

# FDII Deduction and GILTI Rules: Claiming Section 250 Tax Incentives on Eligible Foreign Income

MONDAY, DECEMBER 6, 2021, 1:00-2:50 pm Eastern

## IMPORTANT INFORMATION FOR THE LIVE PROGRAM

This program is approved for 2 CPE credit hours. To earn credit you must:

- **Participate in the program on your own computer connection (no sharing)** - if you need to register additional people, please call customer service at 1-800-926-7926 ext. 1 (or 404-881-1141 ext. 1). Strafford accepts American Express, Visa, MasterCard, Discover.
- Listen on-line via your computer speakers.
- Respond to five prompts during the program plus a single verification code.
- To earn full credit, you must remain connected for the entire program.

## WHO TO CONTACT DURING THE LIVE PROGRAM

For Additional Registrations:

-Call Strafford Customer Service 1-800-926-7926 x1 (or 404-881-1141 x1)

For Assistance During the Live Program:

-On the web, use the Chat function to send a message

If you get disconnected during the program, you can simply log in using your original instructions and PIN.

## *Tips for Optimal Quality*

FOR LIVE PROGRAM ONLY

---

### Sound Quality

When listening via your computer speakers, please note that the quality of your sound will vary depending on the speed and quality of your internet connection.

If the sound quality is not satisfactory, please e-mail [sound@straffordpub.com](mailto:sound@straffordpub.com) immediately so we can address the problem.

---

**Recording our programs is not permitted. However, today's participants can order a recorded version of this event at a special attendee price. Please call Customer Service at 800-926-7926 ext.1 or visit Strafford's website at [www.straffordpub.com](http://www.straffordpub.com).**

# FDII Deduction and GILTI Rules: Claiming Section 250 Tax Incentives on Eligible Foreign Income

---

December 6, 2021

---

William R. Skinner  
Partner  
Fenwick & West LLP  
[wrskinner@fenwick.com](mailto:wrskinner@fenwick.com)

Kyle Brandon  
Senior Manager, International Tax Services  
Grant Thornton LLP  
[kyle.brandon@us.gt.com](mailto:kyle.brandon@us.gt.com)

# Notice

---

ANY TAX ADVICE IN THIS COMMUNICATION IS NOT INTENDED OR WRITTEN BY THE SPEAKERS' FIRMS TO BE USED, AND CANNOT BE USED, BY A CLIENT OR ANY OTHER PERSON OR ENTITY FOR THE PURPOSE OF (i) AVOIDING PENALTIES THAT MAY BE IMPOSED ON ANY TAXPAYER OR (ii) PROMOTING, MARKETING OR RECOMMENDING TO ANOTHER PARTY ANY MATTERS ADDRESSED HEREIN.

You (and your employees, representatives, or agents) may disclose to any and all persons, without limitation, the tax treatment or tax structure, or both, of any transaction described in the associated materials we provide to you, including, but not limited to, any tax opinions, memoranda, or other tax analyses contained in those materials.

The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.



Grant Thornton

---

# Introduction

# Section 250 - Deduction for foreign-derived intangible income

- Incentive for domestic corporations that earn "foreign derived-intangible income" (FDII)
- Generally provides a deduction of 37.5% of the sum of its FDII and a 50% deduction of the sum of its GILTI
- Results in a 13.125% effective tax rate on excess returns on certain foreign derived income (21.875% for taxable years beginning after Dec. 31, 2025)
- Generally subject to a taxable income limitation
- Effective date – Taxable years beginning after Dec. 31, 2017
- Final regulations reserved on ordering rules for application of Section(s) 163(j), 250, and 172

# Applicability dates

Taxpayers are afforded flexibility with respect to the application of final regulations:

On July 9, 2020 the IRS issued final regulations that provide guidance regarding the deduction for foreign-derived intangible income (FDII) and global intangible low-taxed income (GILTI). The final regulations retain the basic approach and structure of the proposed regulations but include numerous revisions



## Prospective

Generally, the final rules under Section 250 apply to taxable years beginning on or after Jan. 1, 2021



## Retroactive

Taxpayers may choose to apply the final or proposed regulations for taxable years beginning before Jan. 1, 2021, provided they are applied in their entirety



## Flexibility

Taxpayers that choose to rely on the proposed regulations may apply the proposed transition rules (ordinary course documentation) for documentation to tax years beginning before Jan. 1, 2021, provided that the proposed regulations are applied to such years



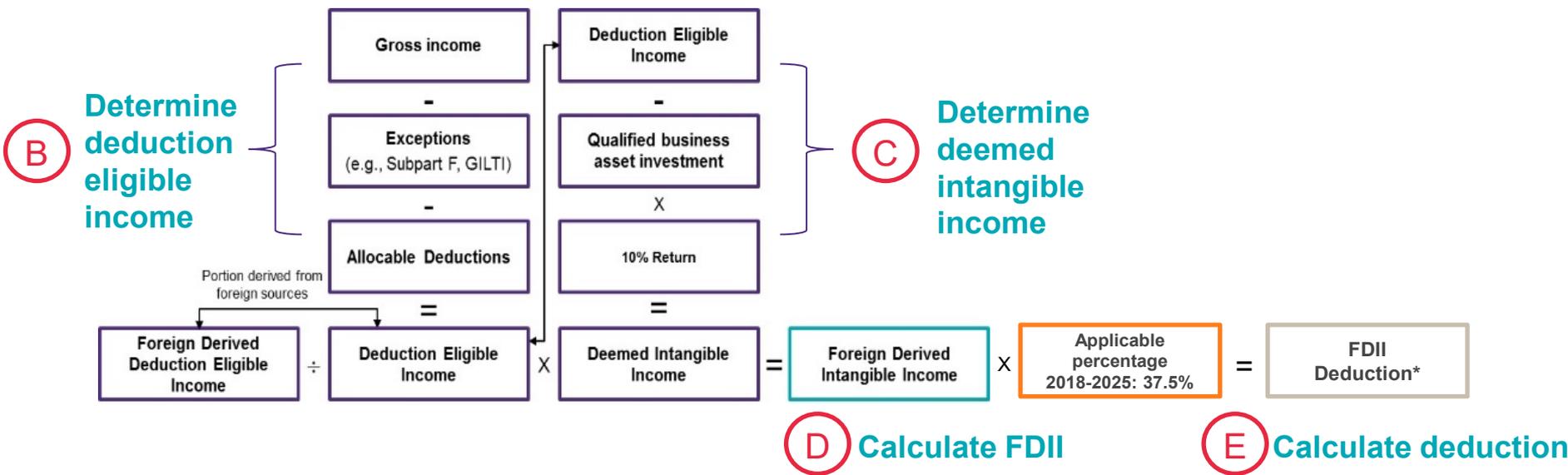
Grant Thornton

---

## **Overview and general mechanics in proposed and final regulations**

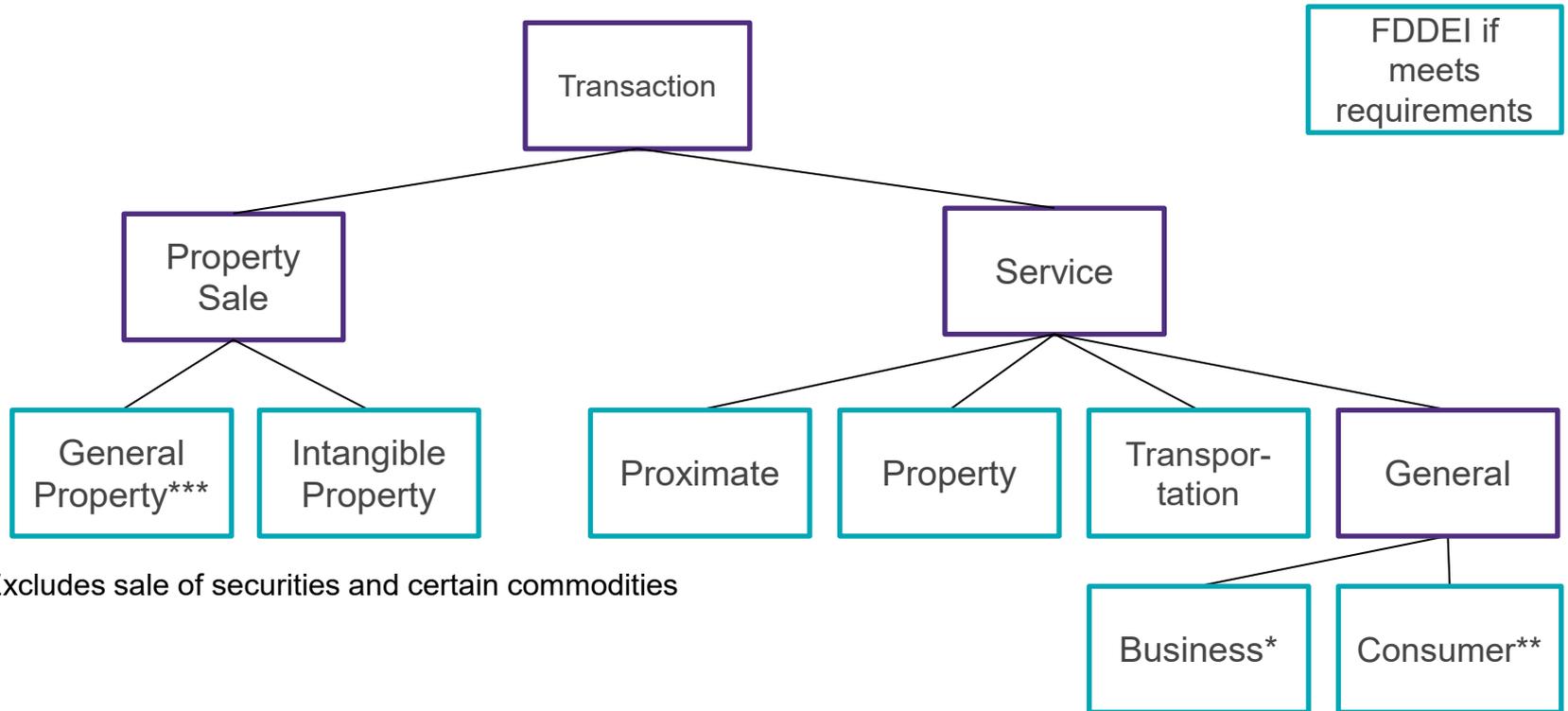
# The FDII calculation

- A Determine if taxpayer is eligible**
- 1: Is taxpayer a domestic C corporation?
  - 2: Did taxpayer have qualifying foreign income?
  - 3: Did taxpayer generate taxable income for the tax year?
- If the answers to the above questions is yes, then perform the following calculation:



\* Subject to a limitation based on taxable income.

