early 1990s, the multi-factor entity classification test was further complicated by new U.S. State laws that allowed for the creation of "limited liability companies" (LLCs) and "limited liability partnerships" (LLPs).
- All 50 U.S. states eventually adopted LLC statutes, which typically provided for both limited liability and centralized management—but not continuity of life or free transferability of interests.
- Thus, failing 2 of the last 4 *Kintner* factors, taxpayers could organize an LLC that would insulate LLC members from personal liability, yet be taxed as a partnership (with only one layer of tax).
- Eureka! *LLC statutes gave even unsophisticated taxpayers the opportunity to essentially elect the federal tax classification of their companies: Organize the company under the state's "incorporation" law and be taxed as a C-Corp OR organized as an "LLC" and be taxed as a partnership.*
- Some states adopted similar laws for LLPs (limited liability partnerships), PLLCs (professional limited liability companies), etc. (Extent of liability & other characteristics differs from state to state).

IRS Notice 95-14

- Acknowledging that LLCs had diminished the traditional distinctions between corporations and partnerships, IRS announced it was considering a move to an explicitly ELECTIVE system for categorizing entities.
- According to IRS, old system was costly to both taxpayers and the IRS, and had become essentially elective anyway.
- Longstanding debate raged over whether forthcoming elective system—the Check-the-Box Regs—should apply to foreign corporations in the international context.
- Final CTB Regs apply to both domestic and foreign business entities.

Key Definitions for "Check-the-Box" Regs

- **Domestic:** a corporation or partnership created or organized in U.S. or under U.S. law or any U.S. State, unless in case of P/Ss, a Treas. Reg. provides otherwise. IRC §7701(a)(4).
- **Foreign**: Respecting a corporation or partnership-one that is not "domestic." § 7701(a)(5).
- **Business Entity**: Broadly defined as "any entity recognized for federal tax purposes (including an entity with a single owner that may be disregarded as an entity separate from its owner under Reg. § 301.7701-3) that is not properly classified as a trust as defined in Reg. § 301.7701-4 or otherwise subject to special treatment under the Internal Revenue Code." *See* Reg. § 301.7701-2(a).
  - A "business entity" with 2 or more members = either a corporation or a partnership.
  - A business entity with only one owner = a corporation or is disregarded (i.e., treated like a sole proprietorship, branch, or division of the owner.
  - ***Caution – de facto entities:*** *Whether an "entity" exists at all for US federal tax purposes is a fundamental issue that remains unclear, and one that the CTB Regs do not resolve with "bright-line" rules. Local law definitions/registrations do not control whether an entity exists for US tax purposes. See slides below.*
- **Eligible Entity**: Any entity that meets 3 conjunctive requirements:
  - 1. Entity must exist separately from owners,
  - 2. Must be a "business entity" (i.e., not a trust), AND
  - 3. Must *not* be a "deemed corporation" as defined.
- **Deemed Corporation:** Reg. § 301-7701-2(b) provides that certain entities are automatically treated as "corporations" and not allowed to elect their tax classification. These so-called "per se corporations" include (1) entities formed under explicit U.S. state corporate statutes (not including the LLC statutes), and (2) certain foreign entities, as shown in the comprehensive list at Reg. § 301-7701-2(b). (There's about 100…)
- **"Per Se Corporation"**: This is only a common *slang tax term* referring to any foreign entity included in the "per se corporation" list in the above cited Reg. § 301.7701-2(b)(8). (The term "per se corporation" does not appear in the Code, but tax professionals use it all the time.)

Key Definitions for CTB Regs (cont'd)

- **Limited Liability**: With respect to "foreign eligible entities," limited liability exists if the member has no personal liability for the debts of, or claims against ,the entity by reason of being a member. This determination is based solely on the statute/law pursuant to which the entity is organized (i.e., foreign law not U.S. law). If that underlying statute/law allows the entity to specify in its organizational documents whether the member has personal liability, such documents may be relevant. If personal liability exists for purposes of this determination, it is not affected by any indemnity agreement. Reg. § 301.7701-3(b)(2)(ii).
- **Hybrid Entity**: A single business entity that is characterized inconsistently by two different tax jurisdictions relevant to a transaction or investment. *Eg.,* an entity that is viewed as a tax opaque corporation by one country, and as a flow-through partnership (or disregarded branch) by another country.
- **Regular Hybrid:** An entity that the U.S. views as a tax transparent partnership or disregarded entity, and another jurisdiction views as a corporation.
- **Reverse Hybrid**: An entity the U.S. views as a corporation, and the other country views as a flow-through partnership or branch.
- **Domestic Reverse Hybrid**: a reverse hybrid, but organized in the United States.

Key Operating Rules of the Check-the-Box Regulations - Reg. § 301.7701-2 and -3

- **General Rule:** Both domestic and foreign "eligible entities" are able to *elect* to be taxed as either a partnership or corporation for U.S. federal income tax purposes. *See* IRS Form 8832 ("Entity Classification Election").
- **Important Default classifications apply if no affirmative election is made.** *See* Reg. § 301.7701-3b.
- **Default Rules for Un-electing Domestic "Eligible Entities":**
  - Domestic entity w/multiple members : ***default = partnership.***
  - Domestic entity w/1 member only: ***default = disregarded entity (branch of its parent)***
  - (Note that un-electing eligible *domestic* entities default to tax transparency)
- **Default Rules for Un-electing Foreign "Eligible Entities":**
  - Foreign Entity where ALL members enjoy "limited liability": ***Default = corporation.***
  - Foreign Entity with 2 or more members and at least 1 member bears personal liability: ***Default = partnership.***
  - Foreign Entity where there is only 1 member total, and such member bears personal liability: ***Default = Disregarded Entity.***

When does classification of a foreign eligible entity (FEE) "become relevant"? Importance?

- **Foreign eligible entities (FEEs):** Unlike U.S. entities, foreign entities are subject to special rules as to when they must elect their classification for U.S. tax purposes.
  - FEEs formed on or after Oct. 22, 2003 have a classification ***only when it becomes relevant.***
  - FEEs formed before Oct. 22, 2003 have a classification ***even if not relevant.***
- **RULE: Classification of an FEE is relevant when *it affects the liability of any person for U.S. federal tax or information purposes.***
  - **Example**: FEE's classification would be relevant if US-source income is paid to the entity, and the amount to be withheld by the withholding agent would vary depending upon whether the entity is classified as a partnership or a corporation.
  - **Example:** FEE's classification also becomes relevant on date some duty arises that will be affected by such classification. (E.g., when a U.S. person acquires an interest in the FEE necessitating the filing of Form 5471--an Information Return of US Persons w/Respect to Foreign Corporations).

"Relevance of a foreign entity" Why is this determination so important??

- A foreign eligible entity is also deemed to be relevant on the *effective date* of its entity classification election.
- An entity whose initial classification is determined *by default* generally retains that classification until the entity makes an election to change its classification.
  - ***Caution*: *A change in the classification of an entity can result in inadvertent and unplanned tax consequences to the entity and/or its shareholders. Thus, it is critical to know if an entity's classification has already been determined under the default rules!***
    - ***Example:*** A change in the classification of a foreign branch to a corporation will be treated as a deemed outbound transfer of the branches assets to a foreign corporation under §367(a) (taxable).
    - ***Example:*** Changing the classification of a foreign corporation to a partnership is a deemed liquidation for U.S. tax purposes and may result in a deemed dividend equal to the "all E&P amount" or "§ 1248 amount" and the shareholder's increased basis in the entity.
- An initial CTB election for an entity that has ***never*** been previously relevant, however, ***does not result in a recognition event*** for U.S. tax purposes and therefore no basis step-up or step-down occurs!
- Consequently, the "relevance of the foreign entity" is critical in determining whether the entity classification election is treated as an "initial classification" or a "change in classification"—with only the latter being treated as a recognition event.

Has a *de facto* "entity" been formed at all for U.S. tax purposes? (May require analysis!) (1 of 3)

- **Local & foreign law definitions and registrations are NOT controlling:** "Whether an organization is an entity, separate from its owners for federal tax purposes is a matter of federal tax law and does not depend on whether the organization is recognized as an entity under local law." *See* Reg. § 301.7701-1(a)(3).
- **Reg. § 301.7701-2(a) defines "business entity" broadly** as "<u>any entity recognized for federal tax purposes</u> [including a single-member LLC treated as disregarded] that is not properly classified as a trust * * * or otherwise subject to special treatment under the [Code]."
- **Informal joint ventures & mere contractual arrangements "**may create a separate entity for federal tax purposes if the participants carry on a trade, business, financial operation, or venture and divide the profits therefrom." Reg. § 301.7701-1(a)(2).
  - **Regulatory example:** A separate entity may exist for federal tax purposes if co- owners of an apartment building lease space and in addition provide services to the occupants either directly or through an agent. But a joint undertaking merely to share expenses does not create a separate entity for federal tax purposes.
  - **Regulatory examples**: If 2 or more persons jointly construct a ditch merely to drain surface water from their properties, they have not created a separate entity for federal tax purposes. Similarly, mere co-ownership of property that is maintained, kept in repair, and rented or leased does not necessarily constitute a separate entity for federal tax purposes.

Has a *de facto* "entity" been formed at all for U.S. tax purposes? (2 of 3)

- In analyzing whether a de facto foreign entity has been formed, one should also think about the body of US case law that as developed in U.S. courts to determine whether a "partnership" has been formed.
- Code §§ 761(a) and 7701(a)(2) define the term "partnership for federal tax law purposes as follows:

  > [T]he term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a corporation or a trust or estate.

- When Congress enacted this broad definition of "partnership" in 1932, it was concerned that many multi-party business arrangements were slipping through the cracks of existing tax classifications. The legislative history reveals that Congress did not like the fact that the imposition of tax was being deferred by means of an artificial arrangement specifically designed to not be a corporation, trust, or estate.
- Logically, the question of whether a particular arrangement is a partnership (or creates a taxable presence at either the entity level or partner/owner level, for tax purposes) ***should*** begin with this Code definition, but, surprisingly, many cases that consider the issue do not even refer to it, and most fail to analyze it (including the majority opinions of two U.S. Supreme court seminal decisions).

Has a *de facto* "entity" been formed at all for U.S. tax purposes? (3 of 3)

- In both of the following seminal cases, the US Supreme Court drew definitional guidance from the commercial, non-tax law of partnerships, and infused an intent-focused test to determine when an entity exists for tax purposes. (Ironically, this is what Congress wanted to avoid!)
  - **Commissioner v. Tower**, 327 US 280, 286 (1946) ("A partnership is generally said to be created when persons join together their money, goods, labor, or skill for the purpose of carrying on a trade, profession, or business and when there is community of interest in the profits and losses.").
  - **Commissioner v. Culbertson**, 337 U.S. 733, 742 (1946)("The question in determining whether a family partnership is real for income tax purposes is whether, considering all the facts, (the agreement, the conduct of the parties in execution of its provisions, their statements, the testimony of disinterested persons, the relationship of the parties, their respective abilities and capital contributions, the actual control of income and the purposes for which it is used, and any other facts throwing light on their true intent), the parties in good faith and **acting with a business purpose intended to join together in the present conduct of the enterprise."**). (Emphasis added).
- Generally, these cases established **three requirements** that must be satisfied for an enterprise to be considered a partnership for tax purposes:

  (1) the parties must form the enterprise for the purposes of producing profits;

  (2) the profits must be shared jointly by two or more persons; and

  (3) the persons sharing the profits must have a proprietary interest in those profits.

- ***Has the intent-based analysis employed by the US Supreme Court been rendered moot by 1996 promulgation of the Check-the-Box Regs (with their bright-line rules)? NO--not likely!! Practitioners may still be required to analyze the parties' objective intentions in light of the existing case law because the parties' intent is still treated as a predominant element in determining whether any "entity" was formed in the first place (and/or whether an entity still exists), even though none was formed under local/foreign law.***

III. Key U.S Anti-Tax-Deferral Regimes if Foreign Subsidiary-Entity is classified as a "Corporation"

- How 2017 Tax Act Expanded Purview of Subpart F
- Identifying "Controlled Foreign Corporations" under the expanded attribution rules
- The "Global Intangible Low-Taxed Income" (GILTI) Regime
- Passive Foreign Investment Companies (PFICs)
- Overlap rules

IF the foreign sub-entity is a "corporation," *three key* U.S. anti-tax deferral regimes could apply

1. **<u>Subpart F's CFC Rules</u>:** If the foreign-subsidiary entity is properly classified as a "corporation," for U.S. tax purposes, AND meets the definition of a "controlled foreign corporation" (CFC), then Subpart F may apply (*i.e.,* Code §§ 951 – 964), as well as the many accompanying regulations promulgated thereunder.
   - **"Phantom income" effect to "U.S. Shareholders" of a CFC:** The CFC's E&P that falls within certain categories (*e.g.,* "foreign personal holding company income" as defined in §954(c) or "foreign base company sales income (§ 954(d) or foreign base company services income(§954(e) is imputed and taxed currently to "U.S shareholders" (defined in § 951(b)) even though such E&P is not physically distributed to them.
2. **<u>GILTI's income inclusion rules ("tested income" of a CFC)</u>:** If the foreign-subsidiary entity is properly classified as a "corporation" for U.S. tax purposes, AND is a CFC, then as of 2017, the provisions of the new "Global Intangible Low Taxed Income" (GILTI) regime may apply (to the extent that the income is not already being currently taxed under Subpart F, or as ECI, or otherwise exempted from GILTI). *See* § 951A.
3. **<u>Passive Foreign Investment Company (PFIC) Rules</u>:** If the foreign-subsidiary entity is classified as a "corporation" but does NOT meet the definition of "CFC," then neither the Subpart F rules nor the GILTI rules will apply BUT the foreign corporation may be a "PFIC" as defined in Code §1297. If it is a "PFIC" (even for a moment), then the draconian provisions of Code § 1291 can potentially apply to impose an interest charge on certain "excess distributions" or stock dispositions. An election to become a "qualified electing fund" (QEF election) may be made to avoid the interest charge, but the election makes "pass-through income" treatment mandatory. *See* IRC §§ 1293-1295.

