

Tax Directors Conference

US Tax Updates

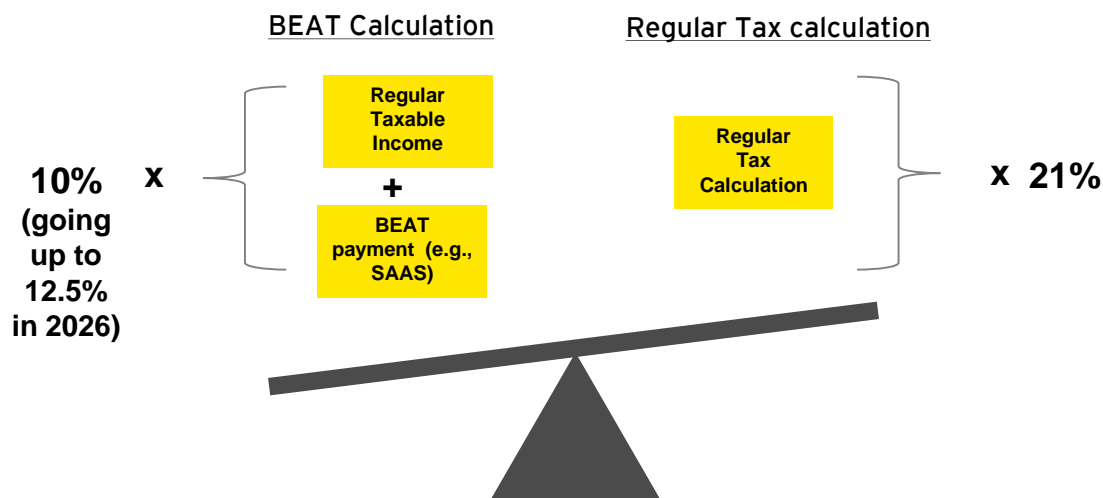
June 2019

Base Erosion Anti-abuse Tax



The BEAT - Key Principles

- ▶ **Base Erosion & Anti-Abuse Tax (BEAT):** In general, BEAT minimum tax is due if the BEAT tax amount is greater than federal corporate tax as computed on the taxable income of the company as computed under regular rules.
 - ▶ In general, the BEAT applies to US corporations* with average annual gross receipts of at least \$500 million for the three-year period ending with the preceding tax year, and having made certain related-party deductible payments. Base erosion payments include cross-border deductible payments to foreign related parties such as royalties, rentals, services fees.
 - ▶ Two main exceptions: (1) for COGS (2) for payments for services eligible for SCM.
 - ▶ **Payment for SaaS is NOT COGs, nor eligible for SCM.**
- ▶ Below is a high level and simplified illustration of the BEAT formula:



*Based on BEAT proposed regulations, the BEAT may equally apply to internal dealings between a foreign corporation and its permanent establishment in the U.S.

BEAT Mitigation Measures

What are global groups with foreign principal companies doing?

There are various mitigation measures taken by foreign principal companies with BEAT issue. For example:

1. Trying to qualify for COGS exception:

- ▶ However, this position depends on the group's product. For example, SaaS companies may not be able to take this position because they are not "selling" software to customers.

2. US IP Migration:

- ▶ Generally, this option may be very costly for a valuable IP (with no sufficient losses) in a location that will assess exit tax.

3. Making direct payments to foreign 3rd parties

- ▶ Segregating payments to 3rd parties that are channeled through foreign related parties

4. Trying to qualify for SCM: Separating and tracking outbound service payments that qualify for the services cost method (SCM) (mostly low value/back office services) from other payment for non-qualifying services.

5. Change of supply chain (reversing the direction of payments) - Disclosed Agent Strategy:*

- ▶ Converting US distribution subsidiary into a commission agent or sales support entity such that Israel/non-US entity contracts directly with third parties.

Controlled Foreign Corporation



CFC – General

- ▶ Generally, if a non-US corporation is a controlled foreign corporation (“**CFC**”) at any time during the taxable year, 10% US Shareholders are required to include in their personal US tax returns certain items of income.
- ▶ Two primary changes to the CFC provision in the TCJA (US Tax Reform):
 - ▶ Change to the stock ownership attribution rules which are applied in order to determine whether non-US companies are CFCs. **As a result, starting 2017, more non-US companies are considered CFCs.**
 - ▶ The GILTI category was added. **As a result, the tax cost at the level of 10% US Shareholders are greater.**

CFC – General

- ▶ Generally, a foreign corporation is considered to be a controlled foreign corporation (“**CFC**”) if 10% US Shareholders own more than 50% of
 - ▶ The total voting power of such foreign corporation (the voting test);
 - or
 - ▶ The total value of the stock of such corporation (the value test).

Note: determination of ownership percentage under the voting and value test, is not necessarily consistent with the company’s “simple” cap table and various considerations must be taken into account.
- ▶ If a non-US corporation is a CFC at any time during the taxable year, 10% US Shareholder are required to include in their personal US tax returns certain items of income.