# FDDEI – Breakout



\*\*\*Excludes sale of securities and certain commodities

\*Further subdivided into electronically supplied, advertising and other general services

\*\*Further subdivided into electronically supplied and other general services

# Taxable income limitation reserved

## Taxable income limit

The Section 250 deduction is subject to a limitation based on the taxable income of the taxpayer. If a domestic corporation's GILTI and FDII exceed its taxable income, the excess is allocated pro rata to reduce these amounts for purposes of computing the Section 250 deduction\*



Five-step process in the preamble to the proposed regulations



Final regulations reserve



No current order to resolve circularity (e.g., limitations to secs. 163(j), 250 and 172)



Reasonable method, including proposed rule (see next slide) or simultaneous equations, until further notice

# Coordination of Sections 163(j), 172 and 250 limitations – Proposed Regs.

The 5 step process to determine taxable income for purposes of Section 250(a)(2) is as follows:

- 1 Calculate Section 250 deduction without respect to taxable income limitation (“tentative Section 250 deduction”)
- 2 Compute Section 163(j) limitation with regard to the tentative Section 250 deduction but without considering Section 172(a)
- 3 Compute NOL deduction under 172(a)
- 4 Calculate FDII, taking into account the deduction limitations under Sections 163(j) and 172(a)
- 5 Compute the Section 250 deduction, taking into account the taxable income limitation of Section 250(a)(2), including the application of Sections 163(j) and 172(a) in prior steps.

\*There is the option to follow this process as outlined in the proposed regulations. This section was reserved in the FINAL regulations.

# Other general mechanics - highlights

- Clarify that “sale” includes transfer of property resulting in gain/income under Sec. 367
- Provide rules for QBAI, which are substantially similar to GILTI
  - Also include any anti-abuse rule on sale-leaseback transactions
- Cost of goods sold are attributed to gross DEI and FDDEI using any reasonable method
- Deductions allocated and apportioned against gross Comp DEI and FDDEI under the rules of Treas. Reg. Secs. 1.861-8 through 1.861-14T and 1.861-17 (with modifications)
- Definition of a branch expanded for DEI exclusion

# Other general mechanics - highlights

- Reporting of deduction on Form 8993 (updated form in December 2020)
- Section 250 deduction for GILTI available to individuals making a Section 962 election
- Consolidated group rules that apply combined approach, push-down and intercompany transaction rules
- Partnership rules that provide for a distributive share of FDII items and GILTI
- Related party rules which impose additional requirements on FDDEI transaction



Grant Thornton

---

## DEI & QBAI

# DEI - Deduction eligible income

Deduction eligible income (“DEI”) is the gross income of the corporation determined without regard to the certain exceptions (below) less properly allocable deductions (including taxes)



**Subpart F income and Section 956 inclusions**

**GILTI inclusions**

**Certain financial services income**

**Any dividend received from a CFC which is a CFC of the domestic corporation**

**Domestic oil and gas extraction income**

**Foreign branch income**

# Definition of a branch for DEI exclusion

- The final regulations modify the definition of foreign branch income to align with the definition under Treas. Reg. Sec. 1.904-4(f)(2)
- In addition, the rules remove the modification to the definition that would have included as foreign branch income any income from the sale of any asset that produces gross income attributable to a foreign branch, including the sale of a disregarded entity or partnership interest

# Definition of financial services income for DEI exclusion

The final regulations define financial services income by reference to section 904(d)(2)(D) and §1.904-4(e)(1)(ii), which generally includes income derived by a financial services entity, such as:

- Income derived in the active conduct of a banking, insurance, financing, or similar business;
- Passive income as defined in section 904(d)(2)(B) determined before the application of the exception for high-taxed income but after the application of the exception for export financing interest (generally FPHCI); or
- certain incidental income

Financial services entity means an individual or entity that is predominantly engaged in the active conduct of a banking, insurance, financing, or similar business

# DII - Deemed intangible income

- The domestic corporation's deemed intangible income means the excess (if any) of its DEI over its deemed tangible income return ("DTIR")
- DTIR is 10% of the corporation's qualified business asset investment ("QBAI")
  - QBAI is determined under Section 250 in a similar manner as it is for GILTI
- QBAI is the quarterly average of a domestic corporation's adjusted tax basis in depreciable tangible assets used in the production of deduction eligible income ("DEI")
- Adjusted basis of property is determined under the alternative depreciation (ADS) rule of Section 168(g)
- The final regulations provide special rules for dual use property, calculating QBAI in a short taxable year and calculating a domestic partner's share of partnership QBAI

# QBAI anti-abuse rule

- Special anti-avoidance rules apply in the final regulations to disregard a transfer of specified tangible property by a domestic corporation to decrease QBAI
- The rules apply if:
  - a principal purpose exists of decreasing the amount of its DTIR,
  - a domestic corporation transfers specified tangible property to a related party of the domestic corporation, and
  - within the disqualified period (generally a two year period), the domestic corporation or related party leases the same or substantially similar property from any specified related party
- If the rules apply then, solely for purposes of determining QBAI, the domestic corporation is treated as owning the transferred property (i.e., the transfer is disregarded).
- If both the transfer and the lease occur within a six-month period, then the transfer is treated per se as occurring pursuant to a principal purpose of decreasing DTIR

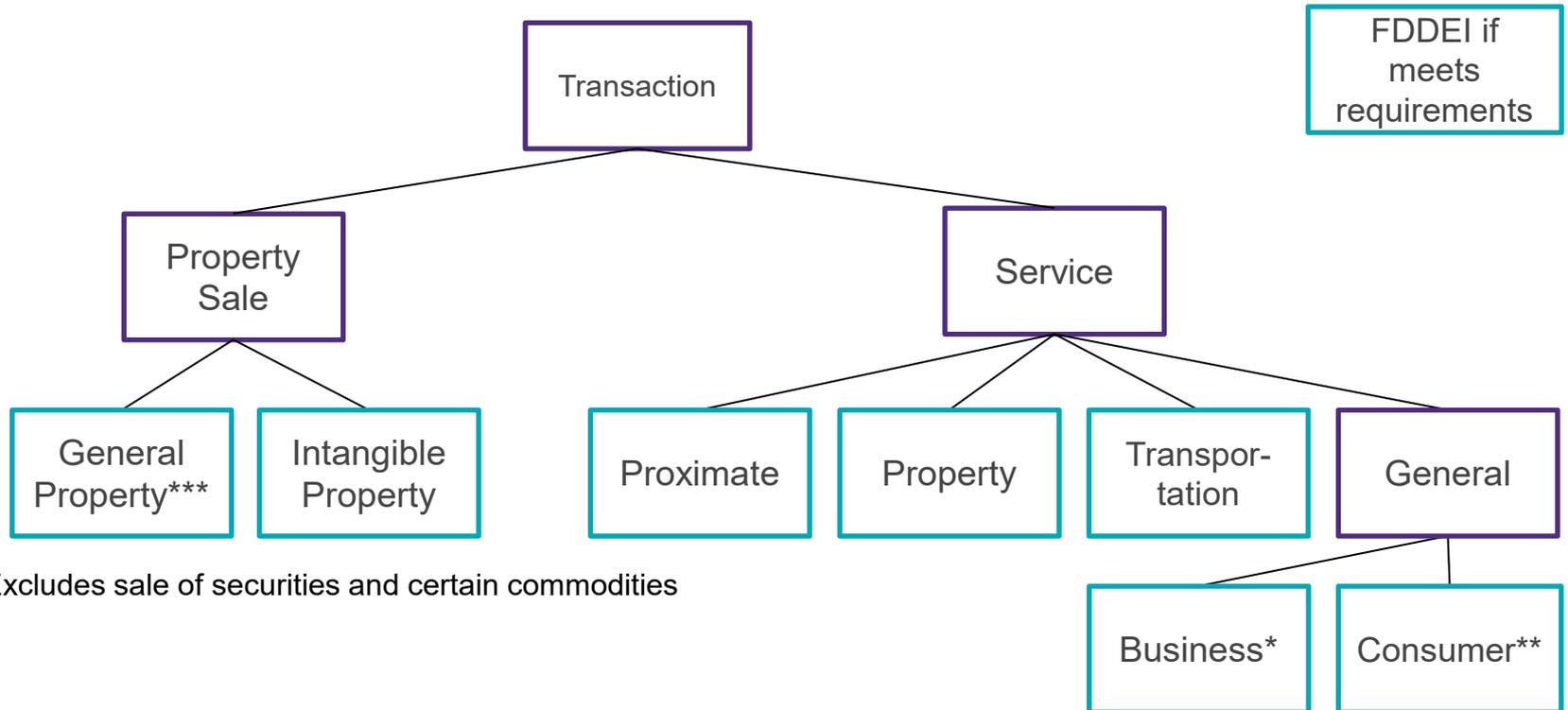


Grant Thornton

---

## FDDEI sales and services

# FDDEI – Breakout



\*\*\*Excludes sale of securities and certain commodities

\*Further subdivided into electronically supplied, advertising and other general services