Six ways the 2017 Act Expanded Purview of Subpart F

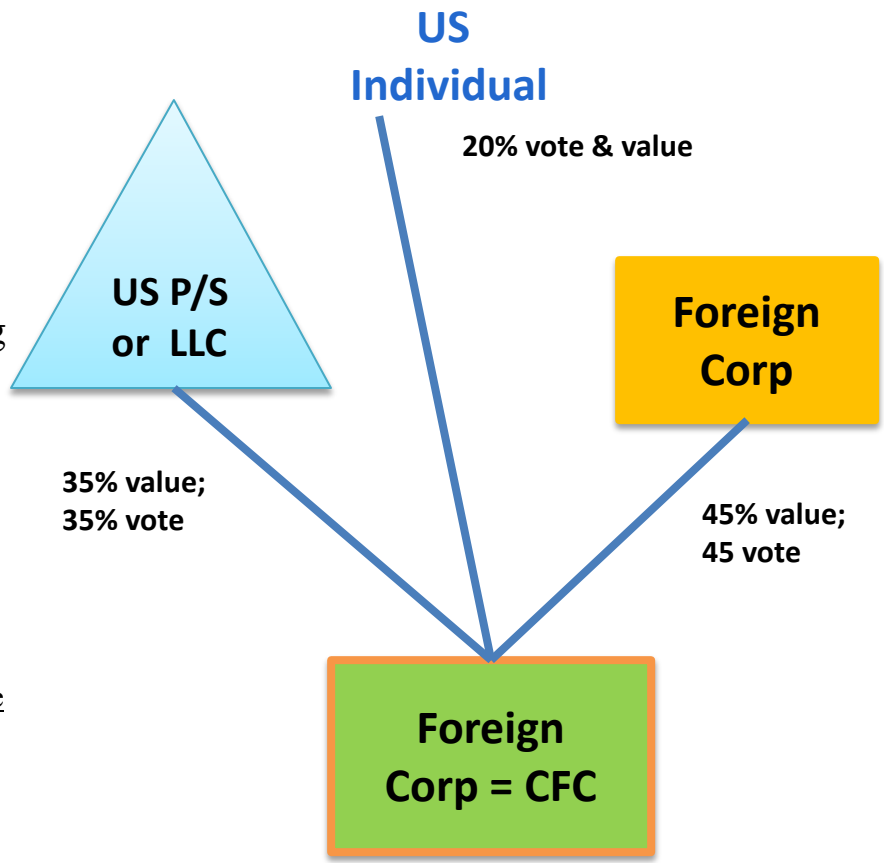
1. § 951(b) definition of "US shareholder" was broadened to include a value test -(after TCJA, the test for "US shldr" is a US person owning at least 10% of EITHER vote OR *10% of value* of a foreign corporation (directly, indirectly through foreign entities, or constructively through modified § 318 attribution rules).
2. Amended § 951(b) to provide that the new definition of "U.S. shareholder" applies "for purposes of this title," – (i.e., Title 26—the whole U.S. Internal Revenue Code)—instead of just for purposes of Subpart F as under pre-TCJA law.
3. Eliminated from § 951's income inclusion rule the requirement that a foreign corporation must be a CFC for at least "an uninterrupted period of 30 days" during any taxable year in order for a US shldr to be taxed. (Now a foreign corporation need only be a CFC for 1 day.)
4. Repealed IRC § 958(b)(4), which had (prior to repeal) turned-off the downward stock attribution rules of § 318(a)(3)(A) through (C) for purposes of imputing stock owned by a foreign person to a US person (in identifying US shareholders and CFCs).
5. Added a broad new category of income to Subpart F—*i.e.*, § 951A "Global Intangible Low Taxed Income" (GILTI). Although § 951A GILTI is not technically within § 952's definition of "Subpart F Income," GILTI is part of Subpart F, and GILTI's application thresholds are basically the same (*i.e.*, only "US shlders" in a "CFC" are taxed on GILTI inclusions, as that new residual category is defined).
6. Added , to very end of Subpart F, new § 965 --"Treatment of deferred foreign income upon transition to participation exemption system of taxation" (*i.e.*, the "Transition Tax" that applied in 2018)

KEY POINT: *When foreign "corporation" status is selected deliberately (or by default), it is now more likely that the foreign entity will qualify as a "controlled foreign corporation" (CFC), with its E&P being taxed currently to the U.S. shareholder—either under the Subpart F regime of Code § 951(a) OR under the "Global Intangible Low-Taxed Income" ("GILTI") regime of § 951A. So, if there will be "pass-through" treatment regardless of whether a foreign corporation or P/S is chosen,* ***the real stakes shift to the effective tax rate.***

2017 Tax Act - Expansion of Subpart F:

Basically, when does Subpart F regime apply?

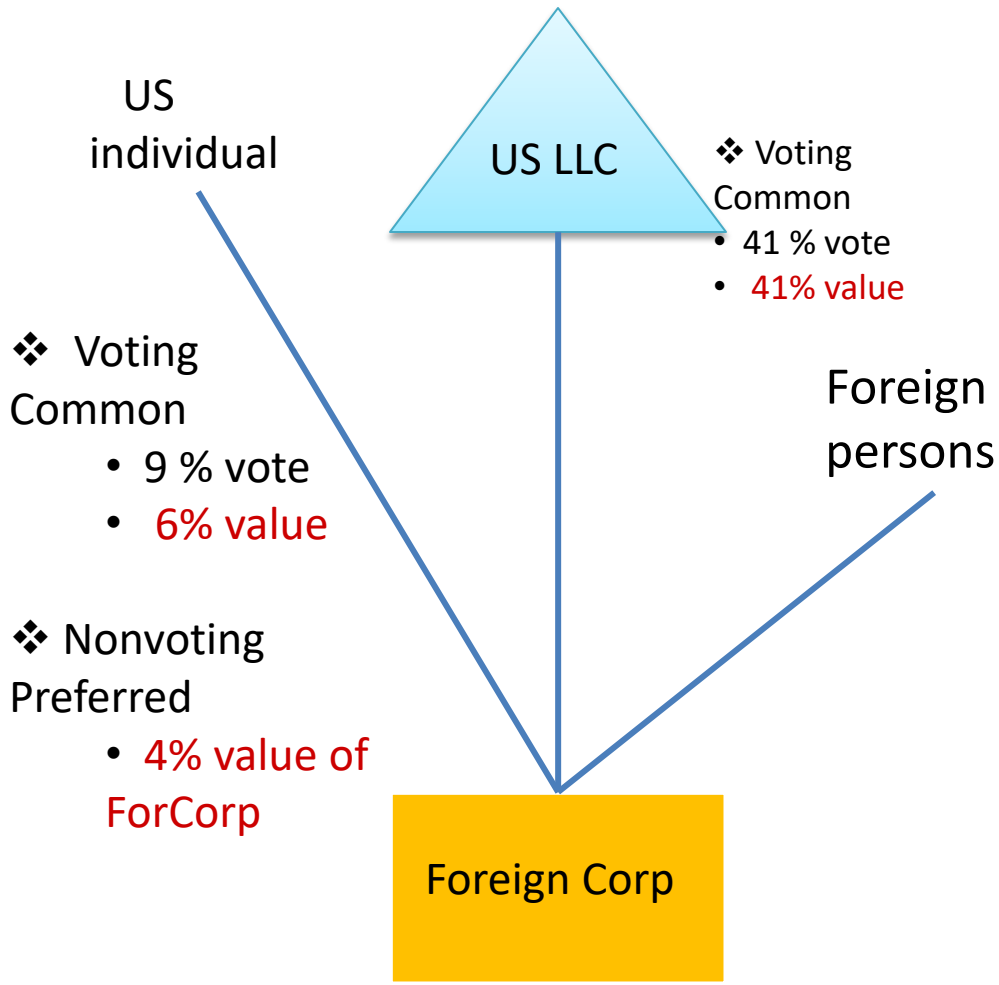
- Subpart F regime can potentially apply whenever there is a "controlled foreign corporation" (CFC).
- CFC is defined in § 958(a) as "any foreign corporation if > 50% of the total voting power OR > 50% of total value is owned by 10% "US shareholders" on any 1 day.
- For purposes of identifying "US shldrs" and testing for "CFC" status, stock ownership can be direct, indirect through foreign entities, or constructive. (Attribution rules of § 318 are incorporated by reference in Subpart F, but with modifications.)
- Beware of control premiums and value discounts ("drag along" & "tag along" rights)
- With respect to voting power, courts have looked *to power to control board of directors*. See Framatome v. *Cir.* 118 TC (2002) (because the veto powers and supermajority requirements prevented US shldr from exercising powers over Japanese corp ordinarily exercised by a domestic board of directors, US shareholder did not have > 50% voting power. Court relied on *Alumax v. Cir., 109 TC 133 (1997), aff'd 11th Cir.*



Foreign Corp is a "CFC" because the "US shareholders" (i.e., the US LLC and the US individual together own > 50% of the vote (and here, also 55% of the value). IF US individual owned only 5%, then there would be no CFC.

2017 Tax Act - Expansion of Subpart F:
"US shareholder" broadened to include 10% of vote ***OR VALUE***

- **PRE- TCJA law:** "US shareholder" defined as a US person owning stock representing 10% or more of the total voting power of all stock of the foreign corporation. § 951(b).
- Thus, a US person holding nonvoting preferred shares representing 10% of the VALUE was not treated as a "US shlder." (So not counted for purposes of determining whether a foreign corporation was a CFC. Nor would a person with < 10% VOTE be subject to US taxation under Subpart F.
- **POST-TCJA Law**: TCJA expanded definition of "US shareholder" to include a US person owning shares representing 10% or more of the VOTE OR VALUE
- **RIGHT:** US individual qualifies as a "US shareholder" of the Foreign Corp because she owns stock representing at least 10% of the foreign corporation's value.
- But IF the value of US individual's shares is only 9% of the Foreign Corp's total value, then US individual is not a "US shareholder" and her shares can not be counted to determine if Foreign Corp is a CFC. (Note that she also only owns 9% of vote.)
- Here, value of US individual's shares is critical. (If the value of her shares is only 9%, then Foreign Corp is not a CFC because US LLC does not own > 50% of vote or value. IF US individual's shares can be counted (because she has at least 10% of total value, then her ownership counts, and together US LLC and US individual own shares totaling > 50% of the total value of Foreign Corp.



2017 Tax Act - Expansion of Subpart F

Attribution rules of § 958 (a) & (b) - different purposes

§ 958 contains the rules for determining stock ownership. Subsections (a) and (b) serve different purposes, and contain distinct rules.

§ 958(a)(1) - General Rule: For purposes of Subpart F (other than § 960(a)(1)), stock owned means—

- § 958(a)(1) and (2):
  - stock owned *directly* (§ 958(a)(1) and
  - Stock owned *indirectly* through foreign entities, including a foreign corporation, foreign partnership, foreign trust, or foreign estate. § 958(a)(2). (Do not attribute up through domestic entities.)
- US shlds are taxed only on their direct and indirect ownership as determined under §958(a)(1) & (2)—not on their constructive ownership.
- § 958(b) defines "constructive ownership" of stock, for purposes of identifying a
  - "US shareholder" defined in § 951(b);
  - "CFC" defined in § 957;
  - "related person" as defined in § 954(d)(3); and
  - US shldr(s) that has "invested in US property" under through domestic corporations, pursuant to §956(c)(2).
- ***§ 958(b) expressly incorporates the familiar attribution rules of § 318(a), but modifies them in important ways with respect to attribution thresholds.***

Family Constructive Attribution Rules of § 318:

Incorporated in §958(b) and not changed by TCJA

Family Attribution

An individual is considered to own stock that is owned, directly or indirectly, by or for

- a spouse (unless legally separated by decree of divorce or separate maintenance),
- children,
- grandchildren, and
- parents.

However, the family attribution rules under §318(a)(1) do not treat an individual as owning stock actually owned by the individual's siblings, grandparents, great-grandparents, great-grandchildren, uncles, aunts, nephews, nieces, or cousins.

- Stock constructively owned by applying the family attribution rules cannot be attributed a second time to another family member. § 318(a)(5)(B). Thus, while shares of stock owned by a child are attributed to a parent, that stock cannot be reattributed from the parent to another child.
- **NO NRA to US person attribution:** Family attribution rules do not apply for purposes of attributing stock owned by a nonresident alien individual (NRA), other than a foreign trust/estate, TO to a US person (e.g., for purposes of identifying a US shldr). §958(b)(1).
- These rules remained unchanged under the TCJA.

How did § 958(b) modify the § 318(a) attribution rules, prior to the 2017 TCJA?

PRE-TCJA:

Section 958(b): Constructive attribution rules, for purposes of Subpart F, incorporate the attribution rules of § 318, but modify them as follows:

1) **NO NRA to US individual stock attribution:** In applying § 318(a)(1)(A), no stock of a non-resident alien is to be attributed to a US citizen or a US resident alien for purposes of making the US individual a "US shareholder" or § 954(d)(3) "related person" or identifying a CFC;

2) **Upward Attribution (*i.e.*, up TO owners of entities from the entities):** In applying §318(a)(2)(A) – (C), if a partnership, estate, trust, or corporation owns, directly or indirectly, more than 50 % of the total combined voting power of all classes of stock entitled to vote of a corporation, it shall be considered as owning ALL the stock entitled to vote. (Policy: effective control is assumed.)

3) **In applying § 318(a)(2)(C),** the phrase "10 percent" shall be substituted for the phrase "50 percent" used in subparagraph (C).

4) ***** Downward Attribution rules of 318(a)(3)(A) –(C) are turned OFF:** Such rules can never be applied so as attribute stock owned by a foreign person to a US person (*e.g.*, to make the US person a US shareholder).

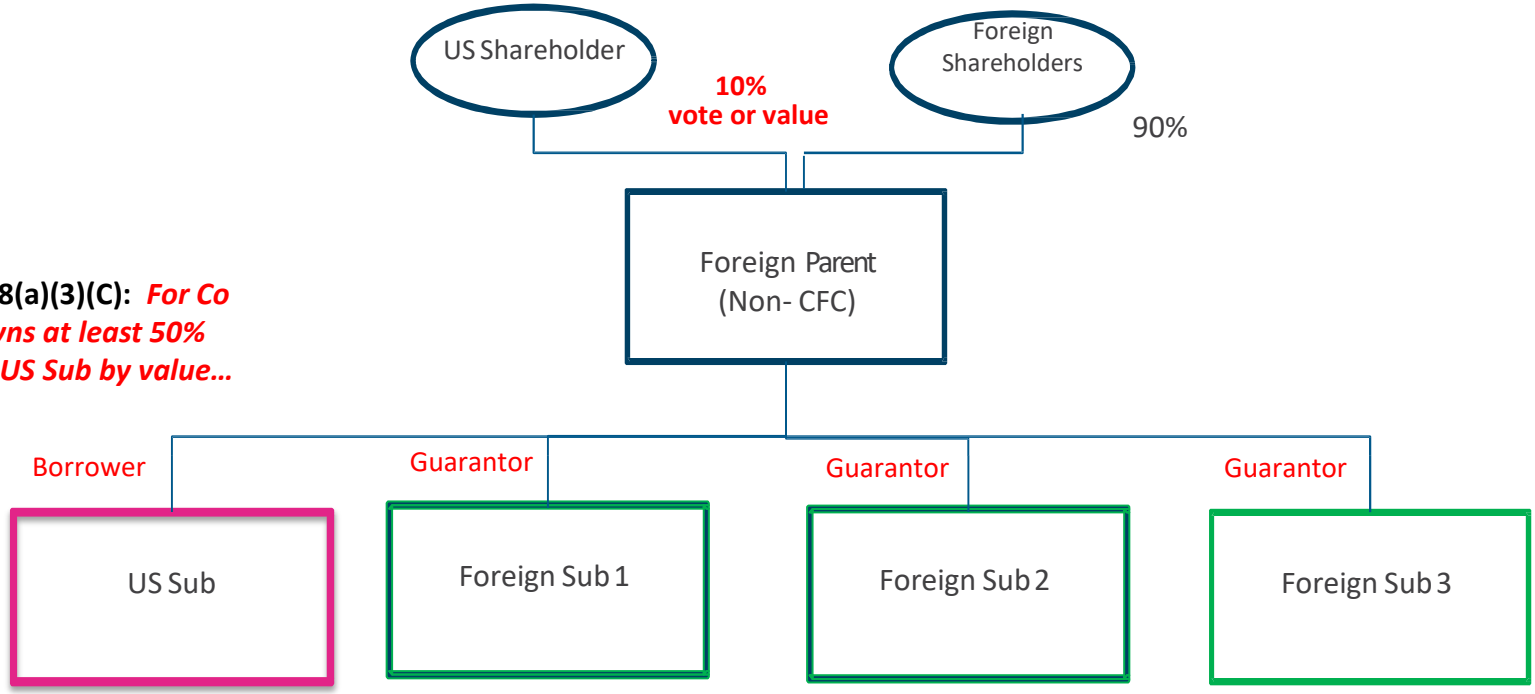
How does § 958(b) modify the § 318(a) attribution rules, following the 2017 TCJA?