CFC – Attribution Rules

- ▶ Solely for purposes of determining the CFC status of a non-US corporation, constructive ownership is taken into account.
- ▶ There are complex attribution rules which apply in order to determine constructive ownership.
- ▶ The following slides present a non-exhaustive list of common attribution rules relevant to Israeli companies.

CFC – Attribution Rules (Cont'd)

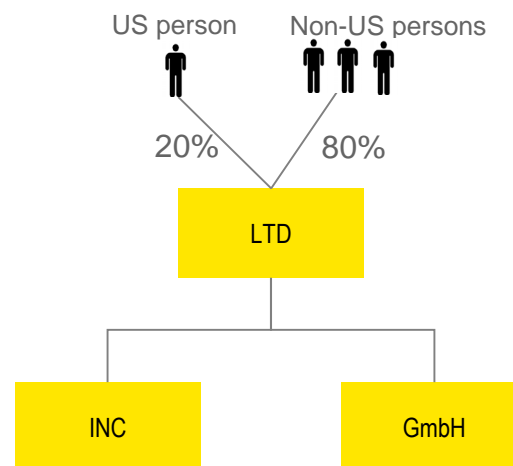
Attribution to corporations

- ▶ If 50% 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.
- ▶ Until 2017, a special provision in the Internal Revenue Code provided that a US person will not be attributed stock ownership from a non-US person under the above rule. This provision was repealed effective as of the 2017 tax year; **as a result every affiliate of a US company is a CFC (see example in the following slide).**

CFC - Attribution Rules (Cont'd)

Attribution to corporations (cont'd)

- ▶ In this example, LTD is not a CFC since only 20% is owned by a 10% US Shareholders.
- ▶ Without regard to the attribution rules, GmbH is also not a CFC, similar to LTD.
- ▶ Under the above attribution rule GmbH is a CFC since the stock owned by LTD is attributed to INC and INC is considered as constructively owning GmbH.
- ▶ Implications:
 - ▶ Reporting obligations and potential taxability at level of 10% US Shareholder;
 - ▶ Reporting obligations at INC level



CFC – Attribution Rules (Cont'd)

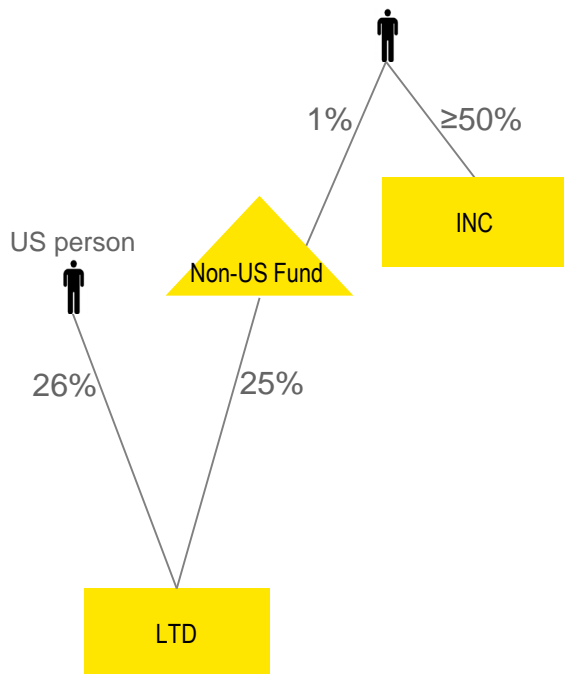
Attribution to partnerships

- ▶ Stock owned, directly or indirectly, by or for a partnership or estate shall be considered as owned proportionately by its partners or beneficiaries. Please note:
 - ▶ Similar to the previous rule, until 2017 a special provision provided that a US person will not be attributed stock ownership from a non-US person.
 - ▶ Unlike the previous rule (attribution to corporations), this rule is applied regardless of the partner's percentage of interest in the partnership.
- ▶ The combination of the attribution to partnerships and attribution to corporations, creates a very broad attribution in case a non-US company is owned by a partnership.

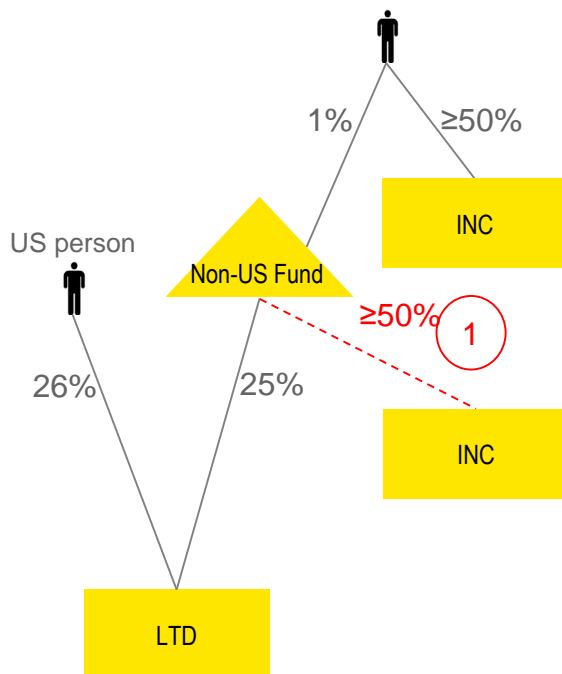
CFC - Attribution Rules (Cont'd)