\*\*Further subdivided into electronically supplied and other general services

# FDDEI sales – General rules

- Generally, a FDDEI sale is a sale of property that is:
  1. to a **foreign person** and
  2. for a **foreign use**
- "Sale" is broadly defined to include any lease, license, exchange, or other disposition and includes a transfer of property resulting in a gain or income under Section 367
- Different standards apply for determining if a sale of property is for a foreign use depending on whether the property is "general property" or "intangible property"
  - "Intangible property" is defined by cross-reference to Section 367(d)(4)
  - "General property" is any property other than intangible property, a commodity, or a security
    - Sale of a commodity or security is not an FDDEI sale

# Foreign person and foreign use

## Foreign person status

- Presumption of foreign person status if the sale is described in one of four categories
- Categories include sales is a foreign retail sale, delivered to the recipient or end user, and the shipping address is outside of the U.S., etc.
- Does not apply if the seller knows or has “reason to know” that the sale is not to a foreign person

## Foreign use status

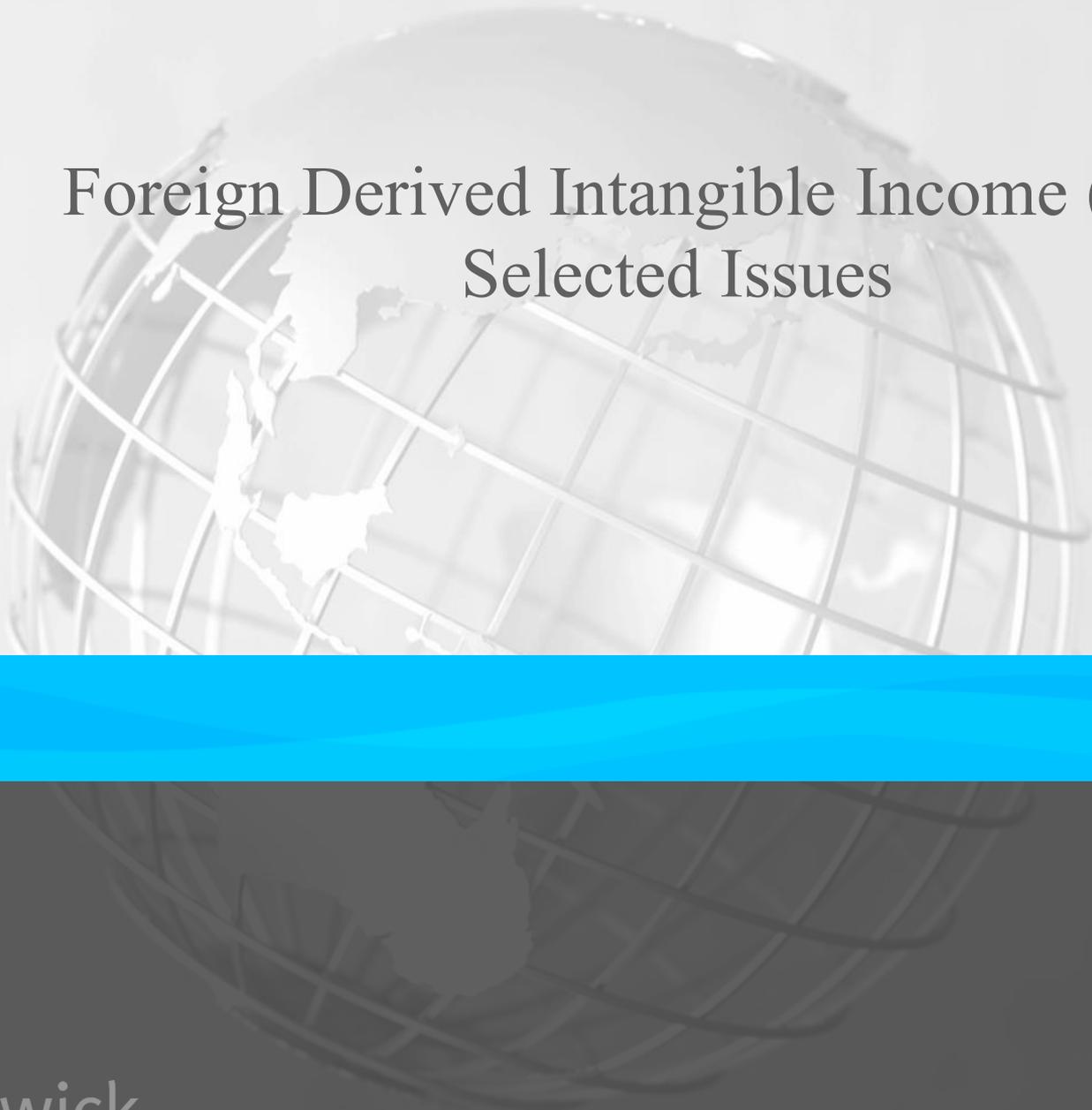
- Provide that a sale of general property is for foreign use if the property is subject to manufacturing, assembly or other processing outside the United States, or if delivered to an end-user outside the United States (e.g., delivered by freight forwarder to a recipient outside the U.S. that is an end user)
- No longer requires that property not be subject to domestic use within three years

Replaced prescriptive documentation rule (e.g., requirement for documentation like a valid ID) required in the proposed regulations with a presumptive test for foreign person status

# Manufacturing exception

- The final regulations retain the manufacturing exception and the two tests from the proposed regulations but revise it in several key ways:
  - Clarifies the **physical and material change test** providing that general property satisfies the test if it is “**substantially transformed and is distinguishable from and cannot be readily returned to its original state**”
  - Expands the **component part test**
    - Component incorporated into another product if incorporation involves activities that are substantial in nature and generally considered to constitute manufacture, assembly, or other processing of property based on **facts and circumstances**
    - Retains the **20% threshold** in the component part test, but only as a safe harbor
      - Fair market value of component is no more than 20% of the fair market value of final product into which component is incorporated





# Foreign Derived Intangible Income (FDII): Selected Issues

Strafford Webinar  
December 6, 2021



William R. Skinner  
Partner, Tax Group

Phone: 650.335.7669

Fax: 650.938.5200

E-mail:  
[wrskinner@fenwick.com](mailto:wrskinner@fenwick.com)

Emphasis:  
International Tax  
Tax Planning  
Tax Controversy

William R. Skinner, Esq. is a tax partner with Fenwick & West LLP, in Mountain View, CA. He graduated from Stanford Law School and clerked for the Honorable Carlos T. Bea on the Ninth Circuit Court of Appeals.

He focuses his practice on U.S. international tax matters, including tax planning and controversy. He has significant experience with subpart F / GILTI, tax treaties, inbound and outbound tax matters, international restructuring, and the international provisions of the TCJA.

# Topics

---

- Eligibility of IP Transfers for FDII Benefits
- Proposed Changes to the FDII Regime
- FDII For Third-Party and Intercompany Services Transactions

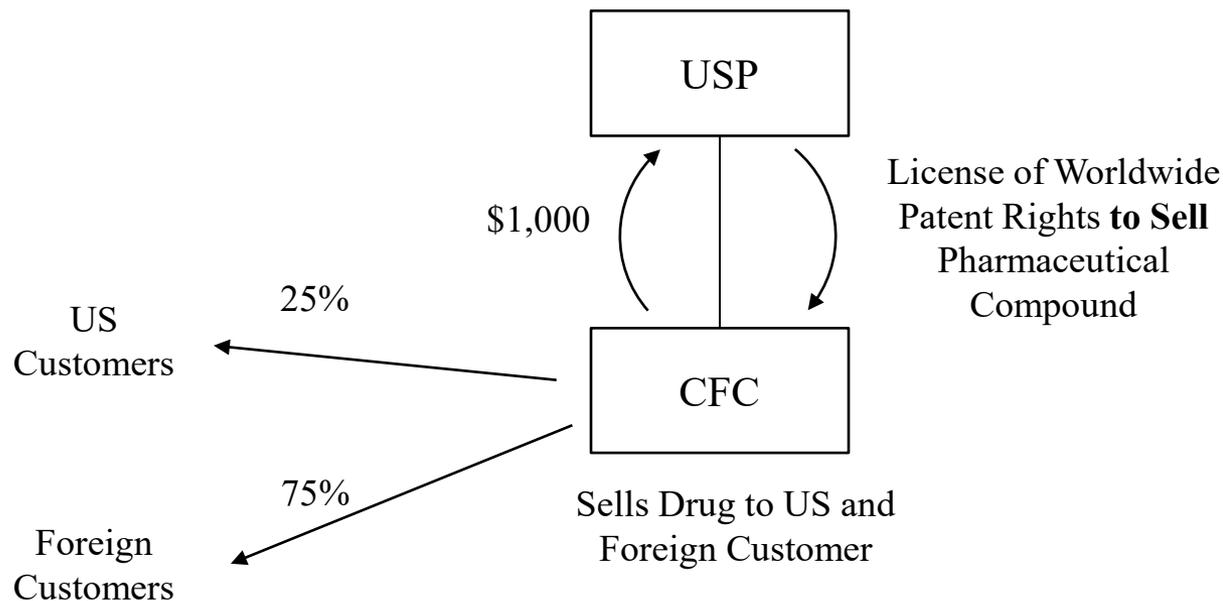
# FDDEI – Transfers of Intangible Property to Related Parties

## Reg. 1.250(b)-4(d)(2)

- Application of FDII to transfers of intangible property to related parties, such as CFCs of the US Corporation, provide significant potential benefits.
- To qualify for foreign use, the taxpayer must demonstrate that the exploitation of the IP will be outside of the US, based on end-user location:
  - If IP is embedded in tangible property or used to render services, then foreign use means that the underlying tangible property or services are provided for a foreign person
  - Special rules for manufacturing intangibles apply to treat a foreign **unrelated** party as making a foreign use unless the facts indicate that the manufacturing will be done in the U.S. However, for foreign related parties, the place of use continues to be determined based on ultimate sale of the manufactured products by the CFC.