- The 2017 Act repealed IRC § 958(b)(4)…..*RETROACTIVELY.* That means the downward attribution rules of § 318(a)(3) now apply!
- This change is applicable to the last year of the foreign corporation that begins before Jan. 1, 2018 (and the taxable years of its US shareholders that end with or within the CFC's taxable year). This means that for calendar year taxpayers, the repeal of § 958(b)(4) applies retroactively—*i.e.,* to taxable years ending in 2017.
- **Before its deletion** from the US Tax Code, § 958(b)(4) provided:
  " Subparagraphs (A), (B), and (C) of Section 318(a)(3) shall not be applied so as to consider a United States person as owning stock which is owned by a person who is not a United States person."
  - § 318(a)(3)(A) provides for downward attribution of stock ownership **TO partnerships and estates .** (The partnership/estate is treated as owning whatever the partner or estate owns.)
  - § 318(a)(3)(B) provides for downward attribution of stock ownership **TO trusts** (exception for "remote contingent interests" in which case there is no downward attribution to the trust).
  - § 318(a)(3)(C) provides for downward attribution of stock ownership **TO corporations**:

    "If 50 percent or more in value of the stock in a corporation is owned, directly or indirectly, by or for any person, such corporation shall be considered as owning the stock owned, directly or indirectly, by or for such person." *

* Note that the relevant threshold under § 318(a)(3)(C) is "AT LEAST 50%" of the value…

Repeal of § 958(b)(4) – Myriad Collateral Effects:
"Pop-Up CFCs" & real, substantive Subpart F tax exposure



- Prior to the TCJA, Foreign Subs 1, 2 and 3 were not CFCs
- Because Foreign Parent Co owns US Sub stock w/at least 50% total value, § 318(a)(3)(C) is triggered. Thus, ALL the stock owned by Foreign Parent is treated as owned by US Sub--making US Sub both a § 951(b) "US shlr" and Foreign Subs 1, 2, and 3 "CFCs."
- US Sub not taxed on constructive ownership (which is all it owns in this diagram).
- BUT the 10% US shlder (at the top) owns 10% of the CFC indirectly (through Foreign Corps) and thus IS taxed on its pro rata share of all Subpart F earnings of Foreign Subs 1, 2, 3. Also, the indirect US Shldr could also have tax under §§ 956 (Earnings invested in US Property); §951A (GILTI; § 965 Transition Tax (even though none of the foreign corps are "controlled" directly or indirectly by US shs.
- **Here, advisors should review income and earnings of each CFC. Also, need to review loan documentation requiring guarantees** (because under of § 956 Investment in US Property, any CFC guarantee of a U.S. obligation could trigger a deemed dividend).

Increased Obligation to file IRS Form 5471 due to repeal of §958(b)(4)
Notice 2018-13 (limited relief)

- **General Rule: Notice 2018-13 provides limited relief for "constructive US shldrs" from obligation to file a Form 5471 but only with respect to "constructive" CFCs**
- Specifically, in section 5.02 of the Notice, IRS announced its intent to "amend the Instructions for Form 5471 to provide an exception from Category 5 filing for a US person that is a US shareholder with respect to a CFC if:

  (1) "*no US shareholder (including such US person) owns, within the meaning of §958(a), stock (directly or indirectly) in such CFC, and*

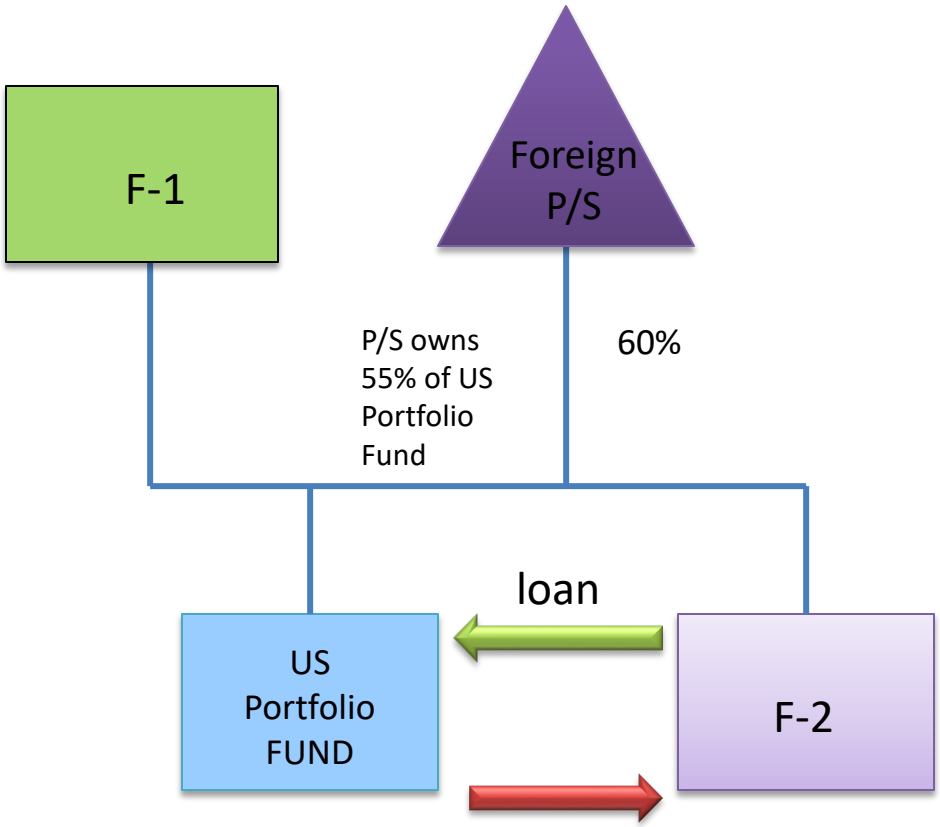
  (2) *the foreign corporation is a CFC solely because such US person is considered to own the stock of the CFC owned by a foreign person under § 318(a)(3)."*
- **Thus, a very limited exception!** Basically, it is a "but for" test. If the foreign corp would not be a CFC *but for* the constructive ownership of the US shareholder (who owns no stock directly or indirectly), then a Form 5471 may not need to be filed. Also, it appears from language in the Notice, that no other US shareholder may hold ANY stock directly or indirectly. So…use caution when trying to fit within this narrow exception.
- **Group filing exception to filing Form 5471:** To alleviate redundant filings, a joint ownership exception generally allows one U.S. person to file a joint 5471 on behalf of other persons required to file the same information for the same CFC. Example: Only one Form 5471 for a CFC may need to be filed by a consolidated group even when there multiple Category 5 US shldrs due to expanded § 958(b) constructive ownership rules.
- When a U.S. person files a Form 5471 on behalf of a person that is not in its consolidated return group, the person relying on the exception must attach to its return a statement that identifies the filer and provides certain other information.
- *Look for updated Instructions to Form 5471. Anticipate more guidance on Form 5471 filing obligations from IRS.*

Repeal of § 958(b)(4): Increases exposure to Subpart F, §956, § 951A GILTI, and §965 Transition Tax

- Not only can classification of the foreign sub as a CFC under § 318(a)(3)(C) increase exposure to taxation under § 951(a) (Foreign Personal Holding Company Income, Foreign Base Company Sale & Services Income and other categories of § 951(a)0, it can also trigger the application of many other tax provisions in the Code. For example:
- **§ 956 Earning Invested in U.S. Property:** Where a foreign corp suddenly becomes a "CFC," many types of transactions can be characterized as "deemed repatriations" under § 956 (e.g., loans, pledges of stock).
- **GILTI Exposure under § 951A**: applies to §951(b) "US shareholder" of a "CFC," using the same exact same definitions and ownership thresholds. But as under § 951(a), § 951A GILTI tax is computed on with respect to shares actually owned (i.e., directly and indirectly).
- **§ 965 Transition Tax:** The mandatory repatriation rules of 965 apply to "US shareholders" of "specified foreign corporations" (SPF) that have post-1986 E&P that was not previously taxed (or repatriated). A SPF is defined as a CFC or any foreign corporation that has at least one domestic C-Corp that is a § 951(b).
- **§245A participation exemption:** The DRD is denied with respect to "hybrid dividends" in certain tiered CFC structures.
- **Many other provisions can be triggered,** even though the underlying policy reasons for the application of those provisions is often not present.

Repeal of § 958(b)(4) – Collateral Effects:
Could Destroy Eligibility for *US Portfolio Interest Exemption*

- A CFC cannot qualify for the all important US Portfolio Interest Exemption if it received interest from a "related person." § 881(c)(3)(C).
- Excluded from the definition of "portfolio interest" is interest "received by a CFC from a related person" (within meaning of §864(d)(4)/ § 267(b), (f).
- Because TCJA repealed §958(b)(4), the downward attribution rules of §318(a)(3) are no longer "turned off," and are operative beginning with foreign corporation's tax years beginning before 12/31/2018.
- Because Foreign Partnership owns at least 50% of the value in US Portfolio Corporate Fund, such Fund is deemed to own all the stock that Foreign P/S owns. (Same rule would apply if F-1 owned at 50% of the value). Therefore, under §318(a)(2), US Portfolio Fund constructively owns 60% of F-2, making it a "US shldr" and making F-2 a CFC.
- Suddenly, F-2 (a CFC) cannot qualify for the US Portfolio interest exemption because F-2 is a CFC receiving the interest from a "related person" within the meaning of §267(b), (f)
- A lot of restructuring has been (or must be) done to get around this sudden loss of the US Portfolio Interest Exemption…(lost retroactively for taxable year beginning before 2018).



Interest payments *(often exempted from US 30% withholding tax if they qualify as "portfolio interest")*

If the Foreign Entity is classified as a "corporation" but NOT a "CFC"—then should test for PFIC status

- **How is a PFIC defined?**

- **Code § 1297 defines "Passive Foreign Investment Company" (PFIC)** as basically "any foreign corporation" (unless otherwise provided in this subpart) *if either one of TWO alternative tests is met (at anytime):*

  1) 75 percent or more of the gross income of such corporation for the taxable year is passive income, (known as the **"gross income test"**) **OR**

  2) the average percentage of assets (as determined in accordance with subsection (e)) held by such corporation during the taxable year which produce passive income or which are held for the production of passive income is at least 50 percent. (Known as the **"asset test"** for PFIC status).

- **"Passive income" defined by reference to IRC 954(c)** ("foreign personal holding company income" of the CFC rules).

- **The CFC-PFIC "overlap rule" of § 1297(d):** a foreign corporation that is a CFC as to any U.S. inclusion shareholder cannot be a PFIC. **But note – PFIC rules are not turned-off completely!!** This overlap rule only applies to the § 951(b) shareholders of a CFC; the PFIC rules can apply to the US shareholders of the foreign corporation that own both < 10% of vote and <10% of value!

Repeal of § 958(b)(4) – Collateral Effects:
Could wreak havoc with PFIC/CFC overlap rules

- TCJA's removal of § 958(b)(4) from the Internal Revenue Code will cause some PFICs to become "CFCs" and subject to CFC rules, instead of the dreaded PFIC rules. (A "good thing" usually…)

- **§ 1297(d):** a foreign corporation that is a CFC as to any U.S. inclusion shareholder cannot be a PFIC. Many may find this is a happy consequence of the repeal of §958(b)(4) since it may help some avoid the horrid PFIC rules. (Some may have even tried to qualify for the CFC regime instead of the PFIC regime but failed. Application of 318(a)(3) can help in that instance.)

- **Eligibility for §245A Deduction.** Dividends from a PFIC do not qualify for the §245A deduction, but dividends from a CFC do. (Thus, where repeal of §958(b)(4) causes a foreign corp that would have been a PFIC to become a CFC, a US shlder that is a "corporation" will be allowed the deduction.

- **Pop-Up PFICs:** A foreign corporation can be a PFIC with respect to non § 951(b) shldrs (owning < 10%) and a CFC with respect to § 951(b) shldrs. Under §1297(e)(2), if the foreign corporation is a CFC (and not publicly traded), it is required to apply the PFIC *asset test* of §1297(a)(2) by reference to the *adjusted basis*, rather the fair market value, of its assets. This will often cause the corporation to be treated as a PFIC when it would not have otherwise qualified had the FMV test applied.

- **PFIC Parent, CFC Sub.** Recall the simplest example of a "faux CFC" (i.e., foreign sub of a foreign parent that happens to own a US sub). Although the results in such a case might merely be annoying, like having to file Form 5471, there is a possibility that foreign parent in such a case might be a PFIC as to some U.S. shareholders, with very strange results since a PFIC would then own a "faux CFC." * **See K. Blanchard, *Top Ten Reasons to Limit 958(b)(4) Repeal*, 47:6 TAX MNGMT, INT'L J. (2018)**

Potential Techniques to Mitigate Tax Liability stemming from § 958(b)(4)'s repeal

1. **Convert the Foreign "Pop-Up" CFCs to "Disregarded Entities" with CTB Election**
   - Treated by US taxable "liquidations" triggering a § 1248 dividend, but the "all 1248 amount" may be zero, if E&P already picked up by the Transition Tax.
   - *This strategy would likely not avoid the 2017 imposition of the one-time Transition Tax* unless a retroactive CTB election could be made—NOT likely to be allowed under Final 965 regulations
2. **Make Maximum Use of the *High Foreign Tax Exception*** to reduce both Subpart F & GILTI income
3. **Elect § 962 to Treat the Foreign Dividends "as if" they were received by a U.S. C Corporation.** *But see Smith v. CIR*, __T.C. (2018)(no qualified dividend treatment allowed – C corp is not real).
4. **Create a U.S. Irrevocable Non-Grantor Foreign Trust** (to reduce the indirect U.S. shareholder's interest to below 10% vote or value). How does this work? (If remaindermen are NRA children, might work under the § 318 attribution rules)
5. **Interpose a US C corporation between the § 951(b) individual /S-Corp US shareholder and the CFCs** (to get the 100% DRD under § 245A , and the 50% GILTI deduction under § 250). But some foreign countries forbid a foreign corporate (US) shareholder (*e.g.*, China, Lebanon if real estate)
6. **Actually liquidate the CFCs** (But usually not pragmatic…and then the "liability shield" is lost. Also expensive!)
7. **Take "Wait & See" attitude:** Wait and see if Congress adopts any Technical Corrections Bill (2 have already died in the US House of Reps).

