On Monday, March 4th, the U.S. Treasury and IRS released proposed regulations under IRC section 250, a new section of the Code added by the Tax Cuts and Jobs Act of 2017 (TCJA). Section 250 generally provides domestic corporations with deductions that facilitate reduced taxation on export income as well as foreign subsidiary income. In other words, the regulations cover the deductions for foreign-derived intangible income (FDII) and global intangible low–taxed income (GILTI). The proposed regulations offer insight into the computation of these deductions, as well as the determination of income qualifying for FDII treatment.

Overall, the regulations provide clear and logical guidance, and there are only a few controversial or unforeseen ramifications. There are, however, numerous nuances to follow. For most companies, the challenge will be the intense pace at which they must now modify their many complex calculations in determining the impact of the TCJA for financial statements and tax filings.

We intend to issue thought leadership for our clients and through this Tax Advisor Weekly on these regulations as we make our way through reporting season.

In the meantime, the following is a high–level overview of some of the key features of the proposed regulations.

- **Ordering Rules for Section 163(j) and 172 Interplay:** The proposed regulations provide guidance for U.S. corporations who may be subject to a limitation for deductions under the Internal Revenue Code (IRC) (i.e., 163(j) interest deduction limitation). Multiple code provisions limit a taxpayer’s ability to utilize a deduction based upon a taxpayer’s taxable income. In addition to section 250, section 163(j) (which limits the deduction of business interest) and section 172 (which limits the net operating loss deduction), are two other examples of such provisions. Instead of requiring taxpayers to utilize simultaneous equations to address the interplay of these provisions, the proposed regulations provide an ordering rule for applying sections 163(j) and 172 in conjunction with section 250.

- **250 Deduction Does Not Give Rise to Exempt Income or Assets:** For U.S.–based multinationals who must calculate their foreign tax credit limitation, the proposed regulations state that in order to avoid circularity in applying the deduction allocation rules for purposes of computing FDII, the proposed regulations do not treat the 250 deduction as giving rise to exempt income or assets.

- **Transactions Involving Intangible Property as Qualifying Sales Under the 250 Deduction:** Under the proposed regulations a sale of property that qualifies for FDII may include a lease, license, exchange or other disposition of property. This specifically includes the foreign rights to intellectual property as well as a transfer of property resulting in gain or an income inclusion under section 367.

- **FDII Qualifications for Related Party Services:** U.S. corporations who perform services for related non–U.S. parties got some welcome news under the proposed regulations. The proposed regulations state that in order to avoid circularity in applying the deduction allocation rules for purposes of computing FDII, the proposed regulations do not treat the 250 deduction as giving rise to exempt income or assets.

- **Documentation of FDII Qualifying Transactions:** For a transaction to qualify for the FDII deduction, supporting
documentation must be obtained by the seller or service provider. For example, the seller or service provider must obtain proof that the recipient is in fact a foreign person. There is also a time component, where the documentation must be obtained no earlier than one year before the sale or service is provided.

- **Aggregate Approach for Determination of FDII:** Unlike the previous domestic international sales corporation and foreign sales corporation provisions which were applied on a transaction by transaction basis, FDII is determined on an aggregate basis for all transactions that fit the FDII description. The regulations also prevent taxpayers from excluding loss transactions by intentionally failing to satisfy the documentation requirements.

- **250 Deduction Applies to Electing Individuals Under 962:** Individual U.S. shareholders in controlled foreign corporations (CFCs) received some welcome news under the proposed regulations. For purposes of section 962, an electing individual can reduce their taxable income by the portion of the section 250 deduction that would be allowed to a domestic corporation with respect to the individual’s GILTI and attributable section 78 gross-up.

- **Classifying Transactions with Sale and Service Elements:** For transactions that involve both a sale and a service element, the transaction is classified (as either a sale or a service) based on its “overall predominant character.”

- **QBAI Anti-Avoidance Rule:** Transfers of specified tangible property by a domestic corporation to a related party (whose assets would not otherwise be factored into the FDII calculation) may be disregarded depending on the timing and nature of the transfer.

- **Sales and Services Provided to the U.S. Government:** A sale of property or the provision of service to the U.S. government under the Arms Control Act of 1976 can qualify for FDII treatment.

**Alvarez & Marsal Says:**
The proposed 250 regulations are the final major set of regulations implementing the TCJA, and although not as highly anticipated as the GILTI and 163(j) proposed regulations which came before it, they offer some meaningful benefits and planning tools to domestic taxpayers. With the release of these proposed regulations, companies now have sufficient guidance to complete the lion share of calculations impacted by the TCJA. The new challenge that taxpayers face is to establish supportable positions under these regulations and to incorporate these positions into their modeling exercises. A complicating factor is that these regulations have left tax teams responsible for data creation, requiring informational inputs and modifications that previously did not exist. These new requirements challenge systems, resources and timing. Our teams at A&M Taxand have the expertise and tools to assist with this laborious process. Stay tuned for future insights.

**Related Issues:**

**IRS Releases New Proposed Regulations: Not Your Father's Section 163(j)**

This edition of Tax Advisor Weekly provides a high-level overview of some of the key features of Section 163(j) Proposed Regulations.
Planning and Reporting FX on Foreign Earnings – Don't be GILTI of Relying on Inefficient Tools [3]

While the Tax Cuts and Jobs Act (TCJA) has been marketed as “reform,” it is better described as an expansion of Federal tax law, with many legacy rules remaining intact but now overlaid with additional requirements. One example of this is how companies are required to recognize foreign exchange (FX) gain or loss on distributions from foreign subsidiaries.

IRS Releases First Round of Proposed GILTI Regulations [4]

In this tax alert, we look at key areas where guidance is provided in the proposed regulations in advance of additional commentary and insights from our experts.

Source URL: https://www.alvarezandmarsal.com/insights/proposed-guidance-fdii-and-gilti-deduction

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