# FDDEI – Distribution Rights

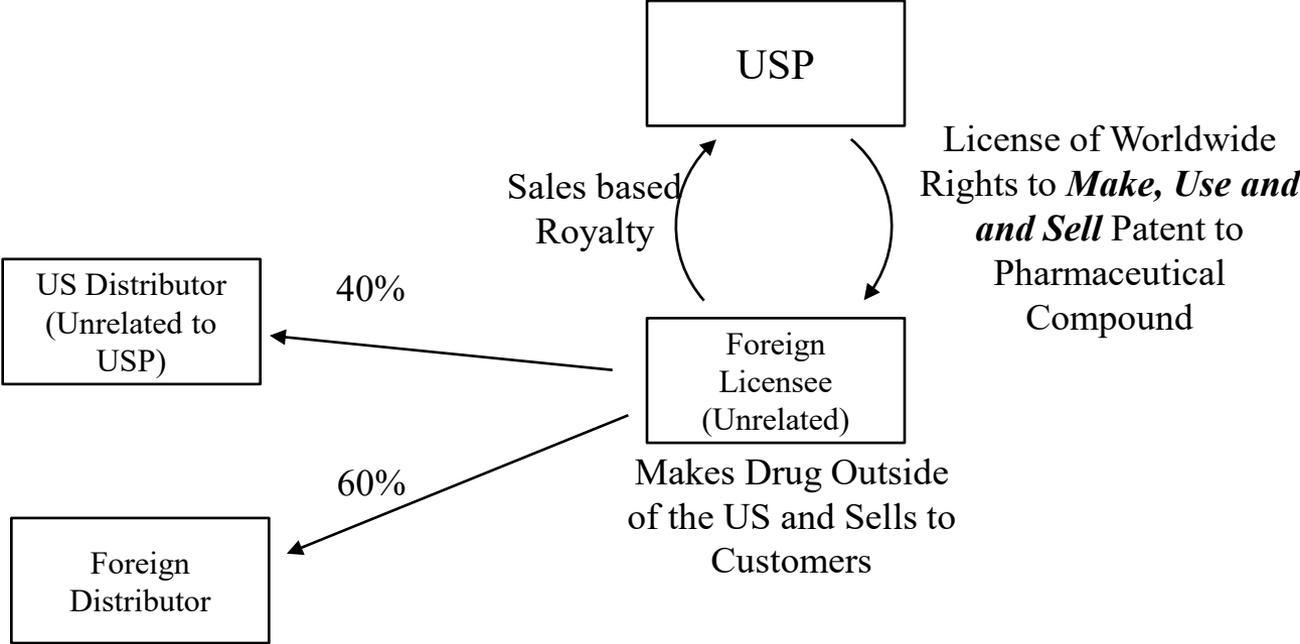
## Reg. § 1.250(b)-4(d)(2)(iv), Example 4



- Foreign use treatment is available only to the extent CFC will sell the product to foreign customers.
- Allocation of \$1,000 lump sum is based on reasonable estimate of future sales.

# FDDEI – License of Manufacturing Rights

## Reg. § 1.250(b)-4(d)(2)(iv), Example 6



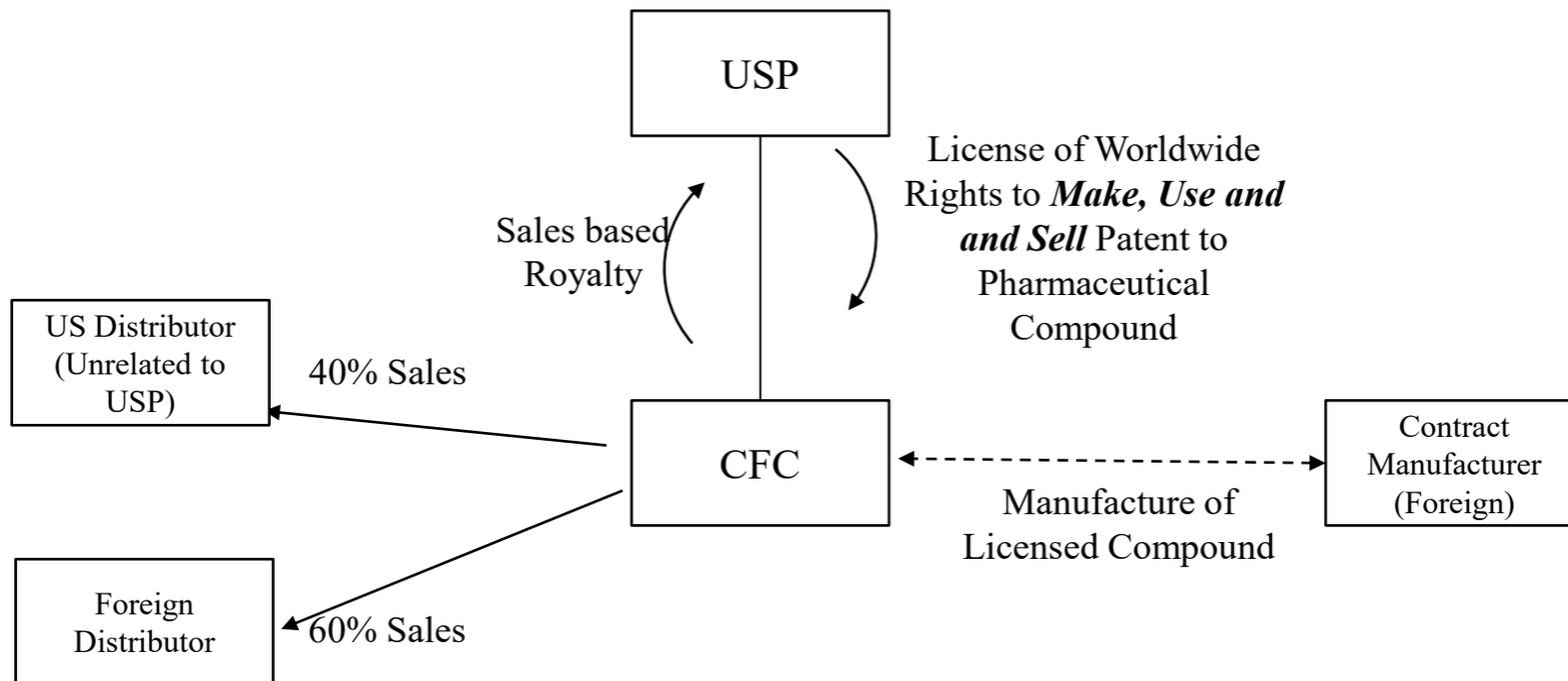
# Reg. § 1.250(b)-4(d)(2)(iv), Example 6

## Analysis

- In Example 6, the rights licensed consist of manufacturing IP and sales IP.
- The regulations illustrate that the taxpayer can bifurcate the royalty between amounts paid for the rights to use the manufacturing process and the rights to sell the patent product. 10% of each \$1 of royalty is attributed to the manufacturing process and remainder to the product.
- The product royalty is 60% FDII based on the location of the end user of the Foreign Licensee.
- The royalty for manufacturing process is 100% FDII because Foreign Unrelated Party manufactures outside of the United States and does not resell to a US person related to US Parent.