Oct. 1, 2019: *Partial Relief* from § 958(b)(4) repeal: Rev. Proc. 2019-40 and Proposed Regs

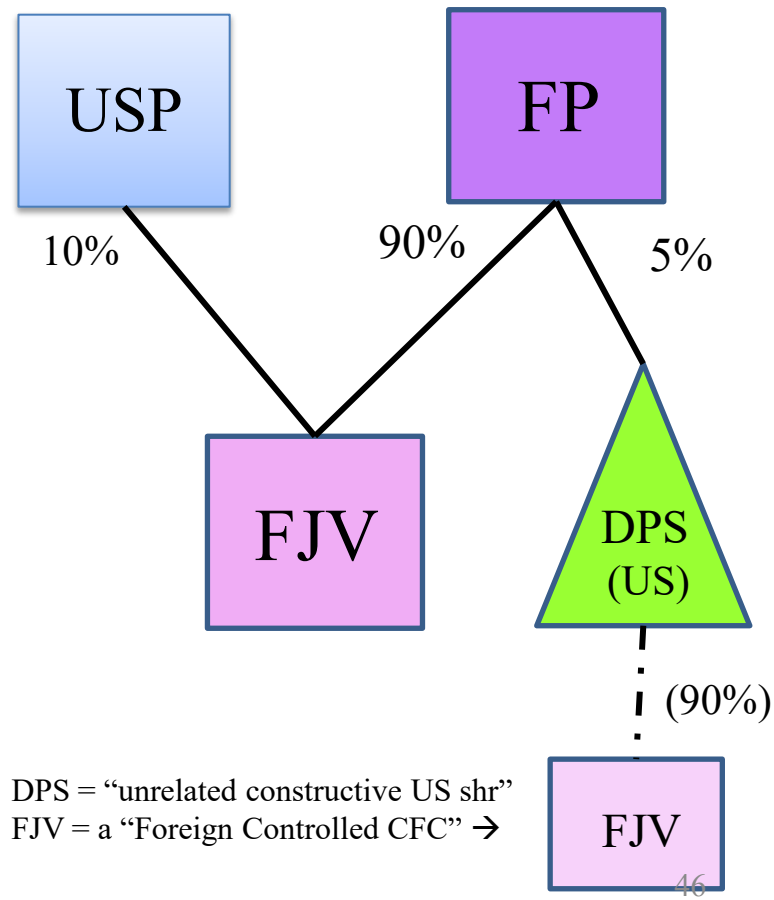
- **Revenue Procedure 2019-40:**
  - **What it does NOT do:** Does NOT "undo" the substantive effects of the repeal of §958(b)(4). Thus, if a foreign corporation is a "CFC" under the downward attribution rules, it remains a CFC, and direct and indirect US shareholders will still have to report phantom income from that CFC (to the extent of shares they actually own), and will have filing requirements –i.e., Form 5471, even if the foreign corp would not have qualified as a "CFC" prior to the repeal of § 958(b)(4).
  - **What it DOES do**:
  - *Gives some limited relief from the due diligence requirements* in certain situations, but only if certain ownership paradigms are met with respect to a "foreign controlled CFC."
  - *Limits application of penalties* under § 6038 (for failure to file Form 5471) and under § 6662 for tax underpayments but ONLY if the taxpayer is within certain "safe harbors."
  - Eases compliance burden by providing a hierarchical list of acceptable "alternative info" in certain situations where getting the normally required info to determine E&P and QBAI proves difficult or impossible.

Revenue Procedure 2019-40 - Example

Safe Harbor for Determining CFC Status

- **Facts:** In 2020, USP, a domestic corp, and FP, a foreign corp, invest in FJV, a newly formed foreign corp. USP receives 10% of the single class of stock of FJV, and FP receives the remaining 90%. Assume that FP is not a related person with respect to USP and that FP has no US shareholders. FP owns 5% of a domestic partnership, DPS, with the remainder held by unrelated persons.
- **Analysis**: DPS as an unrelated constructive US shareholder with respect to FJV. Because FP is a partner in DPS, DPS is considered to own, under § 958(b) and § 318(a)(3)(A), 90% of FJV. Thus, DPS is a constructive US shareholder of FJV, and FJV is a foreign-controlled CFC as defined in Rev. Proc. 2019-40.
- **Further assume**: USP inquired of FJV whether FJV met the section 957 ownership requirements, and FJV did not report that it met the section 957 ownership requirements. There is no reliable publicly available information that would indicate that FJV is a CFC. USP has not received a statement indicating that FJV is a CFC. Furthermore, after making the inquiry of FJV, USP does not know that FJV is a CFC.
- **Analysis: B**ecause FJV is not a US-controlled CFC and FP is not a "related person" with respect to USP, for purposes of determining if FJV meets the § 957 ownership requirements for CFC status, USP may rely on the SAFE HARBOR described in sec, 4.02 of Rev. Proc. 2019-40 without inquiring of FP whether FP owns directly or indirectly (under § 958(a)(2)) or constructively owns (under § 958(b)) stock of, or an interest in, a domestic entity.
- **Further,** because there is no reliable publicly available information that would indicate that FJV is a CFC, and USP has not received a statement indicating that FJV is a CFC, and, after making an inquiry of FJV, USP does not have actual knowledge that FJV is a CFC, USP may treat FJV as not meeting the § 957 ownership requirements for CFC status.
- If USP turns out to be wrong, no penalties imposed.

- Ex. 4 in Rev. Proc.



DPS = "unrelated constructive US shr"
FJV = a "Foreign Controlled CFC" →

IV. The Section 962 Election

V. Global Intangible Low-Taxed Income

A. Definition, Mechanics, Planning Considerations

B. Final and Proposed “High Tax GILTI Exclusion”

DRUCKER & SCACCETTI

TAX AS A BUSINESS STRATEGY®

The GILTI Regime and IRS Form 8832 Entity Classification Elections

Ronald Kalungi, JD, LLM

GLOBAL INTANGIBLE LOW-TAXED INCOME (GILTI)

- Under IRC Sec. 951A, U.S shareholders of a Controlled Foreign Corporation (CFC) must include their share of the Global Intangible Low-Taxed Income (GILTI) in their U.S. federal gross income.
- GILTI was intended to be an anti-base erosion, minimum tax provision intended to discourage multinational corporations (MNCs) from using intangible property (IP) to shift profits out of the U.S. Its tax base, however, extends beyond IP assets and investments.
  - GILTI: Excess of the shareholder's net CFC tested income over the shareholder's net deemed tangible income return.
  - U.S. shareholder and Controlled Foreign Corporation concepts mirror Subpart F.
    - GILTI inclusion treated similarly to Subpart F in many ways, but not technically a component of Subpart F.
  - **An IRC section 250 deduction of 50% of GILTI is available, but ONLY for C Corporations, or individual shareholders that elect to be taxed as C corporations under section 962.**
    - Makes the effective tax rate 10.5%
    - For non-corporate U.S. shareholders who do not elect to be taxed as C corporations under section 962, the GILTI tax rate can be as high as 37%.
    - For taxable years beginning after December 31, 2025, the deduction will be reduced to 37.5%, resulting in an effective tax rate on GILTI of 13.125%.

GLOBAL INTANGIBLE LOW-TAXED INCOME (GILTI) (CONT'D)

- GILTI Application
  - Functionally, GILTI essentially is a tax imposed on U.S. shareholders of a CFC on the excess of an assumed 10% rate of return on an investment in a CFC (i.e., 10% of the adjusted cost basis of the tangible assets (Qualified Business Asset Investment) of the CFC used in the production of income).
    - GILTI imposes a minimum tax on foreign earnings that exceed the 10% rate of return on investment amount.
  - **A U.S. corporate shareholder is eligible for an indirect foreign tax credit with respect to foreign income taxes paid on GILTI, but the FTC is limited to 80% of the foreign taxes paid on GILTI. The FTC is not available to an individual U.S. shareholder unless the individual shareholder makes a section 962 election to be taxed as a C corporation on GILTI.**

GLOBAL INTANGIBLE LOW-TAXED INCOME (GILTI) (CONT'D)

- Income subject to GILTI tax becomes part of a CFC's Previously Taxed Earnings and Profits (PTEP) and is not subject to U.S. federal income taxation again when distributed.
- Income subject to GILTI provisions is not is not eligible for the participation Dividends Received Deduction (DRD) under Code section 245A.
- Section 951A introduced a new FTC basket for GILTI foreign taxes.
- Is GILTI subject to SALT income tax?
  - It depends on the income tax provisions of a given state. For instance, PA currently does not tax GILTI.

GLOBAL INTANGIBLE LOW-TAXED INCOME (GILTI) (CONT'D)

- *GILTI Computation Illustration: U.S. Corporate Shareholder versus U.S. individual shareholder disparity.*
- *Example:*
- *Scenario 1*: A U.S. corporation directly owns stock in a Swiss GmbH, a CFC. The GmbH's net income is $50,000, on which $6,685 of Swiss corporate income tax was paid. The Swiss GmbH has a loan, on which it incurred $2,000 of interest expense and has a Qualified Business Asset Investment (QBAI)(e.g., an intangible asset) of $180,000.
- *Scenario 2*: The facts are the same as in scenario 1 above, except that the U.S. shareholder is a U.S. individual, instead of a U.S. corporation. The U.S. individual does not make a section 962 election to be taxed as a U.S. C corporation on GILTI.

GLOBAL INTANGIBLE LOW-TAXED INCOME (GILTI) (CONT'D)

			U.S. Shareholder	
Step	**Item**	**CFC**	**Corporation**	**Individual**
Step 1: Tested Income	a. Tested income	$ 50,000	$ 50,000	$ 50,000
	b. Tested Loss	-	-	-
	c. Net CFC tested income		$ 50,000	$ 50,000
	d. Tested foreign income taxes	$ 6,685	$ 6,685	$ 6,685
	e. Foreign ETR on tested income (d. / c. * 100%)	13.37%	13.37%	13.37%
Step 2: QBAI	f. Qualified Business Asset Investment (QBAI)	$180,000	$180,000	$180,000
	g. 10% of QBAI (f. * 10%)		$ 18,000	$ 18,000
	h. Interest expense	$ 2,000	$ 2,000	$ 2,000
	i. Net deemed tangible income (g. – h.)		$ 16,000	$ 16,000

GLOBAL INTANGIBLE LOW-TAXED INCOME (GILTI) (CONT'D)

Step 3: Calculate GILTI	j. GILTI (c. – i.)		$34,000	$34,000
Step 4: U.S. Inclusion	k. Inclusion percentage (%) (j. / c. *100%)		68%	68%
For U.S. corporate shareholders only.	l. Deemed foreign tax credit (FTC) before 20% reduction (d. * k.)		$ 4,545.00	
For U.S. corporate shareholders only.	m. Deemed FTC after 20% reduction (l. * 80%)		$ 3,636.64	
	n. Grossed-up GILTI (j. + l.)		$38,545.80	$34,000
For U.S. corporate shareholders only.	**o. 50% GILTI deduction (n. * 50%)**		**$19,272.90**	
	p. Taxable income before FTC and expense		$19,272.90	$34,000
	q. Expense allocated to GILTI basket.		-	-
	r. GILTI for FTC limitation		$19,272.90	$34,000
	s. U.S. federal income tax rate		21%	37%
For U.S. corporate shareholders only.	**t. FTC limitation (p. *s.)**		**$ 4,047**	
	u. GILTI Taxable income before FTC		$19,272.90	$34,000
	v. U.S. federal income tax rate		21%	37%
	x. U.S. tax liability before FTC (u. * v.)		$ 4,047	$12,580
For U.S. corporate shareholders only.	**y. FTC**		**$ 4,047**	
	z. U.S. tax on GILTI (x. – y.)		**$ 0**	**$12,580**

GLOBAL INTANGIBLE LOW-TAXED INCOME (GILTI) (CONT'D)

- In the foregoing example, what tips the GILTI scale in favor of a U.S. corporate shareholder is the availability of the 50% GILTI deduction and the 80% FTC to a U.S. corporate shareholder, and the non-availability of these tax attributes to a U.S. individual shareholder.
- It is these attributes that result in the U.S. corporate shareholder owing no GILTI tax, whereas the U.S. individual shareholder owes substantial GILTI tax on the same GILTI amount.
- Making a section 962 election creates parity in the treatment of a U.S. corporate shareholder and U.S. individual shareholder with respect to GILTI taxation.

SECTION 962 ELECTION

- IRC section 962 allows an individual (or trust or estate) U.S. shareholder of a CFC to elect to be subject to corporate income tax rates on amounts that are included in the individual's gross income under section 951(a), or GILTI under section 951A.
- Section 962 was enacted, along with the rest of the subpart F regime, in 1962 and became effective beginning in the tax year 1963.
  - The top individual tax rate at the time was 91%; whereas the top corporate tax rate was 52%.
  - By enacting section 962, Congress intended to give individual taxpayers a means of reducing the current tax burden on "phantom income"/deemed income created by the subpart F regime to the lower corporate rate.

SECTION 962 ELECTION (CONT'D)

- The section 962 election is made on a year-by-year basis.
- For any year the election is made, it applies to all CFCs and all §951(a) income. This includes: Subpart F (e.g., FPHCI), §956, and §951A (GILTI).
- An individual taxpayer cannot elect to include certain CFCs and exclude others.
- For purposes of computing the §962 tax due - a credit for income taxes paid

at the CFC level is allowed under §960.

- The limitations under §904 apply as they regularly would to a corporation. Reg 1.962-1(b)(2).
- FTCs in the GILTI basket cannot offset §962 tax due in other baskets (e.g., the general and passive baskets).
- A gross up for indirect foreign taxes is required under §78.

SECTION 962 ELECTION (CONT'D)

Deductions

- General rule – no deductions are available when computing the tax due
- under the §962 election.
- §250 deduction for GILTI is available.
- §245A DRD is not available to offset §956 inclusions
- Taxpayers making the election have an increase in basis under §961 only for
- the U.S. tax actually paid under the election.
- The election does not change the payor of the dividend for the purposes of determining whether the dividend is Qualified Dividend Income (QDI) or the source of the dividend (i.e., whether U.S. source or foreign source). *See Barry M. Smith v. Commissioner, 151 TC 41.*
  - "These [section 962] provisions do not create hypothetical corporations or change real-world facts. They simply provide a mechanism that enables an individual U.S. shareholder to elect what he or she may deem more desirable tax treatment." – Judge Lauber.

SECTION 962 ELECTION (CONT'D)

- The §962 election has two potential benefits:
  - Permanent reduction in tax liability (e.g., GILTI being subject to a lower tax rate due to the 50% GILTI deduction and 80% FTC, and actual dividend distributions being subject to a preferential QDI rate because the distributing corporation is a treaty country-based Qualified Foreign Corporation); and/or
  - Deferral (i.e., the taxpayer-friendly tax regime it enables creates an opportunity for deferral by taxpayers of actual distributions of income).
- In order to determine when to make the election, taxpayers will need to project the tax liability with and without the election both on a current and fully distributed basis.
  - If there is a reduced tax liability on a fully distributed basis the election should be made.
  - If there is an increased tax liability on a fully distributed basis then taxpayers must weigh the benefit of deferral vs the increased tax cost.

SECTION 962 ELECTION (CONT'D)

Factors in favor of making the election.