Attribution to partnerships (cont'd)

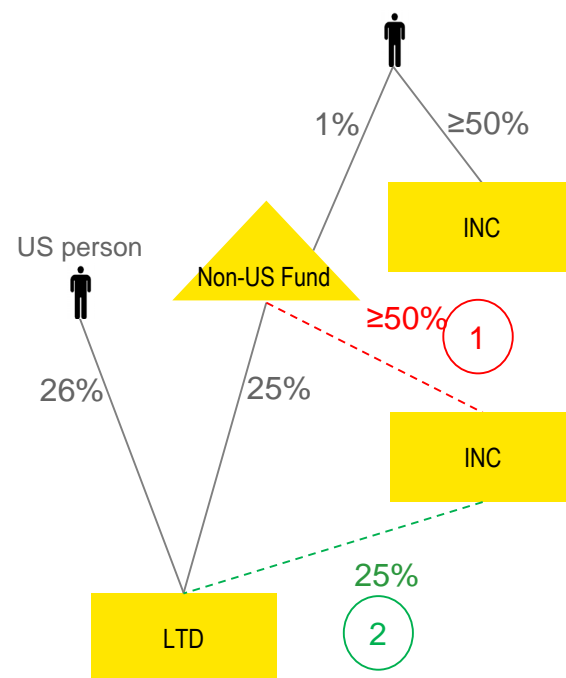
Assume the following facts:



Without regard to attribution rules, assuming none of the US investors in the non-US fund owns 40% or more in the Fund ($40\% \times 25\% = 10\%$), LTD is not a CFC.



1. Attribution to a partnership - stock owned by an investor is attributed to a the non-US fund regardless of ownership percentage.

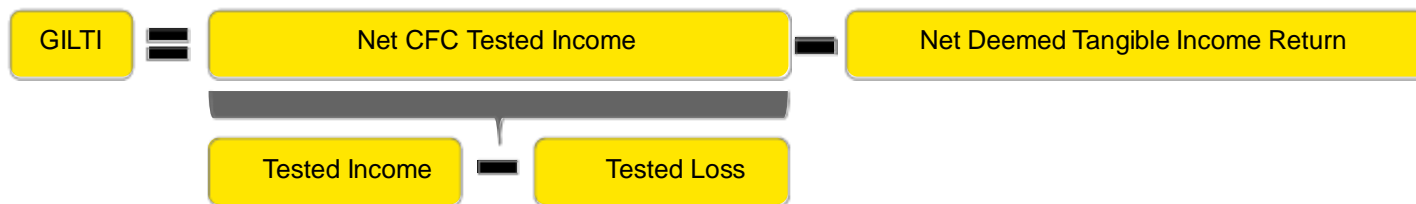


2. Attribution to a corporation - the non-US fund is treated as owning at least 50% in a US corporation (same example as in slide #10).

As a result of the combination of the attribution rules, LTD is a CFC.

CFC – GILTI

- ▶ Generally, 10% US shareholders of a CFC, are required to include in their personal tax return the sum of certain items of income. The US Tax Cuts and Jobs Act of 2017 (TCJA) added the residual GILTI category.
 - ▶ Note: under recent final regulations, in case the 10% US Shareholder is a US partnership, the GILTI inclusion is quantified at the partnership level and reported by it on Form 5471. However, only US partners that indirectly own 10% or more in the CFC, are required to include their pro-rata share in such GILTI amount.
- ▶ For any taxable year of any US shareholder, GILTI is equal to the excess (if any) of:
 - ▶ Such shareholder's **“net CFC tested income”** for such taxable year, over
 - ▶ such shareholder's **“net deemed tangible income return”** for such taxable year.
- ▶ GILTI can be depicted as:



- ▶ Tested loss and deemed tangible income are first determined at the level of the CFC.
- ▶ A 10% US Shareholder then determines his/her pro-rata share of each of these CFC-level items on an aggregate basis.

CFC – GILTI (Cont'd)

Tested income

- ▶ **Tested income** for any CFC includes the gross income of such corporation determined without regard to certain items of income (e.g., Subpart F) over deductions (including taxes) properly allocable to such gross income.

- ▶ The gross income and the allowable deductions are determined by treating the CFC as a US corporation. Accordingly, **in order to compute the tested income of a CFC, a full proforma analysis of book-to-tax adjustments must be performed.** Examples of requires adjustments:
 - ▶ Depreciation and amortization should be determined under US depreciation schedules;
 - ▶ Income recognition adjustments (mainly, deferred revenues);
 - ▶ Interest expenses - final regulations shall determine whether Section 163(j) shall apply;
 - ▶ Option expenses adjustments;
 - ▶ Software development expenses - commencing 2022, such expenses may be required to be amortized over a 15-year period instead of current-year deductions;
 - ▶ Meals and entertainment.

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