# Manufacturing Rights / Related Party License

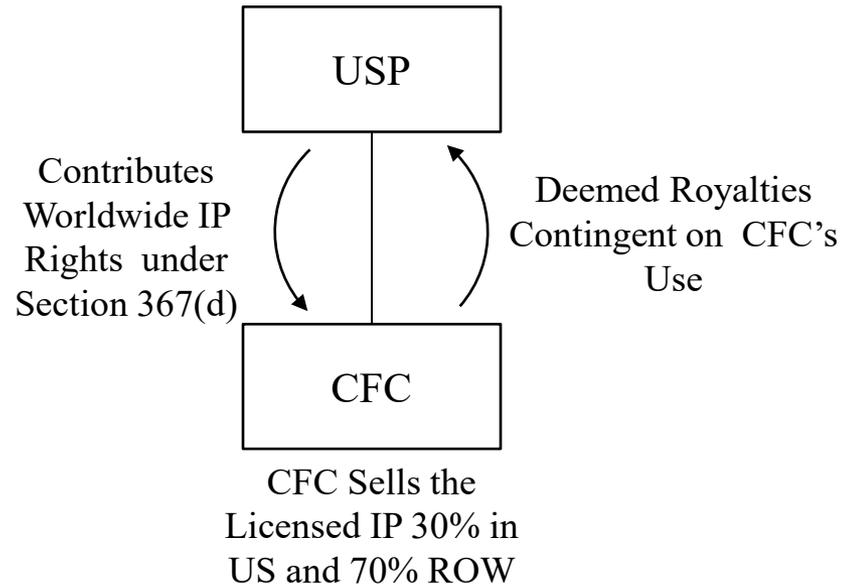
## Reg. § 1.250(b)-4(d)(2)(iv), Example 7



- Here, since CFC is a related party, it cannot qualify for special rule treating foreign manufacturer as an end user. All of CFC's royalty to USP is analyzed based on end customer location for the compound.

# Section 367(d) Deemed Royalties

## Reg. 1.250(b)-5(d)(iv)(D)(2), Example 8



- Royalties that are deemed paid under Section 367(d) on an outbound transfer of intangible property or imputed under Section 482 also may be eligible for FDII benefits.

# FDII – Proposed Changes by House & Senate Democrat

- Biden administration’s FY 2022 Greenbook proposed to repeal FDII and replace it with unstated R&D incentives.
- Senate Bill (Wyden et al. – September 2021) would reform the FDII deduction to serve as a “domestic innovation” incentive.
- House Build Back Better (BBB) Bill would change tax rate structure for FDII and GILTI eligible income, and also make technical changes to the definition of FDII eligible income.

# Democratic Reform Proposals – Senate Bill

- Senate Bill would reform the FDII deduction to serve as a “domestic innovation” incentive.
- Same rules would define FDII eligible income as under the current statute.
- However, the amount of the benefit would be capped at the US corporation’s “domestic innovation income,” which determined by reference to the domestic R&D activities and qualified U.S. job training expenses of the taxpayer.

# Democratic Reform Proposals – BBB Bill (HR 5376)

- The House Tax Bill would retain the basic FDII deduction but make several changes:
  - Decrease the FDII deduction from 37.5% to 24.8% (thus increasing the rate of tax on FDII)
  - Provide that the FDII deduction is no longer taxable income limited; thus the Section 250 deduction may give rise to or increase an NOL.
  - Exclude certain types of foreign-derived income from FDII benefits:
    - Any income that would be passive income within the meaning of Section 904(d)
    - Except as otherwise provided in the regulations, gain from the sale or deemed sale of IP held for the production of active royalties.

# Services Transactions

- Section 250 also provides benefits for income from the provision of services where the taxpayer establishes, to the satisfaction of the IRS, that the recipient of the service is located outside of the U.S. or the service relates to property located outside of the US. See Sec. 250(b)(4)(B).
- This provision may be helpful where the taxpayer is engaged in a service business and also where any taxpayer earns income from providing related party services.

# FDDEI – General Services

- The Regulations provide different rules for types of services:
  1. General services for a consumer
  2. General services for a business recipient
  3. Proximate services
  4. Property services
  5. Transportation services
- “General services” mean all services other than proximate services, property services, and transportation services.
- Consumers vs. Business recipients depend on whether the services are sold to individuals for their personal use or to businesses.

# FDDEI – Documentation for Services Provided to Consumers

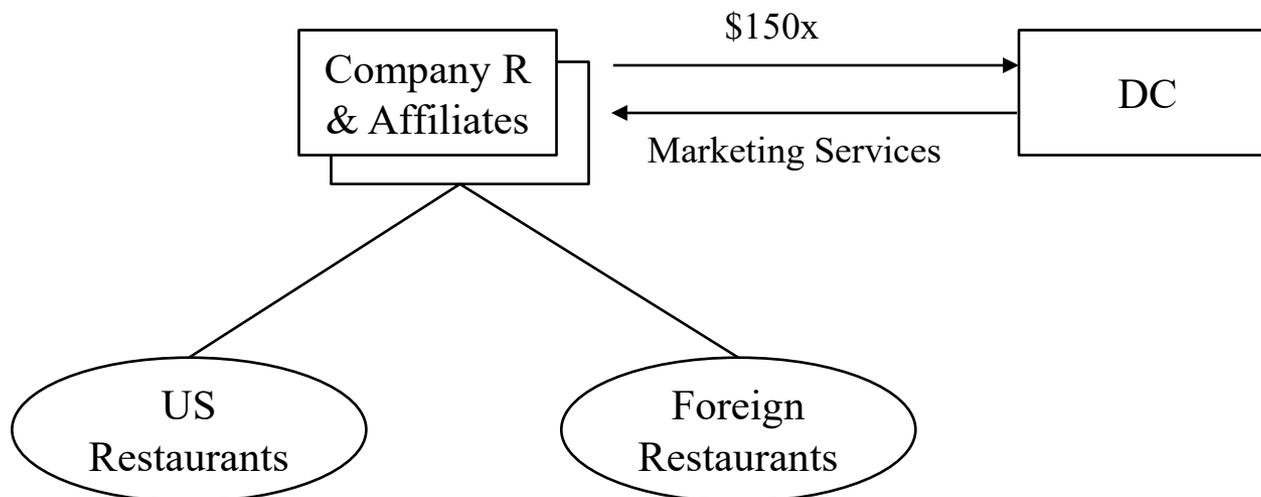
- For consumers, the service provider need only demonstrate, through appropriate documentation, that the consumer is located outside of the US when the service is received.
- The customer's location can be documented through a written statement of non-US residency, appropriate government-issued ID, or other valid forms of documentation prescribed by the IRS in instructions or forms.
- The service provider cannot know or have reason to know that the customer is located in the US when the service is received.

# FDDEI – General Services Provided to Business Recipients

- For business recipients, the Proposed Regulations provide that it is insufficient to demonstrate that the business recipient is a foreign entity with a foreign invoice address.
- Rather, the service provider must demonstrate through appropriate documentation the location of operations of business recipient that benefit from the General Service.
- Documentation may include:
  - A written statement from the service recipient as to where the benefit of the service is provided
  - A binding contractual provision as to where the benefit of the service is received
  - Documentation received in the ordinary course of business
  - Publicly available information.

# Example of General Services to a Business

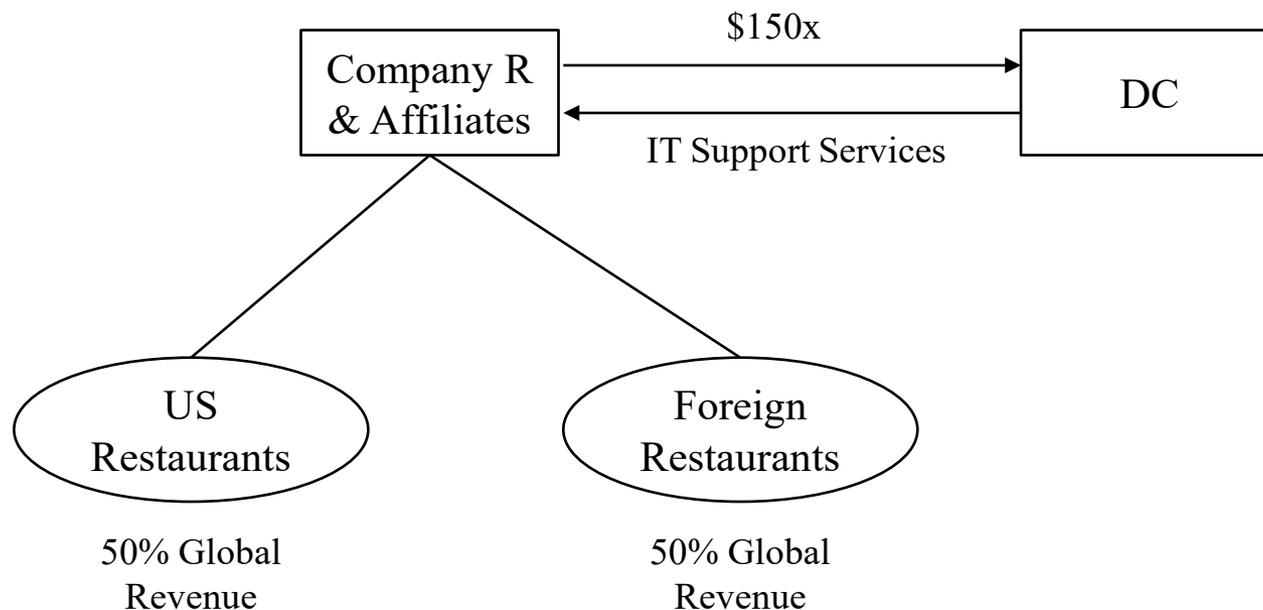
## Reg. 1.250(b)-5(e)(5)(ii) Example 1



- DC provides marketing services specific to one restaurant chain.
- Data supplied by R shows that this restaurant chain of R and affiliates is 70% located in the US and 30% foreign.
- Accordingly **30% of DC's \$150x** is FDDEI.