- §951A GILTI represents large portion of the total §951(a) income.
- The foreign corporation is a treaty country-based Qualified Foreign Corporation whose dividends qualify for QDI treatment.
- Significant deemed paid foreign tax credits are available.
- Large difference between corporate (21%) rate and individual's income tax rate (up to 37%).
- Significant time period between income inclusion and eventual distribution.
- High importance of deferral to taxpayer (time value of money).

SECTION 962 ELECTION (CONT'D)

Factors against making the election.

- §951A GILTI represents a small portion of the total §951(a) income.
- Foreign corporate tax paid is low - jurisdiction with low/no tax, NOLs in foreign country, incentive rates.
- Individual has NOLs or foreign tax credits (withholding tax) that can offset §951(a) liability.
- Distributions are made from foreign corporation on a regular basis.
- Deferral is not important to the taxpayer.

MAKING THE SECTION 962 ELECTION

- The election is made by attaching a statement to a taxpayer's income tax
- return. The statement must include the following:
  - I. Name, address, and taxable year of each CFC of which the taxpayer is a U.S. shareholder.
  - II. Any foreign entity through which the taxpayer is an indirect owner of a CFC under §958(a).
  - III. The §951(a) Subpart F income and section 951A GILTI included in the §962 election on a CFC-by-CFC basis.
  - IV. Taxpayer's pro-rata share of E&P and taxes paid for each applicable CFC.
  - V. Distributions actually received by the taxpayer during the year on a CFC-by-CFC basis with details on the amounts that relate to (1) excludible §962 E&P; (2) taxable §962 E&P; and (3) E&P other than §962.

MAKING THE SECTION 962 ELECTION (CONT'D)

- The election needs to be made with the taxpayer's return.
- There is no additional guidance on the timing of the election (original return, timely filed return, etc.). In *Dougherty v. Commissioner 60 T.C. 917 (U.S.T.C. 1973),* the taxpayers were allowed to make the election on an amended return after they determined that they had a 951(a) liability. In GCM 36325, the IRS fully acquiesced in *Dougherty*.

MAKING THE SECTION 962 ELECTION (CONT'D)

Sample Election

Statement of Election by Individual Stockholder to be Taxed on Income from his Controlled Foreign Corporations at Corporate Rates

Rich Greenbucks

SSN: xxx-xx-xxxx

Form 1040, Tax Year Ending 12/31/2021

Taxpayer hereby elects, under Code Sec. 962 to be subject to tax at corporate rates on amounts that are included in taxpayer's gross income for calendar year 2021 under Code Sec. 951A. Taxpayer also elects to have the benefit of a credit for certain foreign taxes paid with regard to the earnings and profits attributable to such amounts.

The following information is submitted pursuant to the requirements of Treas. Reg Sec.1.962-2(b):

1. Taxpayer qualified as a U.S. shareholder for calendar year 2021 of (names and addresses of the foreign companies), each a controlled foreign corporation whose tax years ended on December 31, 2021.

MAKING THE SECTION 962 ELECTION (CONT'D)

2. The corporations' gross income for calendar year 2021 which was included in taxpayer's gross income for calendar year 2021 under Code Sec. 951A, was $xx,xxx,xxx.

3. Taxpayer's pro-rata share of the Global Intangible Low-Taxed income of said corporations (determined under Reg. Sec. 1.951A-1) for calendar year 2021 was $xx,xxx,xxx, with respect to which $x,xxx,xxx foreign income taxes were paid.

4. During calendar year 2021, taxpayer received no distribution

from such corporations of excludable Code Sec. 962 earnings and profits and no distribution of taxable Code Sec. 962 earnings and profits. Taxpayer received no other distributions from such corporations during or for calendar year 2021.

5. Taxpayer did not qualify as a United States shareholder of any other

Controlled Foreign Corporation for calendar year 2021.

MAKING THE SECTION 962 ELECTION (CONT'D)

§962 Election Statement

- Supporting statement to show the relevant tax calculations.
- No direct guidance on what needs to be included on the statement apart from the requirement that it must show how the tax was determined. *Tip*: it is generally a good idea to show the methodology for tax computations in the statement so that the return can be followed.
- Form 8992 and Form 8993 filings would be required. When a §962 election is made, there is GILTI, and a §250 deduction is taken (50% deduction on GILTI).
- Form 1118 (instead of 1116) is required when a foreign tax credit is taken under the section 962 election regime.
- The §962 tax is reported directly on the taxpayer's income tax return and added to any other income taxes due.

THE GILTI HIGH TAX EXCLUSION

- For U.S. shareholders owning CFCs operating in high tax jurisdictions, the GILTI high tax exclusion offers a tax planning alternative.
- Unlike the section 962 election which only reduces, but may not eliminate entirely, the GILTI tax, income that qualifies for the GILTI high tax exclusion is not subject to GILTI tax at all.
- The IRS issued the GILTI high tax exclusion (GILTI HTE) final regulations on July 20, 2020.
- Under the regulations, a U.S. shareholder of a CFC can exclude from its GILTI inclusion items of the CFC's gross tested income if the CFC's effective foreign tax rate on the GILTI gross tested income exceeds 18.9 percent (i.e., 90% of the U.S. corporate income tax rate, which, currently, is 21%) and the U.S. shareholder elects for the taxable year to exclude the high taxed income.
- The election is made on an annual basis. This allows U.S. shareholders flexibility in modeling their tax situations on a year-by-year basis and choosing to make the election only in years in which it makes economic sense to do so.

THE GILTI HIGH TAX EXCLUSION (CONT'D)

- The election is made on a tax return (an original or amended return) by attaching a statement.
- The election applies on a consistent basis to all CFCs owned by the same domestic controlling U.S. shareholders (i.e., shareholders who own more than 50% of the CFC stock) and to all of the CFC's U.S. shareholders (in this regard, a controlling U.S. shareholder notifies non-controlling U.S. shareholders of the decision to make the election).
- The 18.9% foreign effective tax rate determination is made on a "Tested Unit" basis.
  - A tested unit includes a (1) CFC; (2) an interest in a pass-through entity (not treated as fiscally transparent under foreign law, e.g., foreign entities that elect to be treated as pass-through entities for U.S. federal income tax purposes by filing Form 8832) held by a CFC; and (3) certain branches of a CFC.
  - All tested units of a CFC located or resident in the same country are required to be combined as a single tested unit.

THE GILTI HIGH TAX EXCLUSION (CONT'D)

- The foreign effective tax rate determination is based on the books and records of each tested unit, and gross income is determined under U.S. federal income tax principles, with certain adjustments to reflect disregarded payments, which serve as a reasonable proxy for determining the amount of gross income of the tested unit that is likely to be subject to tax in the foreign country of the tested unit.
- The regulations apply to taxable years of CFCs beginning on or after July 23,2020, and for years of U.S. shareholders in which, or with which, such tax years of foreign corporations end.
- Taxpayers may elect to apply the final regulations retroactively for tax years beginning after December 31, 2017, and before July 23, 2020, provided certain consistency requirements are met. This creates opportunities for amending tax returns and claiming tax refunds in certain circumstances.

THE GILTI HIGH TAX EXCLUSION (CONT'D)

GILTI HTE Statement – Treas. Reg. section 1.951A-2(c)(7)(viii)

- The statement must include:
  - The name and address of each CFC (or other tested unit);
  - The U.S. shareholder's shareholding in each CFC (or other tested unit) (e.g., class of shares, number of shares per class and percentage of shareholding per class);
  - A description of how the U.S. taxpayer determined that a CFC's foreign income was subject to foreign tax at an effective tax rate that is greater than 18.9% (i.e., 90% of the U.S. corporate income tax rate, which, currently, is 21%);
  - A description of the accounting standards under which the CFC's books and records were prepared and its corporate tax base (especially taxable income) determined; and
  - The amount of tentative gross tested income the U.S. taxpayer is seeking to exclude from GILTI inclusion under the GILTI HTE.

THE SUBPART F HIGH TAX EXCLUSION

- On the same day the GILTI HTE final regulations were issued (July 20,2020), the IRS also issued proposed subpart F high tax exclusion regulations (proposed regulations) under section 954(b)(4).
- The proposed regulations would conform the historic subpart F high tax exclusion to the more recent GILTI HTE. Thus, the proposed regulations significantly revise the subpart F high tax exclusion by combining both exclusions into a unified rule that is modeled on the GILTI HTE.
- Since the subpart F high tax exclusion and GILTI HTE will be combined into a single rule, the proposed regulations, once finalized, would withdraw the GILTI HTE final regulations.
- Under the proposed regulations, a single unified election applies for purposes of both Subpart F and GILTI, with such election applicable to all high-taxed incomes of all CFCs that are members of a CFC group. Thus, the proposed regulations eliminate the ability to apply the Subpart F high-tax exclusion to particular CFCs and particular items of income of CFCs.

THE SUBPART F HIGH TAX EXCLUSION (CONT'D)

- The proposed regulations would modify the approach for determining gross income attributable to each tested unit. Unlike the GILTI HTE final regulations that use the separate set of books and records as the starting point for determining a tested unit's gross income, the proposed regulations would use applicable financial statements instead.
- The proposed regulations list different types of financial statements (in order of priority) that may be relied on under this determination, with the higher priority given to audited financial statements prepared in accordance with U.S. Generally Accepted Accounting Principles (US GAAP) or International Financial Reporting Standards (IFRS).
- The proposed regulations would apply to taxable years of CFCs and their U.S. shareholders beginning after the date of publication of the final regulations in the federal register.

PLANNING INTO THE SUBPART F REGIME?

- Factors that make the idea of planning into the Subpart F regime worth considering:
  - No FTC haircut (unlike under the GILTI regime which allows only 80% of the foreign taxes to be claimed as FTCs).
  - Utilization of excess FTCs (no FTC carryback or carryforwards under GILTI).
  - Utilization of NOLs (GILTI tested loss cannot be carried forward).
- Before the Subpart F high tax exclusion proposed regulations are finalized, it is plausible for a U.S. taxpayer to plan into Subpart F by making a GILTI HTE election and not making Subpart F HTE election on the same CFC income. *Note*: It is these types of "pick and choose" strategies that the proposed Subpart F HTE regulations seek to curb.
- Like most tax planning strategies, modeling would be key in determining whether planning into Subpart F would make economic sense to a given U.S. shareholder.

VI. Other Considerations & Tax Strategies Relevant to Foreign Entity Selection

- Planning into Subpart F to avoid GILTI (and vice versa)
- Check-and-Sell Transactions
- CTB to flow-through treatment to combine QBAI or avoid §59A BEAT
- Outbound transfers to foreign "corporations" vs. to foreign "partnerships"
- Disposition of partnership interests by foreign partners - § 864(c)(8)
- Final Anti-Hybrid Regs under § 267A (brief overview)

Outbound Transfers to foreign "corporations" vs. "partnerships" (1 of 2)

- The otherwise applicable "non-recognition" provisions of Code §§ 351, 354, 356, 361, 332 and/or §721 may be "turned-off" depending on whether the outbound transfer of property by a US person is to a foreign "corporation" or a foreign "partnership."
- **Outbound transfers to a foreign *corporation*** can trigger the application of Code § 367 and/or § 7874 (the anti-corporate inversion rules).
- **§ 367(a)(1) – General Rule:** "If, in connection with any exchange described in section 332, 351, 354, 356, or 361 , a US person transfers property to a foreign corporation, such foreign corporation shall not, for purposes of determining the extent to which gain shall be recognized on such transfer, be treated as a corporation."
  - **General rule is one of taxation unless an exception applies.** If the transaction does not qualify as a "reorg" under § 368, then § 367 does not apply (transfer is treated as a sale, which might yield a better result—e.g., installment sale treatment under § 453A). § 367(a)(3) was repealed: Transfers of property to an active foreign trade-or-business are no longer excepted from 367(a).
  - Intangibles - § 367(d): Almost all outbound transfers of intangibles are not taxed as sales due to broader definition of "intangible."
- **§ 7874 – General Rule:** focuses on ownership of the new foreign parent by the historic shareholders of the "inverted" domestic entity—both for purposes of its application and its effects.
  - **If historic Shldrs of US Corp receive > 50% of NFP:** Deal is *generally taxable to U.S. Shrlds* of the U.S. Corp under §367.
  - **If historic Shldrs of U.S. Corp own at least 60%, but < 80% of NFP:** Restrictions are imposed on the inverting U.S. Corp, but NFP is respected for U.S. tax purposes as a foreign (non-U.S.) corporation. But U.S. Corporate group is taxed on "inversion gain" (as defined).
  - **If historic Shldrs own 80% or more of NFP:** Then NFP will be treated as a U.S. corporation for U.S. TAX purposes (even though it remains a foreign corporation for other legal purposes) -- a tax disaster! (U.S. tax planning is rendered meaningless; multiple juridical taxation could now be a real risk).

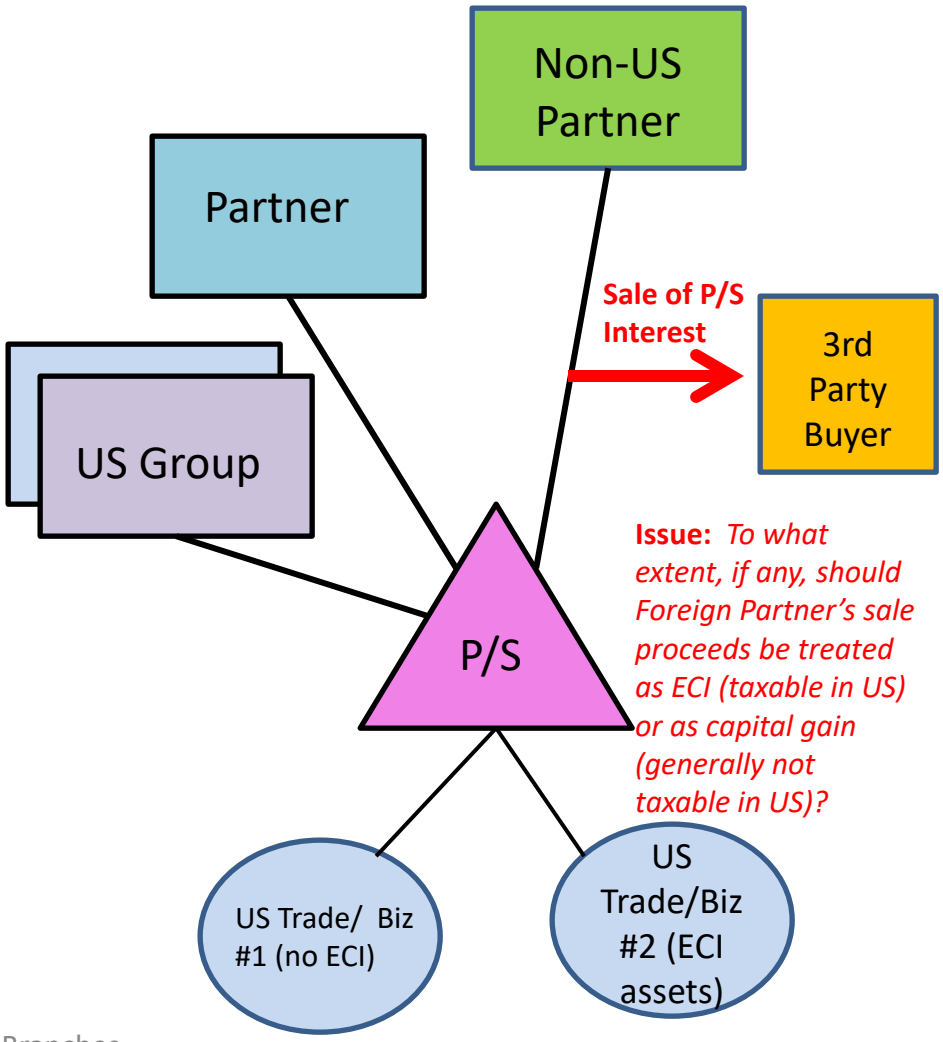
Outbound Transfers to foreign "corporations" vs. "partnerships" (2 of 2)

- Outbound transfers of appreciated property to a foreign partnership may trigger the application of Code § 721(c)—thus overriding the non-recognition rule of 721(a).
  - Code § 721(c) was enacted as a corollary to §367(a).
  - Code 721 and the Regulations promulgated thereunder override the non-recognition of gain upon a contribution of "section 721(c) property" to a "section 721(c) partnership."
  - Reg. § 1.721(c)-3 describes the gain deferral method, which may be applied in order to avoid the immediate recognition of gain upon a contribution of section 721(c) property to a section 721(c) partnership. The regulations contain special "acceleration events" for purposes of applying the gain deferral method.
- **"Section 721 partnership"defined in Reg. § 1.721(c)-1:** A partnership (domestic or foreign) is a section 721(c) partnership if there is a contribution of §721(c) property to the partnership and, after the contribution and all transactions related to the contribution
  - **(A)** A related foreign person with respect to the U.S. transferor is a direct or indirect partner in the partnership; and
  - **(B)** The U.S. transferor and related persons own 80 percent or more of the interests in partnership capital, profits, deductions, or losses (with "relatedness" determined under the attribution rules of §§ 267(b) or 707(b)(1)).
- ***Caution:*** Always check application of §§367, 7874 and 721(c) (and Regs) before checking the box on an entity; it could trigger an outbound transfer of property (or inbound LQ).

Potential PITFALL: Dispositions by Foreign Partners of Interests in ***Partnerships*** with a "U.S. Trade or Business"

BACKGROUND

- **Rev. Rule 91-32:** IRS rules that a foreign partner who sells an interest in a P/S is subject to US taxation if that P/S is engaged in a US trade/biz through a US office, to the extent the gain is attributable to property of the P/S which was used to produce "effectively connected income" (ECI).
  - Many US taxpayers tried to ignore this Revenue Ruling, arguing any gain should be capital gain—not taxable in US.
  - Obama Administration, in its proposed budget, recommended codifying Rev. Rul. 91-32 and adding a withholding obligation.
- ***Grecian Magnesite v. CIR*, 149 T.C. (2017):** US Tax Court rejected Rev. Rule 91-32, holding that gain or loss recognized by a foreign partner disposing of a P/S interest is generally not considered ECI (or effectively connected loss) with respect to any US trade/biz that partnership may be conducting.
- **New IRC § 864(c)(8):** Enacted as part of the 2017 TCJA. Treats as ECI the foreign partner's "distributive share of the amount of gain (or loss) which would have been ECI if the partnership entity has sold all of its assets at FMV just prior to the foreign partner's disposition (but reduced for any gain already subject to the FRPTA regime).
  - § 864(c)(8) effectively reverses the result obtained in *Grecian Magnesite* court opinion, issued earlier in the year 2017.



IRC § 864(c)(8): What it does

- **Reverses holding in Grecian Magnesite (retroactively to November 27, 2017), so that foreign partners will be taxed on the sale/exchange of their interests in partnerships (US or foreign) that are conducting a trade or business in the United States.**
- **§ 864(c)(8)(A) provides:** Notwithstanding any other provision of subtitle A (Income Taxes) of the Code, gain or loss of a nonresident alien individual or foreign corporation from the sale, exchange, or other disposition of a "directly or indirectly"* held partnership interest *shall be treated as effectively connected to the extent that such gain or loss does not exceed the gain or loss such person would have recognized as effectively connected gain or loss had the partnership sold all of its assets at their fair market value as of the date of the transfer.*
  - **Applies to tiered P/S structures:** Conference Report makes clear that interests in a partnership that holds ECI assets, and that is held by a partner indirectly through other partnerships, is subject to new 864(c)(8). the provision.
- **Tax recognition of the outside gain the foreign partner realizes on sale its partnership interest is limited** to the disposing partner's share of gain inherent in any ECI assets held by the partnership. ECI gain and loss is apparently netted to arrive at net ECI gain or net ECI loss.
- **Coordination with the FRPTA rules to avoid double taxation:** Subpar. (C) of §864(c)(8) provides that the amount of gain or loss on the sale, exchange or other disposition of the partnership interest that is treated as ECI under subparagraph (A) shall be reduced by the amount of gain or loss on such disposition that is treated as effectively connected under §897 (i.e., the FIRPTA rules).
  - **The Foreign Investment in Real Property Tax Act of 1980** (**FIRPTA**) authorizes the US to tax foreign persons on dispositions of "U.S. real property interests." When a foreign person disposes of a U.S. real property interest in a sale, exchange, or transactions that normally would be a non-recognition transactions, FIRPTA treats such gains as "effectively connected income" (ECI), and imposes withholding obligations under § 1445.
- **§ 864(c)(8)(E) grants regulatory authority to Treasury** to promulgate Regs or other appropriate guidance for the applying §864(c)(8), including with respect to various corporate non-recognition provisions.
  - **Example:** If a P/S interest is contributed by a non-US partner to a corporation, should the non-recognition rule of §351 be turned off? Section 864(c)(8) does not purport to override any non-recognition provisions.

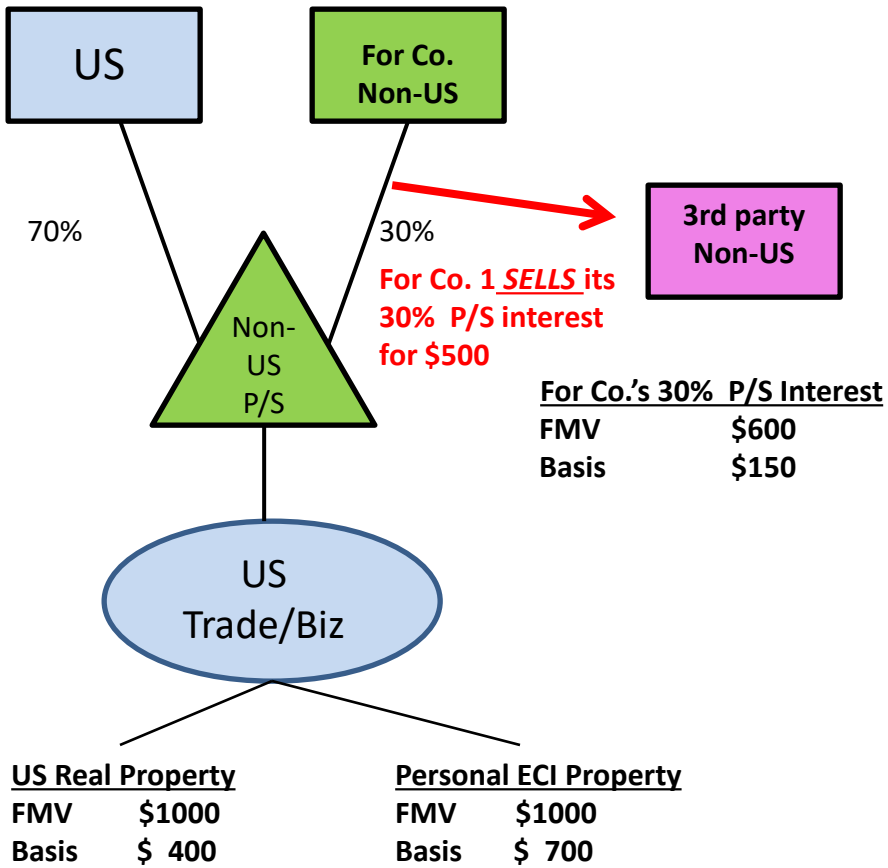
Example: Disposition of P/S Interest (with US Trade/Biz) by Foreign Partner (1 of 2)

Facts:

Foreign Co. sells its 30% interest in US P/S to an unrelated party on Feb. 14, 2018, realizing a $450 gain. Is any of it subject to US tax as "ECI"?

Analysis:

- Under §864(c)(8), For Co's $450 realized gain is treated as income "effectively connected with the conduct of a US trade/business to extent such gain does not exceed its distributive share of gain that would be ECI had the P/S sold all of its assets at FMV as of date of sale/exchange of such interest (but reduced by real property gains that would already be separately taxed as ECI under the FIRPTA regime).
- Hypothetical sale of all of P/S's assets would result in $600 US Real Property gain, and $300 ECI gain in personal property assets, for a total of $900 ECI gain. (NOTE: FIRPTA gains are treated as ECI under that tax law.)
- § 864(c)(8) provides that the amount treated as ECI in the hypothetical asset sale is reduced by the amount that would already be taxed as ECI under the § 896(g) of the FIRPTA regime—here $600.
- Thus, 30% of the inherent $600 FIRPTA gain (i.e., $180) is allowed to first offset For Co.'s OUTSIDE gain on the sale of its P/S interest--($450 realized gain less $180 = $270. How much of the remaining outside gain is treated as ECI to For Co?
- For Co.'s 30% distributive share of the $900 total ECI gains = $270. That $270, representing For Co's share of total ECI gain is also offset by 30% of the FIRPTA gain: ($270 - $180 =**$90**).
- **Thus, under § 864(c), $90 of For. Co.'s realized gain on the sale of its P/S interest is treated as ECI—and taxed in the U.S.** (This makes sense as $90 equals For Co.'s 30% distributive share of the ECI gains on the personal property held by the P/S , which assets are effectively connected with a US Trade or Business.)



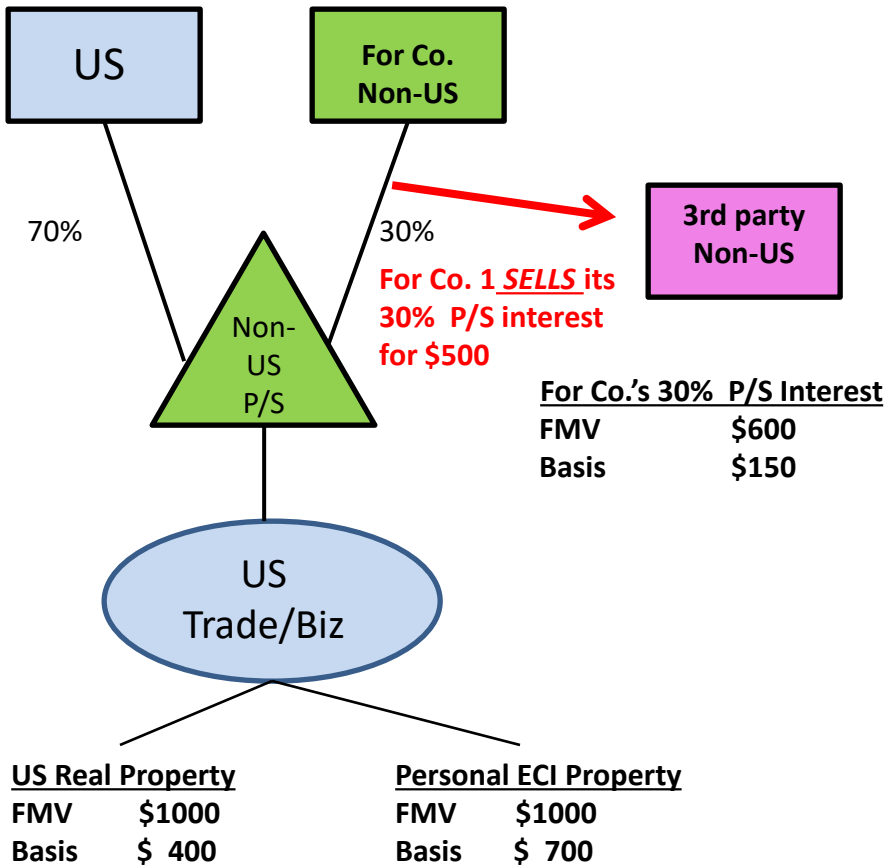
Example continued: Disposition of P/S Interest (with US Trade/Biz) by Foreign Partner (2 of 2)

- **Facts:**

  Foreign Co. sells its 30% interest in US P/S to an unrelated party on Feb. 14, 2018, realizing a $450 gain. Is any of it subject to US tax as "ECI"?

- **Analysis of transferee withholding duty under §1446(f) and Notice 2018-29:**

- §1446(f) became effective Jan. 1, 2018, and it applies to this sale of For Co's P/S interest which occurred on Feb. 14, 2018.
- Section 10 of Notice 2018-29 provides that if a transferee is required to withhold on an "amount realized" under §1446(e)(5) or Reg. § 1.1445-11T(d) *only FIRPTA withholding applies.*
- However, there is no FIRPTA withholding in this example because the P/S assets are not 90% US Real Property Interests and cash. Thus, withholding under new 1446(f) conceivably applies to the ENTIRE amount realized—i.e., 10% w/h X $600 = $60.

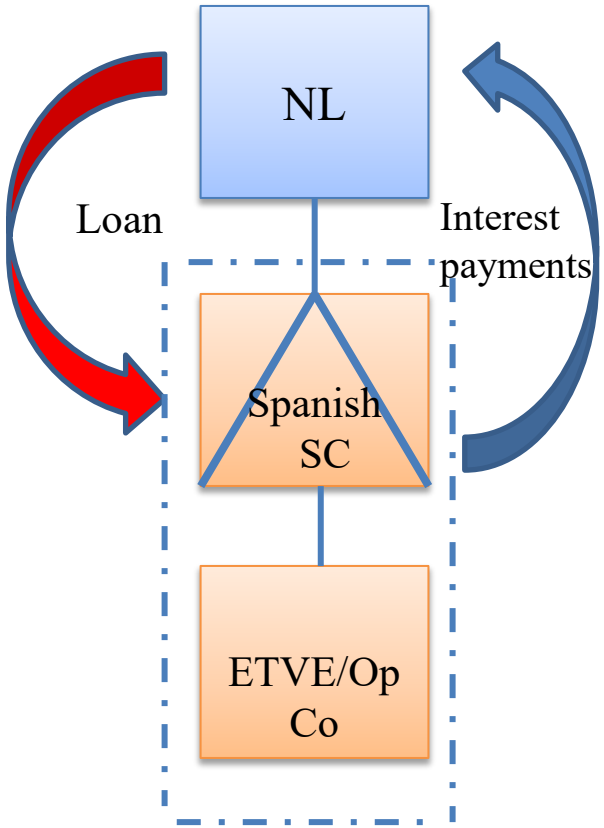


New Limits on Deductible Payments to Foreign Branches involving HYBRIDS: **The Perceived Abuse**

- **Hybrid arrangements**, such as those involving hybrid entities or hybrid instruments are viewed as abusive because their use can erode the tax bases of both jurisdictions involved in a transaction.
- A **"hybrid entity"** is one that is viewed as tax transparent in one country, but as a separate corporate taxpayer in another country. The use of hybrid entities can result in income that is not taxed in any country because, for example, each country views the item as not being received by a person taxable within its own jurisdiction or, alternatively, the item is eligible for some beneficial treatment.
- A **"hybrid instrument"** can result in an income deduction in the country viewing the instrument as "debt" and in one country where the payor resides, with no income inclusion (or beneficial treatment) in the country that treats the same payment as "equity" received by a resident recipient.
- **Hybrid arrangements typically involve:**
  - A payment in one country where the payor resides, with no corresponding income inclusion where the recipient resides (or a favorable rate of taxation). This is called "Deduction—No Inclusion" **("D/NI")** in BEPS speak)
  - A double deduction for the same expense. This is called "Double Deduction" **("DD")** in BEPS speak); OR
  - Multiple claims of foreign tax credit relief for the same foreign tax paid.