# Example of General Services to a Business

## Reg. 1.250(b)-5(e)(5)(ii) Example 2



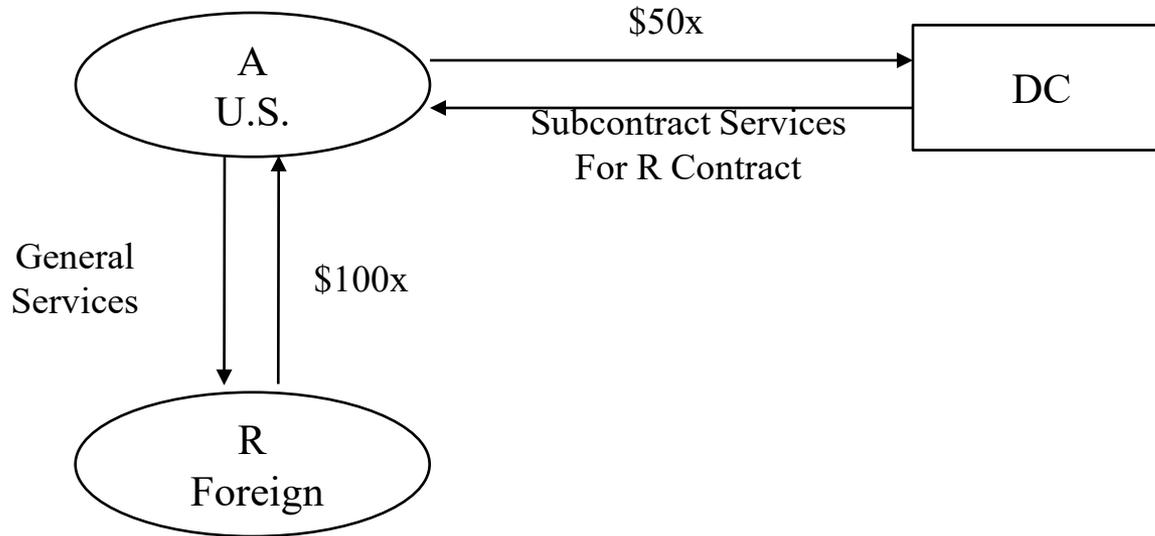
- DC provides IT support services that benefit the overall business operations of R and its affiliates.
- Based on publicly available information, DC can conclude that ***50% of R's operations are foreign, and 50% of the \$150x is FDDEI.***

# FDDEI –

## Rules for Other Services

- Property Services – FDDEI if property is located outside the US while services occur
- Proximate services – FDDEI to the extent recipient is located outside the US while services occur.
- Transportation services – deem services to be FDDEI 50% based on origin point and 50% based on destination point.

# Domestic Intermediaries



- DC's \$50x is not FDDEI because the service benefits A's operations in the US. The fact that A incorporates DC's service in the service to R is immaterial.
- A may have FDDEI on its \$100x under the rules discussed above.

# FDDEI – Related Party Services Rules

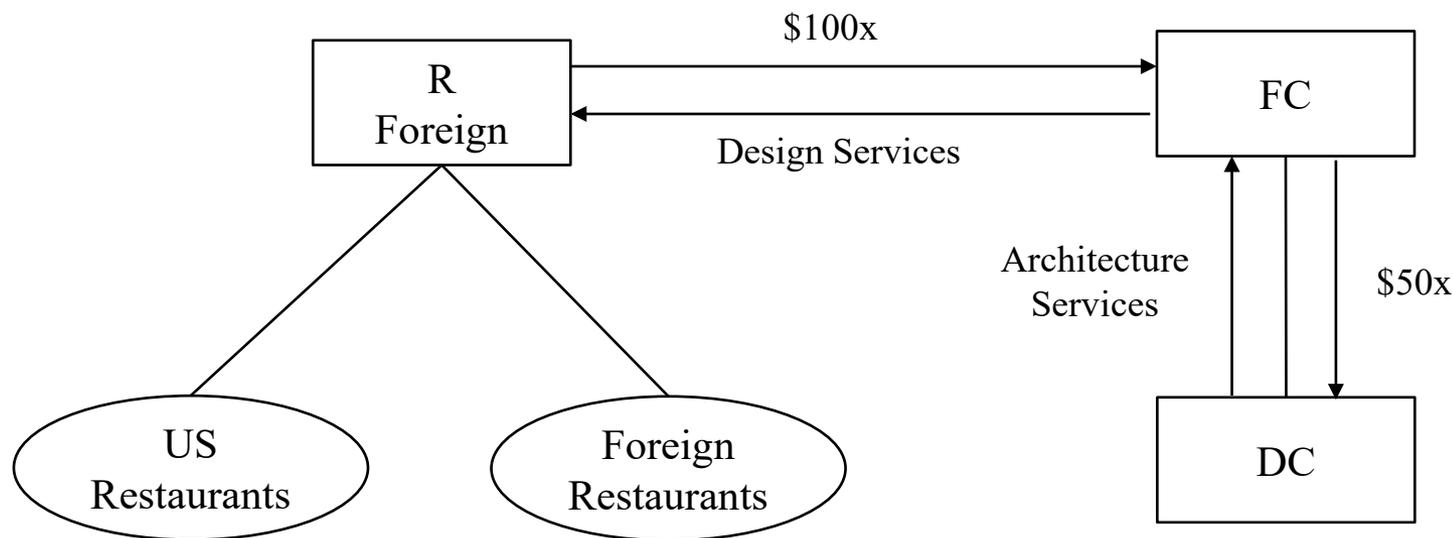
- Services provided to a related party may qualify for FDII if the related party is located outside of the United States.
- However, the related party must not provide a “substantially similar” service to a US person using the services provided by the US person claiming FDII. See IRC § 250(b)(5)(C)(ii).
- The proposed regulations include numerical tests to identify such “substantially similar” services.

## Related Party Services Rules (Reg. 1.250(b)-6(d))

- The proposed regulations provide that related-party services may be “substantially similar” to a domestic service under one of two conditions:
  - i. 60% or more of the benefits conferred by the related party service are conferred on persons in the United States, OR
  - ii. 60% or more of the price paid by persons in the US for the service furnished by the related party are attributable to the related party service.
- In the case of services that are substantially similar solely under (ii), a proportionate amount of the service fee is FDDEI based on the fraction of benefit of the related party service that is passed on to the foreign recipients. See Reg. § 1.250(b)-6(d)(1).

# FDDEI – Related Party Services

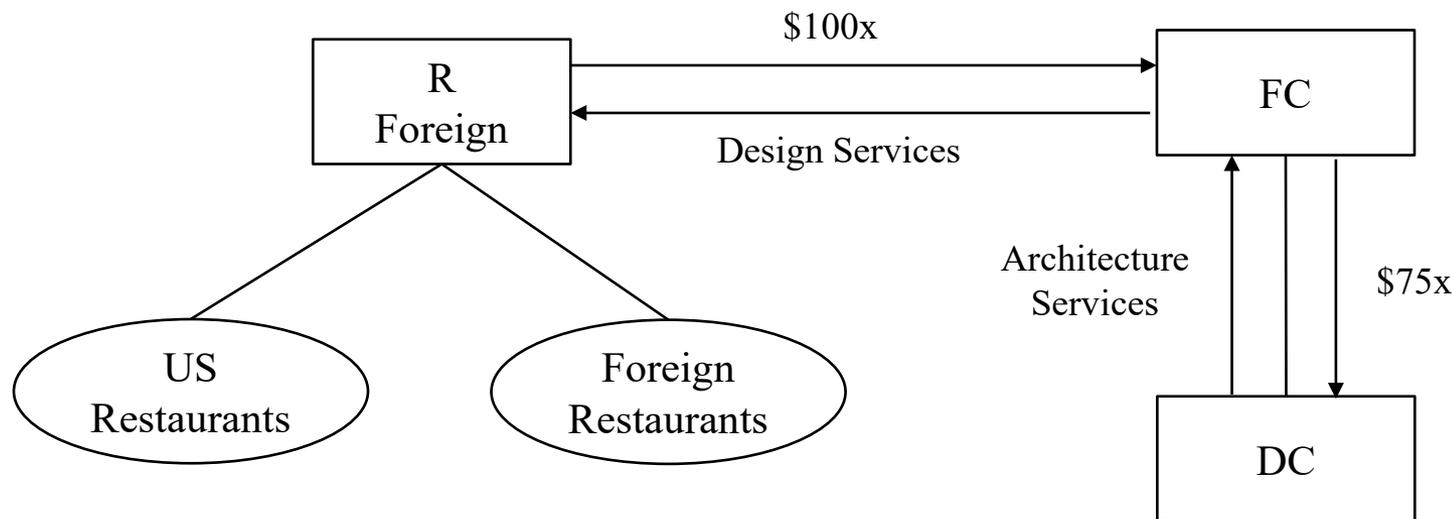
## Reg. § 1.250(b)-6(e), Example 1



- DC provides architecture services to foreign related party, FC, that solely relate to FC's contract with Company R. Also, the benefit of the *architecture services* are received by Company R only in the United States.
- Under -6(d)(2)(i), DC's service is substantially similar to services rendered by FC to a US recipient. **None of DC's \$50x is FDDEI.**

# FDDEI – Related Party Services

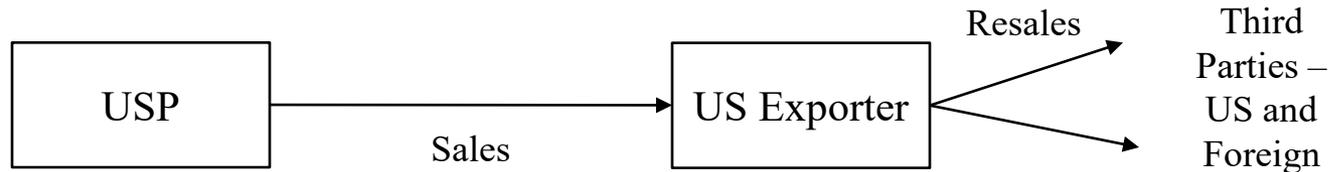
## Reg. § 1.250(b)-6(e), Example 2



- DC provides architecture services to foreign related party, FC. Unlike Example 1, the DC architecture services benefit 90% R's foreign operations and 10% R's US operations.
- Because less than 60% of the benefit of DC's architecture services is received by R in the US, (d)(2)(i) does not apply.
- Because >60% of the cost of FC's service is attributable to DC, (d)(2)(ii) applies. ***90% of DC's \$75x is treated as FDDEI and 10% of DC's \$75x is treated as non-FDDEI.***

# FDII Planning and Structuring Considerations

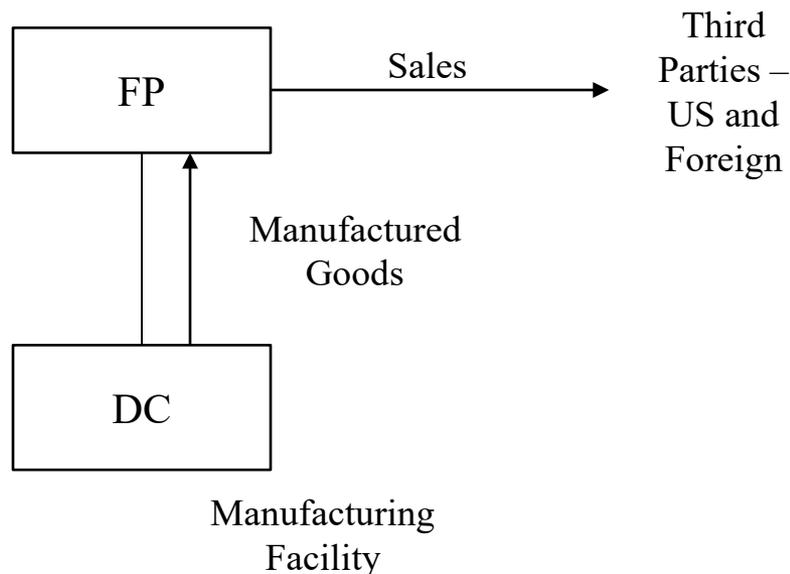
## Importance of Form – Domestic Intermediaries



- Consider different FDDEI treatment if US exporter is a buy-sell distributor of USP vs. a commission agent

# FDII Planning and Structuring Considerations

## Consignment vs. Buy-Sell



- Consider different FDDEI treatment if US Subsidiary acts as a buy-sell contract manufacturer for Foreign Parent or a toll manufacturer (service provider).





Grant Thornton

---

## Documentation Rules

# Relaxed rules for documentation

## Then – Proposed regulations

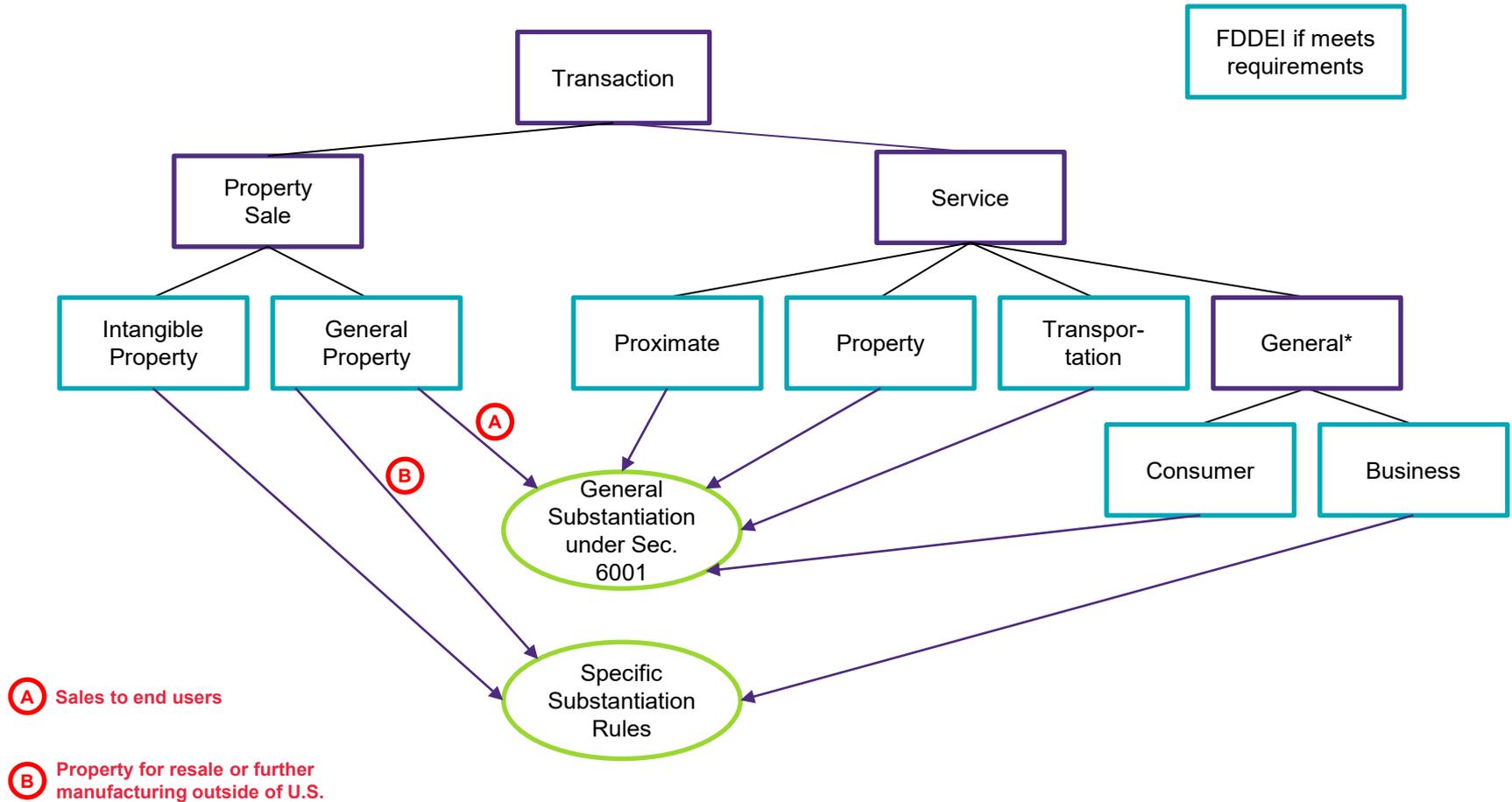
- Imposed strict documentation requirements on domestic corporations that many observed to be unduly onerous
- Included differing requirements depending on the type of transaction
- Provided finite lists of qualifying documentation required to support a FDII deduction
- Documentation had to be obtained by the FDII filing date (generally the extended due date of the income tax return on which the Section 250 deduction is claimed) and no earlier than one year before the sale or service



## Now – Final regulations

- Includes a more flexible “substantiation” requirement
- No longer requires specific types of documents to establish: foreign-person status; foreign use with respect to sales of certain general property that are made directly to end users; and, location of general services provided to consumers
- Includes specific requirements for substantiating sales of general property to recipients other than end-users, sales of intangible property and general services provided to business recipients
- For the rules without specific substantiation requirements, taxpayers are generally required under Section 6001 to keep necessary records to support deductions claimed on its return

# FDDEI – Documentation Overview



# General documentation requirements

- Substantiating documents generally must be in existence by the “FDII filing date”
  - The date (including extensions) by which the seller or renderer is required to file an income tax return for the taxable year in which the gross income from the sale of property or provision of a service is included in its gross income
- No requirement to annually certify or update documentation
  - However, timing of when substantiating documents are created may affect the credibility of the substantiating documents
- The seller must not “know” or “have reason to know” that the transaction fails to satisfy a substantive requirement

Generally must be provided to the IRS within 30 days of request

Small business exception available to taxpayers with less than \$25 million in gross receipts (includes gross receipts of taxpayer and certain related parties)

# Special rule for loss transactions

- Generally, a FDDEI sale or FDDEI service will increase a domestic corporation's section 250 deduction, because the income from such sale or service will increase the corporation's FDDEI/foreign-derived ratio
- In certain situations, an FDDEI sale or service could reduce FDDEI (e.g. domestic corporation's cost of goods sold attributed to property sold in a FDDEI sale exceeds its gross receipts from the sale, or the expenses allocated to the gross income from a FDDEI sale or FDDEI service exceed the gross income arising from the sale or service)
- Without an anti-abuse rule, a domestic corporation could intentionally fail to satisfy the documentation requirements with respect to these certain transactions
- If a seller or renderer knows or has reason to know that property is sold to a foreign person for a foreign use or a general service is provided to a person located outside the United States, but documentation requirements are not satisfied, the transaction is nonetheless deemed a FDDEI transaction if it would reduce a domestic corporation's FDDEI