Classic Example of Hybrid Entity

SC is a Hybrid Entity



Spanish Financing Structure –

"Sociedad Colectiva"

- Assume Netherlands views the SC (a *Sociedad Colectiva*) as tax transparent—i.e., a disregarded branch.
- Assume Spain treats the SC as a corporate taxpayer—i.e., a regarded entity for tax purposes.
- The SC is a "hybrid entity" because the two countries relevant to the transaction classify the SC differently for tax purposes.
- **Result:**
- Netherlands does not tax NL on the receipt of interest because it views NL as having made a loan to itself.
- Under Spanish tax law, SC may deduct the interest it pays against the income of its tax group formed by SC and the ETVE (75% participation exemption). In addition, there may no w/h tax or (a preferential rate) under the Netherlands-Spain treaty.
- The payment is deductible from income in Spain, but not included in income of the recipient the Residence country– resulting in a "deduction—no inclusion" ("DD/NI" in BEPS speak).
- Results under EU law—ATAD II? EU Parent-Sub Directive ?

Nails in "Hybrid Coffin"

Escalating Limits on Hybrid Arrangements in Last 20 Years

A. **USA:** IRC § 894 and Reg. § 1.894-1(d)(2)(ii) – Domestic law limits tax benefits of arrangements using domestic reverse hybrids

B. **USA:** IRS Notice 98-11, but soon withdrawn by Notice 98-35.

C. **U.S. Model Tax Treaty** (going back to at the 1996 US Model Treaty): U.S. negotiating position has been to ensure that treaty benefits are limited when "fiscally transparent entities" are used to achieve double non-taxation. Stricter and broader anti-hybrid provisions in 2016 US Model Tax Treaty.

D. OECD's Partnership Report of 1999 – "The Application of the OECD Model Tax Convention to Partnerships"

E. OECD/G20's "BEPS" initiative – (Base Erosion Profit Shifting report, Action 2 "Neutralising the Effects of Hybrid Mismatch Arrangements"

1. Oct. 2015: Final Report on Action 2 issued (expands on Sept. 2014 Interim Report)
2. Aug. 22, 2016: "Branch Mismatch Structures" discussion draft released (detailed)
3. OECD recommends changes to domestic law and OECD Model Tax Treaty.
4. OECD's Multilateral Instrument signed (containing anti-hybrid provisions)

F. "Fruit of BEPS": Implementation of Action 2 in an increasing number of countries' domestic law (and EU)

G. EU's Anti-Tax-Abuse Directive (ATA Directive), Article 9 (ATAD I and ATAD II) and EU's Amendment to Parent-Sub Directive

H. Unilateral limits imposed by other countries (independent from OECD's BEPS): UK's "Hybrid Mismatch Rules" effective Jan. 1, 2017 (BREXIT?); Netherlands; Germany; France; Australian proposal

I. **USA:** Obama Proposals; 2016 Model Tax Treaty restrictions; US Congress asked to fix "hybrid problem," and **finally, in 2017, US Congress enacts IRC § 267A** (GOP Senate's provision was enacted--very similar to Obama proposal!)

J. **USA:** Proposed Regulations under 267A issued in 2018. **Final Regulations issued in April 2020 (T.D. 9896).**

§ 267A Targets Hybrid Arrangements (2017 TCJA)

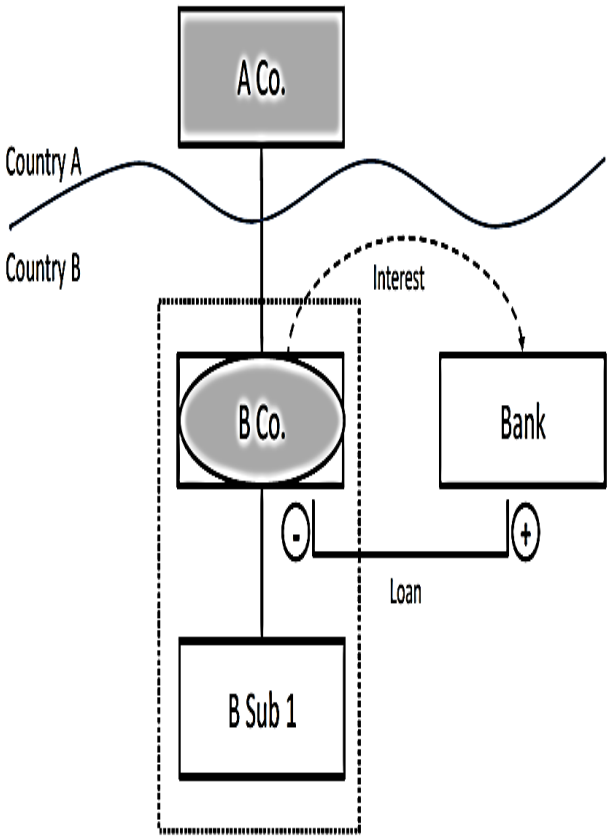
- **§ 267A disallows U.S. tax deductions for any "disqualified related party amount," which is interest and royalties paid or accrued to a "related party" in a "hybrid transaction," or paid to or by a "hybrid entity." §267A(a).**
- **"Related party"** for § 267A purposes is defined by reference to "related person" in **§ 954(d)(3)** (substituting the payor for the CFC). Thus, related party includes an individual, corporation, partnership, trust or estate that controls, is controlled by, the payor, or where both payor and recipient of the interest or royalty are "controlled" by same person(s). Control means >50% ownership (by vote or value). Ownership can be direct, indirect, or constructive through labyrinthine attribution rules. See § 958(a), (b). ***(And, consider the scope of application given repeal of § 958(b)(4)).***
- **"Hybrid Transaction" defined broadly** as "any transaction, series of transactions, agreement, or instrument one of more payments of which are treated as interest or royalties" for U.S. tax purposes and which are not so treated for purposes of the tax law of the recipient's foreign country. (*E.g.*, Otherwise deductible interest payments that are considered dividends, subject to preferential treatment like participation exemption for foreign tax purposes.)
- ***"Hybrid Entity"*** is an entity treated as fiscally transparent in the U.S., but not for purposes of the tax law of the foreign country where the recipient is resident, or vice versa.
- **"Disqualified Related Party Amount"** is any interest or royalty paid or accrued *to the extent that* the payment:
  - **Is not included in the income of the related foreign party under the tax law of the country in which the related party is resident or subject to tax OR**
  - **The related party will (also) be allowed a deduction with respect to the amount under the tax law of the foreign country.** (***Exception***: to extent such payment is included in income of a US shareholder under § 951(a) (Subpart F)).
- **§ 267A(e) grants IRS/ Treasury Dept. broad regulatory authority** to write rules carrying out purposes of § 267A(a), including its application to conduit arrangements, branches, structured transactions, and for treating a "tax preference" as an "income exclusion" if the preference reduces the applicable statutory rate by 25%.
- **The Final 2020 Regulations largely follow the Proposed Regulations, with a few changes based on comments received. In many ways the U.S. Final Regulations *go further than the OECD BEPS Action #2 recommendations.***

General Rules of Final Anti-Hybrid Reg. 1.267A (T.D. 9896 4/2020)

- **Code § 267A:** generally disallows a deduction for interest or royalties paid or accrued in certain transactions involving a hybrid arrangement when U.S. law would otherwise allow a deduction, but the payee does not have a corresponding income inclusion under foreign tax law—i.e., a deduction/no-inclusion (D/NI) outcome or a double deduction outcome (DD).
- **Final Reg. §1.267A-1(b):** A deduction for any interest or royalty paid or accrued (a "specified payment") is disallowed to the extent it is
  1) a disqualified hybrid amount, as described in Reg. §1.267A-2 (hybrid and branch arrangements);
  2) a disqualified imported mismatch amount, as described in Reg. §1.267A-4 (payments offset by a hybrid deduction); or
  3) a specified payment for which the requirements of the anti-avoidance rule of Reg. § 1.267A-5(b)(6) are satisfied.
- **"Relatedness" is required in order for these anti-hybrid provision to apply!!** (In this respect, the U.S. anti-hybrid rules is *narrower in scope* than the OECD BEPS recommendations.) Thus, the disallowance rule of Reg. §1.267A-1(b) only applies if the specified recipient of the payment--could be a tax resident or taxable branch to which the payment is made, an investor, or even just a "home office"--is "related to" the specified party making the interest or royalty payment. "Related" defined by reference to § 954(d)(3) (i.e., > 50% vote OR value control, held directly, indirectly, or (presumably also) constructively under § 218, as modified by § 958(b).
- **A specified party**" is generally a U.S. person, a CFC or a U.S. taxable branch, and the payee must be related to the specified party.

Structures new IRC § 267A does not reach

Figure 6. Basic Double Deduction Structure Using Hybrid Entity



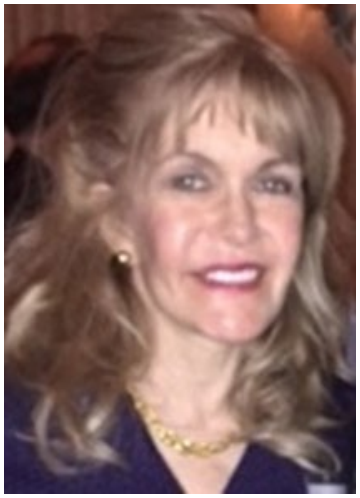
§ 267A , as drafted, apparently *does not disallow* the double deduction in this case because there is no "related party." But other countries' "hybrid mismatch rules" may apply. Does the grant of regulatory authority in §267A (e) give the U.S. Treasury latitude to address this structure in Regs? (i.e., imputing some kind of "related foreign party"?)

- **Assumed Facts:** Countries A and B classify B-Co inconsistently for tax purposes. Country A views B-Co as a tax transparent branch; Country B views B Co. as opaque.
- Thus, B Co is a hybrid entity.
- Country A deducts the interest payments made by its transparent foreign branch.
- B-Co, as borrower, also deducts the same interest payments to on its Country B tax return. (Alternatively, such deductions in B-Co may increase the B Co's losses, which may offset profits under a tax consolidation regime.
- If Country B is the United States, § 267A will *not disallow* the interest deductions because they are not being made to a "related [foreign] party." (If Country A is the United States, the US dual consolidated loss rules will generally disallow any net loss of the B-Co group.)
- Still, but for a special rule, a "double deduction" would result ("double dip" or double deduction –"DD" in BEPS speak).
- **Note:** Obama proposal would have denied interest or royalty deductions arising from certain hybrid arrangements involving unrelated parties in appropriate circumstances, such as structured transactions.
- **BEPS Action 2:**
  - **Primary rule:** to the extent a payment gives rise to a DD outcome, deny the deduction at the **parent level**
  - **Defensive rule:** If A-Co Parent takes the deduction, then the tax law in Country B should deny the deduction at **payor level** (i.e., in Country B).

CAUTION: Special Long-term Deferral, 36-month rule in the Anti-Hybrid Regs

- Long-term deferrals of "income inclusions" may cause a "deduction/no inclusion" (D/NI) outcome.
- A specified payment **will be *treated as made under a hybrid transaction*** *IF* the tax year in which a the specified recipient recognizes the payment under its tax law **ends more than 36 months after** the end of the tax year in which a deduction for the payment would otherwise be allowed for US tax purposes. (In other words, the income inclusion in the recipient's country must occur within 36 months after the end of the payer's tax year to be considered an "income inclusion" for purposes of § 267A.)
- The Final Regulations modify the bright-line 36-month rule from the Proposed Regs.
  - A "reasonable expectation" standard applies: If, at the time of the specified payment, it should be reasonable to expect that the payment will be taken into account and included in income within the 36-month period.
- **Effective dates:** Code § 267A generally applies to tax years ending on or after December 20, 2018, provided that such tax years begin after Dec. 31, 2017 (i.e., for a calendar year taxpayer effective date is January 1, 2018). Most provisions in the Final Regs are subject to special applicability-date rules. (Example: Rules regarding swaps with significant non-periodic payment only apply to NPCs entered into on or after April 8, 2021, unless Tp chooses to apply them earlier.)

Pamela A. Fuller, Esq., LL.M.



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Pamela is an international tax attorney, based in New York City.

Her tax practice is primarily focused on advising private & public companies on crossborder M&A transactions & strategies, transfer pricing & BEPS issues, and complex financings. Her clients hail from a multitude of industries, including the burgeoning world of decentralized finance, which involves myriad legal and tax issues arising from innovative digital assets and services.

Pamela is also a seasoned taxpayer advocate, with decades of experience resolving complex U.S. federal, state, and foreign tax controversies. She began her legal career at the U.S. Tax Court one month after graduating with her J.D. degree, serving three consecutive 2-year terms as an Attorney Advisor to that court's Chief Judge, handling transfer pricing cases and large, complex "tax shelters," at a time when that court (with its 17 federal judges) had a backlog of over 80,000 cases on its docket.

Pamela is presently Chair of the ABA Tax Section's Tax Policy Committee, and also Co-Chair of the International Tax Committee of the ABA's International Law Section, with global membership.

A Fellow of both the American Bar Foundation and the American College of Tax Counsel, Pamela regularly speaks at law conferences, and publishes articles on international tax topics in peer-reviewed law journals. She serves on several steering committees & boards, including TaxLaw 360's International Tax Advisory Board; Strafford's Tax Law Advisory Board; the International Fiscal Assoc.-USA's New York Congress; and the New York State Bar's "Global Law Week." She is a founding member of the New York City Bar's Taskforce on the Independence of Lawyers & Judges.

Prior to becoming an attorney, and earning her LL.M. in Taxation (and international/securities law) at New York University School of Law, Pamela worked as a print & broadcast journalist covering transnational business—and focusing on emerging "tech" industries--for a large metropolitan newspaper and a renowned NBC affiliate in her original hometown of Seattle.

VII. Preparing IRS Form 8832, and Late Elections (§ 9100 Relief)

DRUCKER & SCACCETTI

TAX AS A BUSINESS STRATEGY®

Preparing IRS Form 8832, and Late Elections

IRS FORM 8832: ENTITY CLASSIFICATION ELECTIONS

- Business entities classified as corporations ("per se" corporations) are not eligible to change their classifications by filing Form 8832 (Entity Classification Election).

Default classifications

- Domestic entities
  - A business entity with two or more members is classified as either a corporation or partnership for U.S. federal income tax purposes.
  - A business entity with only one owner is classified as a corporation or disregarded entity.
- Foreign entities
  - A business entity with two or more members, with at least one member who does not have limited liability, is classified as a partnership for U.S. federal income tax purposes.
  - A business entity with only one owner is classified as a disregarded entity if its sole owner does not have limited liability.
  - A business entity all of whose members have limited liability is classified as an association/corporation.

IRS FORM 8832: ENTITY CLASSIFICATION ELECTIONS (CONT'D)

- A Form 8832 entity classification election is required only when an eligibility entity (i.e., a business entity that is not a "per se" corporation) intends to change its default classification.
- An eligible entity can change its default classification by electing the desired classification on and filing Form 8832. The effective date of a regular election *cannot be more than 75 days prior to the date on which the election is filed* or more than 12 months after the date on which the election is filed.

Late Entity Classification Relief under Rev. Proc. 2009-41

- Rev. Proc. 2009-41 late entity classification election relief is available to an eligible entity that failed to file a duly completed Form 8832 within 75 days from the effective date of the desired election.
  - Effective date: The date when the entity became relevant for U.S. federal income tax purposes (e.g., date of formation, date of acquisition of an equity interest in an existing entity, etc.).

IRS FORM 8832: ENTITY CLASSIFICATION ELECTIONS (CONT'D)

- In order to qualify for relief under Rev. Proc. 2009-41, the following requirements must be met:
  - The entity (or affected person) must not have filed a U.S. federal income tax return for the first year of the election because the due date has not passed, or
  - The entity (or affected person) has timely filed all required U.S. federal income tax returns (or, if not timely filed, within 6 months of the original due date) consistent with the desired election for all the years for which the election is to be effective, and no inconsistent returns have been filed during any of the relevant tax years;
  - The entity has reasonable cause for its failure to timely file the election; and
  - The requested effective date of the election is not more than 3 years and 75 days prior to the filing date of the Form 8832.

LATE ELECTION: SECTION 9100 RELIEF – RULING REQUEST

- Treas. Reg. section 301.9100-3 provides an alternative for entities that do not meet the requirements of Rev. Proc. 2009-41. This provision allows late election relief to an entity by way of filing a ruling request with the IRS.
- A 9100-3 relief procedure is the most expensive of all entity classification alternatives available.
  - It involves paying an IRS user fee, which currently is $12,600 (Rev. Proc. 2022-1 Appendix A).
  - Incurring substantial professional fees on engaging the services of a professional tax advisor to draft the private letter ruling (PLR) request.
- The administrative processing time for a PLR request by the IRS is significantly long.

LATE CHANGE OF CLASSIFICATION RELIEF UNDER REV. PROC. 2010-32

- Rev. Proc. 2010-32 provides corrective relief for certain partnership or disregarded entity classification elections. The Rev. Proc. provides a more cost-effective and faster alternative to the 301.9100-3 letter ruling process for a late change of entity classification.
- The relief applies to an entity classified as a partnership that wants to change its classification to that of a disregarded entity (because it has subsequently realized, after making the initial election, that it has only one member instead of at least two), or an entity classified as a disregarded entity that wants to change its classification to that of a partnership (because it has subsequently realized, after making the initial election, that it has at least two members instead of only one).
- If a qualified entity (i.e., an entity that is eligible to make an entity classification election) files an otherwise valid Form 8832 to be classified as a partnership for U.S. federal income tax purposes but it is later determined that the entity had a single owner for federal tax purposes as of the effective date of the election, the IRS will treat the Form 8832 as an election to treat the entity as a disregarded entity for federal tax purposes, provided that:

LATE CHANGE OF CLASSIFICATION RELIEF UNDER REV. PROC. 2010-32 (CONT'D)

- The entity's actual single owner and purported owners as of the effective date of the election file original or amended returns consistent with the treatment of the entity as a disregarded entity for any taxable year that would have been affected if the election had been made to treat the entity as a disregarded entity for federal tax purposes;
- All required amended returns are filed before the close of the period of limitations on assessments under IRC section 6501(a) (e.g., the general 3-year statute of limitations) for any relevant taxable year; and
- A corrected Form 8832 is filed with the appropriate IRS Center and a copy of the corrected Form 8832 is attached to the single owner's amended return for the taxable year during which the original election was made. The statement "FILED PURSUANT TO REVENUE PROCEDURE 2010-32" must be included across the top of the corrected Form 8832. Additionally, the corrected Form 8832 must satisfy all other Form 8832 compliance requirements.

LATE CHANGE OF CLASSIFICATION RELIEF UNDER REV. PROC. 2010-32 (CONT'D)

- If a qualified entity files an otherwise valid Form 8832 to be classified as a disregarded entity for U.S. federal income tax purposes but it is later determined that the entity had two or more owners for federal tax purposes as of the effective date of the election, the IRS will treat the Form 8832 as an election to classify the entity as a partnership for federal tax purposes, provided that:
  - The entity files information returns and its actual owners file original or amended returns consistent with the treatment of the entity as a partnership for any taxable year that would have been affected if the original election had been made to treat the entity as a partnership for federal tax purposes;
  - All required amended returns are filed before the close of the period of limitations on assessments under IRC section 6501(a) (e.g., the general 3-year statute of limitations) for any relevant taxable year; and

LATE CHANGE OF CLASSIFICATION RELIEF UNDER REV. PROC. 2010-32 (CONT'D)

- A corrected Form 8832 is filed with the appropriate IRS Center and a copy of the corrected Form 8832 is attached to the owners' amended returns for the taxable year during which the original election was made. The statement "FILED PURSUANT TO REVENUE PROCEDURE 2010-32" must be included across the top of the corrected Form 8832. Additionally, the corrected Form 8832 must satisfy all other Form 8832 compliance requirements.

PREPARING IRS FORM 8832

Form **8832**
(Rev. December 2013)
Department of the Treasury
Internal Revenue Service

Entity Classification Election

▶ Information about Form 8832 and its instructions is at *www.irs.gov/form8832*.

OMB No. 1545-1516

Type or Print	Name of eligible entity making election	Employer identification number
	Number, street, and room or suite no. If a P.O. box, see instructions.	
	City or town, state, and ZIP code. If a foreign address, enter city, province or state, postal code and country. Follow the country's practice for entering the postal code.	

▶ Check if: ☐ Address change ☐ Late classification relief sought under Revenue Procedure 2009-41
☐ Relief for a late change of entity classification election sought under Revenue Procedure 2010-32

Part I **Election Information**

1 **Type of election** (see instructions):

a ☐ Initial classification by a newly-formed entity. Skip lines 2a and 2b and go to line 3.
b ☐ Change in current classification. Go to line 2a.

2a Has the eligible entity previously filed an entity election that had an effective date within the last 60 months?

☐ **Yes.** Go to line 2b.
☐ **No.** Skip line 2b and go to line 3.

2b Was the eligible entity's prior election an initial classification election by a newly formed entity that was effective on the date of formation?

☐ **Yes.** Go to line 3.
☐ **No.** Stop here. You generally are not currently eligible to make the election (see instructions).

3 Does the eligible entity have more than one owner?

☐ **Yes.** You can elect to be classified as a partnership or an association taxable as a corporation. Skip line 4 and go to line 5.
☐ **No.** You can elect to be classified as an association taxable as a corporation or to be disregarded as a separate entity. Go to line 4.

4 If the eligible entity has only one owner, provide the following information:

a Name of owner ▶ _____
b Identifying number of owner ▶ _____

5 If the eligible entity is owned by one or more affiliated corporations that file a consolidated return, provide the name and employer identification number of the parent corporation:

a Name of parent corporation ▶ _____
b Employer identification number ▶ _____

For Paperwork Reduction Act Notice, see Instructions. Cat. No. 22598R Form **8832** (Rev. 12-2013)

PREPARING IRS FORM 8832 (CONT'D)

Form 8832 (Rev. 12-2013) Page 2

Part I **Election Information** (Continued)

6 **Type of entity** (see instructions):

- **a** ☐ A domestic eligible entity electing to be classified as an association taxable as a corporation.
- **b** ☐ A domestic eligible entity electing to be classified as a partnership.
- **c** ☐ A domestic eligible entity with a single owner electing to be disregarded as a separate entity.
- **d** ☐ A foreign eligible entity electing to be classified as an association taxable as a corporation.
- **e** ☐ A foreign eligible entity electing to be classified as a partnership.
- **f** ☐ A foreign eligible entity with a single owner electing to be disregarded as a separate entity.

7 If the eligible entity is created or organized in a foreign jurisdiction, provide the foreign country of organization ▶ _____

8 Election is to be effective beginning (month, day, year) (see instructions) . . . . . ▶ _____

9 Name and title of contact person whom the IRS may call for more information

10 Contact person's telephone number

Consent Statement and Signature(s) (see instructions)

Under penalties of perjury, I (we) declare that I (we) consent to the election of the above-named entity to be classified as indicated above, and that I (we) have examined this election and consent statement, and to the best of my (our) knowledge and belief, this election and consent statement are true, correct, and complete. If I am an officer, manager, or member signing for the entity, I further declare under penalties of perjury that I am authorized to make the election on its behalf.

Signature(s)	Date	Title

Form **8832** (Rev. 12-2013)

PREPARING IRS FORM 8832 (CONT'D)

- Employer Identification Number (EIN)
  - Must be obtained by the eligible entity by filing Form SS-4 prior to filing Form 8832.
  - Indicating "Applied For" in the EIN box is not acceptable.
- Rev. Proc. 2010-32 relief in the case of a determination of an incorrect number of owners.
  - How to complete Lines 3 and 4 on page 1 and Line 6b, c, e, and f (Type of entity) on page 2 depends in part on a determination of the number of owners of the eligible entity filing Form 8832. If it is discovered subsequently that the original determination of the number of owners was incorrect, the Rev. Proc. 2010-32 relief procedure allows the entity to file a corrected Form 8832 based on an accurate determination of the number of owners.

PREPARING IRS FORM 8832 (CONT'D)

- Consent Statement and Signature(s)
  - Must be signed by each member of the electing entity who is an owner at the time the election is filed; or
  - Any officer, manager or member of the electing entity who is authorized (under local law or organizational documents) to make the election.

PREPARING IRS FORM 8832 (CONT'D)

Part II **Late Election Relief**

11 Provide the explanation as to why the entity classification election was not filed on time (see instructions).

Under penalties of perjury, I (we) declare that I (we) have examined this election, including accompanying documents, and, to the best of my (our) knowledge and belief, the election contains all the relevant facts relating to the election, and such facts are true, correct, and complete. I (we) further declare that I (we) have personal knowledge of the facts and circumstances related to the election. I (we) further declare that the elements required for relief in Section 4.01 of Revenue Procedure 2009-41 have been satisfied.

Signature(s)	Date	Title

PREPARING IRS FORM 8832 (CONT'D)

Part II: Late Election Relief

- The reasonable cause statement. When formulating a reasonable cause statement for a late election, the administrative purpose underpinning the issuance of Rev. Proc. 2009-41 should be borne in mind. The IRS issued Rev. Proc. 2009-41 to provider a more cost-effective and faster relief alternative to the 9100-3 letter ruling relief with respect to the elections filed outside of the regular 75-day filing period.
- Thus, the IRS likely does not apply the "reasonable cause" standard to late elections the same way it does apply such standard to taxpayer requests for the abatement/waiver of penalties for delinquent filings of returns (e.g., information returns such as Forms 5471).

PREPARING IRS FORM 8832 (CONT'D)

Part II: Late Election Relief

- Given the administrative purpose behind Rev. Proc. 2009-41, as set forth on the preceding slide page, the following is a non-exclusive list of explanations that may constitute reasonable cause:
  - The owners of the electing entity never received professional tax advice on the necessity of making the election at the time the entity was formed or acquired, and received such advice after the 75-day filing period had run out;
  - The owners of the electing entity initially received incorrect professional tax advice that the election was not necessary at the time the entity was formed or acquired, but later obtained a second opinion from a more competent tax advisor that the election was necessary, after the 75-day period had run out;
  - An officer of the electing entity responsible for filing the election had a medical condition that kept him away from work for a period of time, and by the time he returned to the office the 75-day filing period had run out; and

PREPARING IRS FORM 8832 (CONT'D)

Part II: Late Election Relief

- Internal administrative confusion as to which officer of the electing entity was responsible for filing the election, which gets sorted out only upon realization that the 75-day filing period for the election was missed.

Who signs the late election relief statement?

- Must be signed by each member of the electing entity who is an owner at the time the election is filed; or
- An authorized representative of the eligible entity (e.g., officer, manager or member); and
- Each affected person (i.e., a person who is required to attach a copy of the Form 8832 to their U.S. federal tax or information return for the tax year that includes the effective date of the election).

PREPARING IRS FORM 8832 (CONT'D)

Post Form 8832 Filing Compliance Obligations

- If the electing entity is required to file a federal tax or information return for the tax year of the election, a copy of the Form 8832 must be attached to that return.
- If the electing entity is not required to file a federal tax or information return for the tax year of the election, a copy of the Form 8832 must be attached to the federal tax returns of all direct or indirect owners of the entity for that year.
- Failure to attach a copy of the Form 8832 does not invalidate an otherwise valid election, but penalties may be assessed by the IRS for this non-compliance.

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VIII. Key Takeaways, Final Remarks, and Q&A

Key Takeaways on Foreign Entity Selection (Post TCJA)

- The choice of entity calculation starts with whether to use a US corporation to make the outbound investment (as opposed to an S-corp, or pass-through entity (LLC taxed as a partnership), or an individual)
- There is no "one size fits all" structure
- CFC status will impose more compliance costs (especially due to GILTI regime under § 951A)
- There is essentially no more deferral . Call it a "quasi-territorial regime" but emphasis is on QUASI (very quasi)
- Foreign tax credit analysis is even more difficult than analyzing interaction between Subpart F and GILTI—especially with the new "GILTI basket" and "foreign branch" limitation basket.
- Avoiding § 951(a) Subpart F income will still usually be cost effective because it is taxed at a higher rate (21%) as opposed to GILTI (10.5% for lucky corporations) —but not always! And, the GILTI rate will be going up.
- Occasionally, because of limited FTCs with the GILTI regime, results under the longtime Subpart F regime may be better!
- Just like foreign entity selection was used for decades to avoid Subpart F income, same techniques may be used to plan "into" Subpart F.
- Foreign entity selection may be used to avoid the application of the Subpart F, GILTI, and even the BEAT, and careful modeling with the right foreign entity selection can mitigate the impact of these taxes (even if you cannot avoid them)
- Hybrid mismatches (entities and instruments) are under attack globally! Be aware of the US and increasing codification of BEPS-inspired anti-hybrid rules that effectively neutralize the former tax advantages of using hybrid entities (and instruments).
- Hybrid mismatches are often impossible to avoid; they arise organically--and can still be benign.
- No § 245A DRD for hybrid dividends (also no FTC or deduction or §78 gross-up)!
- Determining the optimal corporate structure requires more thought than in the past *(and a little "betting")*
- International tax planning seems to have become MORE complicated (when simplification was a stated goal).
- **And finally: Not every outbound structure needs to be *changed*, but every outbound structure should be *re-examined* *(in light of the many recent sets of regulations promulgated and issued by the IRS in the wake of the 2017 US Tax Act and other global tax law changes) !!***