# FDDEI sales – Substantiation Table

	Sale Type	Seller must maintain one of the following types of substantiation
Foreign Use	General Property for Resale	<ol style="list-style-type: none"> <li>1. A binding contract limiting subsequent sales to sales outside the U.S.</li> <li>2. Proof that property is specifically designed, labeled, or adapted for a foreign market</li> <li>3. Proof that the cost of shipping property back to the U.S. relative to the value of the property makes it impractical that the property will be resold in the U.S.</li> <li>4. Credible evidence obtained or created in the ordinary course of business from the recipient showing that property will ultimately be sold outside the U.S.</li> <li>5. A written statement prepared by the seller corroborated by evidence that is credible and sufficient to support the information under Reg. Sec. 1.250(b)-4(d)(3)(ii)(E)(1) through (7)</li> </ol>
	General Property for Mfg, assembly, or other processing	<ol style="list-style-type: none"> <li>1. Credible evidence that the property has been sold to a foreign unrelated party that is a manufacturer and such property generally cannot be sold to end users without being subject to a physical and material change</li> <li>2. Credible evidence obtained or created in the ordinary course of business from the recipient supporting that the product purchased will be subject to manufacture, assembly, or other processing outside the U.S.</li> <li>3. A written statement prepared by the seller corroborated by evidence that is credible and sufficient to support the information under Reg. Sec. 1.250(b)-4(d)(3)(iii)(C)(1) through (7)</li> </ol>
	Intangible Property	<ol style="list-style-type: none"> <li>1. Binding contract that provides IP may only be exploited outside the U.S.</li> <li>2. Credible evidence from the recipient establishing a portion of its revenue for a taxable year that was derived from exploiting the IP outside the U.S.</li> <li>3. A written statement from the seller providing specific information under Reg. Sec. 1.250(b)-4(d)(3)(iv)(C)(1) through (9)</li> </ol>



Grant Thornton

---

## Related Party Transactions

# Related party transactions

A sale of property or a provision of a service may qualify as a FDDEI transaction, regardless of whether the recipient of such service is a related party of the seller or provider

- Additional requirements must be met

This reg. section provides additional rules for determining whether a sale of property or a provision of a service to a related party is a FDDEI transaction, including:

- Additional definitions relevant for determining whether a sale of property or a provision of a service to a related party is a FDDEI transaction;
- Additional rules for determining whether a sale of general property to a foreign related party is a FDDEI sale; and,
- Additional rules for determining whether the provision of a general service to a business recipient that is a related party is a FDDEI service.

# Related party defined

- §1.250(b)-1(c)(19) defines a related party with respect to any person as any member of a “modified affiliated group” that includes such person
- A “modified affiliated group” is defined as an affiliated group as provided in Section 1504(a) but substituting “more than 50 percent” for “at least 80 percent,” and without regard to the exclusion of insurance companies and foreign corporations
- It also includes any person other than a corporation (e.g., partnerships) that is controlled (as defined under Section 954(d)(3)) by one or more members of a modified affiliated group or that controls such a member

# Related party sale and services defined

- Related party sale – A sale of **general property** to a foreign related party that satisfies the requirements of a FDDEI sale without regard to the related party rules
- Related party service – A provision of a **general service to a business recipient** that is a related party of the renderer and that is described in §1.250(b)-5(b)(2) (i.e., a qualifying FDDEI general service business transaction) without regard to the related party rules

# Unrelated party transaction defined

Unrelated party transaction - Is, with respect to property purchased in a related party sale from a seller:

- A sale of the property by a foreign related party to a foreign unrelated party with respect to the seller;
- A sale of property by a foreign related party to a foreign unrelated party with respect to the seller if the property sold in the related party sale is a component of the property sold to the foreign unrelated party;
- A sale of property by a foreign related party to a foreign unrelated party with respect to the seller, other than a sale described above, if the property sold in the related party sale is used in connection with the property sold to the foreign unrelated party; or
- A provision of a service by a foreign related party to a foreign unrelated party with respect to the seller, if the property sold in the related party sale was used in connection with the provision of the service.



Grant Thornton

---

## Other Considerations

# Allocation and apportionment of expenses under section 861

- Cost of goods sold are attributed to gross DEI and FDDEI using any reasonable method
- Computation of DEI and FDDEI requires that deductions (other than the deduction allowed under Section 250(a)) must be allocated and apportioned against gross income
- The final regulations require that expenses are apportioned under the rules of Treas. Reg. Secs. 1.861-8 through 1.861-14T and 1.861-17 (with certain modifications)
  - FDDEI and DEI are treated as different statutory groupings for purposes of Section 250
- For purposes of determining DEI and FDDEI, the Section 250 deduction is not treated as giving rise to exempt income or assets
- The application of the R&E rules under Treas. Reg. Sec. 1.861-17 have been modified for purposes of Section 250
  - Modification eliminates the exclusive apportionment rule in Treas. Reg. 1.861-17(b)

# Partnerships and their domestic corporate partners

- The rules require a domestic corporate partner of a partnership take into account its distributive share of a partnership's gross DEI, gross FDDEI, and deductions in order to calculate the partner's FDII
- To determine a domestic corporate partner's DTIR, a domestic corporation's QBAI is increased by its share of the partnership's adjusted basis in partnership specified tangible property
- A basis adjustment to a domestic corporate partner's interest in a domestic partnership is not necessary to account for a Section 250 deduction
- A partnership is treated as a person for purposes of determining whether a transaction qualifies as FDDEI
  - A sale to a foreign partnership may qualify as a FDDEI sale, whereas a sale to a domestic partnership will not, even if it is for a foreign use

# Consolidated return rules

- A member's section 250 deduction is determined by reference to the relevant items of all members of the same consolidated group
  - The aggregate amount of section 250 deductions allowed to members appropriately reflects the income, expenses, gains, losses, and property of all members
- The overall deduction is allocated among the members on the basis of their respective contributions to the consolidated group's aggregate amount of FDDEI and the consolidated group's aggregate amount of GILTI
  - Each member's FDII deduction is the product of the "consolidated FDII deduction" (the aggregate calculation) and each such member's "FDII deduction allocation ratio" (their positive FDDEI over the sum of all positive FDDEI's in the group)
- The intercompany transaction rules under the Section 1502 regulations apply with respect to the determination of FDDEI

# Treatment of tax exempts and private foundations

- The final regulations provide that organizations subject to unrelated business income tax (UBIT) under Section 511 may claim the Section 250 deduction
- Determination of the deduction is only with respect to items of income, deduction, gain, loss and adjusted basis in property taken into account when computing UBIT
- The Section 250 deduction is not considered to be an ordinary and necessary business expense for purposes of computing the excise tax under Section 4940(a)

# Reporting requirements

- A domestic corporation or an individual making an election under Section 962 that claims a deduction under Section 250 must file Form 8993, Section 250 Deduction for Foreign-Derived Intangible Income (FDII) and Global Intangible Low-Taxed Income (GILTI)
- A partnership that has one or more direct or indirect partners that are domestic corporations must furnish the partner's share of the following:
  - Gross DEI
  - Gross FDDEI
  - Deductions that are definitely related to the partnership's gross DEI and gross FDDEI
  - Partnership QBAI for each taxable year in which the partnership has gross DEI, gross FDDEI, or specified tangible property
- Information relating to transactions with foreign business entities or related parties must now be reported on Forms 5471, 5472, and 8865
  - Failure to comply could result in penalties

# Key takeaways and Questions



# Disclaimer

This Grant Thornton LLP presentation is not a comprehensive analysis of the subject matters covered and may include proposed guidance that is subject to change before it is issued in final form. All relevant facts and circumstances, including the pertinent authoritative literature, need to be considered to arrive at conclusions that comply with matters addressed in this presentation. The views and interpretations expressed in the presentation are those of the presenters and the presentation is not intended to provide accounting or other advice or guidance with respect to the matters covered

For additional information on matters covered in this presentation, contact your Grant Thornton LLP adviser

# Disclaimer

• \*\*\*\*\*

- IRS Circular 230 disclosure: To ensure compliance with requirements imposed by the U.S. Internal Revenue Service, we inform you that any U.S. federal tax advice contained in this PowerPoint is not intended or written to be used, and cannot be used, for the purpose of (a) avoiding penalties under the U.S. Internal Revenue Code or (b) promoting, marketing or recommending to another party any transaction or matter addressed herein.

• \*\*\*\*\*

- The foregoing slides and any materials accompanying them are educational materials prepared by Grant Thornton LLP and are not intended as advice directed at any particular party or to a client-specific fact pattern. The information contained in this presentation provides background information about certain legal and accounting issues and should not be regarded as rendering legal or accounting advice to any person or entity. As such, the information is not privileged and does not create an attorney-client relationship or accountant-client relationship with you. You should not act, or refrain from acting, based upon any information so provided. In addition, the information contained in this presentation is not specific to any particular case or situation and may not reflect the most current legal developments, verdicts or settlements.
- You may contact us or an independent tax advisor to discuss the potential application of these issues to your particular situation. In the event that you have questions about and want to seek legal or professional advice concerning your particular situation in light of the matters discussed in the presentation, please contact us so that we can discuss the necessary steps to form a professional-client relationship if that is warranted. Nothing herein shall be construed as imposing a limitation on any person from disclosing the tax treatment or tax structure of any matter addressed herein.
- © 2019 Grant Thornton LLP, the U.S. member firm of Grant Thornton International Ltd. All rights reserved. Printed in the U.S. This material is the work of Grant Thornton LLP, the U.S. member firm of Grant Thornton International Ltd.

# Thank you for attending



[www.grantthornton.com](http://www.grantthornton.com)



[twitter.com/GrantThorntonUS](https://twitter.com/GrantThorntonUS)



[linkd.in/GrantThorntonUS](https://linkd.in/GrantThorntonUS)