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Congressional Republicans released their tax reform plan November 2. While many of the "talking heads" on television are arguing about who truly benefits, we're continuing to focus on the potential impact on our customer base. Along those lines, we are pleased to see some attention given to the international tax area. Below is a brief listing and summary of the international provisions, largely from the House of Representatives Committee on Ways and Means *Section-by-Section Summary* ("Summary").

Participation Exemption

1. The legislation includes a dividend participation exemption, placing the US in a similar position to many of our trading and treaty partners. This is essentially a dividend exemption system for US corporations owning at least 10% of a foreign corporation where the distribution consists of foreign income (which is generally, although not always, the case). There would not be a foreign tax credit or deduction for any foreign taxes related to the exempt dividend, such as underlying income taxes or withholding taxes. The provision would be effective for distributions made after 2017. The Summary states: *The provision would eliminate the "lock-out" effect under current law, which encourages US companies to avoid bringing their foreign earnings back into the United States so that they can avoid the US residual tax on those earnings.*

2. There is a corresponding tax basis adjustment impacting gain/loss on a future sale. When a US person sells shares in a foreign subsidiary that is a CFC, gain is converted to dividend income to the extent of the foreign company's earnings and profits ("E&P"), and the remaining gain is typically capital. The legislation reduces the US owner's stock basis in the foreign subsidiary by the amount of any exempt dividends (described in 1. above). Note: The basis adjustment only applies for purposes of determining the amount of loss (but not gain) on any sale or exchange of the foreign subsidiary stock by its US parent. The provision would be effective for distributions made after 2017.

3. The legislation also impacts branch losses. In some cases, US companies may operate businesses in foreign countries through a branch rather than through a separate legal entity. In these situations, the foreign branch's financial results flow to the US owner's tax return in the year earned. The legislation provides that if the US company transfers the branch assets to a foreign subsidiary, the transferor must include in income all post-2017 losses that were incurred by the branch – essentially a branch loss recapture. The provision would be effective for transfers after 2017. JCT estimate: According to JCT, the provision would increase revenues by $11.1 billion over 2018-2027.

4. Internal Revenue Code Section 956 today functions as an anti-deferral rule and imposes income recognition when certain foreign subsidiaries invest in US property. This portion of the bill appears to repeal Section 956 as it relates to US corporate shareholders. This

provision complements the dividend participation exemption provision as *presumably* E&P would be repatriated to the US parent. This presumption might not always be accurate depending on operational needs, withholding taxes and other items. It would be effective for tax years of foreign corporations beginning after 2017. JCT estimate: According to JCT, the provision would reduce revenues by $2.0 billion over 2018-2027.

5. Immediate taxation of unrepatriated foreign earnings. There is no "free lunch", so one of the prices to pay for the participation exemption is a deemed repatriation of foreign E&P not yet taxed in the US. The law distinguishes E&P consisting of cash/cash equivalents versus other E&P, such as that reinvested in the foreign business as machinery and equipment. The bill would tax the cash/equivalents at 12% and the other E&P would face a 5% tax. Foreign tax credits would be available. Taxpayers could elect to pay the tax over a maximum 8 year period in equal 12.5% installments. There are separate rules for S corporation shareholders providing a deferral of the income recognition until the S election no longer applies, the S corporation sells its assets or liquidates or the shares are transferred. [Note: In our experience, a S corporation owning a non-US company generally has made (or would likely have benefitted from) an entity classification election to treat the subsidiary as a flow-through entity (unless the foreign corporate tax rate approximates 21% or lower).] JCT estimate: According to JCT, the provision would increase revenues by $223.1 billion over 2018-2027.

Foreign Tax Credit

1. The legislation provides that there is no foreign tax credit for exempt dividends. This makes sense as there would be zero US income or tax.
2. The legislation would also source inventory to the place of production activity. This could be taxpayer-unfavorable as current law allows a 50/50 split between place of production and place of sale. For instance, under today's law a US manufacturer that sells its product with foreign title passage treats 50% of its sales as foreign source income. There would only be US source income under the new rule. JCT estimate: According to JCT, the provision would increase revenues by $0.5 billion over 2018-2027.

Subpart F Modifications

1. Repeal of certain industry-specific types of Subpart F income.
    a. For relevant taxpayers with a net decrease in qualified shipping investments, such decrease would no longer cause Subpart F income.
    b. Foreign base company oil related income.
2. A de minimis rule exists providing that if a CFC's gross Subpart F income is less than the lesser of 5 percent of the foreign subsidiary's gross income or $1 million, then the US parent is not subject to current tax on any of the income. One complaint has been that the dollar threshold is not subject to inflation adjustments. The bill would adjust the figure for inflation. It is unclear what the practical impact will be.
3. Look-through rule made permanent.

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4. Modification of stock attribution rules for determining status as a controlled foreign corporation ("CFC"). Under the legislation, a US corporation would be treated as constructively owning stock held by its foreign shareholder. The provision would be effective for tax years of foreign corporations beginning after 2017, and for tax years of US shareholders in which or with which such tax years of foreign subsidiaries end. This would of course allow for greater likelihood of CFC and/or US Shareholder status.

5. Present law provides a US shareholder of a CFC is subject to current tax on its pro rata share of the CFC's Subpart F income, but only if the US parent owns the stock for an uninterrupted period of 30 days or more during the year. The legislation removes the 30 day requirement. The provision would be effective for tax years of foreign corporations beginning after 2017, and for tax years of US shareholders in which or with which such tax years of foreign subsidiaries end. JCT estimate: According to JCT, the provision would increase revenues by $0.4 billion over 2018-2027.

Prevention of base erosion

1. Unfortunately, some of these items are more nebulous and additional guidance will likely be necessary. The first item provides that a US parent of one or more foreign subsidiaries would be subject to current US tax on 50% of parent's "foreign high returns", which are the excess of the parent's foreign subsidiaries' aggregate net income over a routine return (7% plus the Federal short-term rate) on the subsidiaries' aggregate adjusted bases in depreciable tangible property, adjusted downward for interest expense. Per the Summary, foreign high returns would not include income effectively connected with a US trade or business, Subpart F income, insurance and financing income that meets the requirements for the active finance exemption from Subpart F income under current law, income from the disposition of commodities produced or extracted by the taxpayer, or certain related-party payments. The legislation would impose tax similarly to Subpart F, including allowing foreign tax credits. The foreign tax credits allowed for foreign taxes paid with respect to foreign high returns would be limited to 80 percent of the foreign taxes paid and would not be allowed against US tax imposed on other foreign-source income (*i.e.*, such foreign tax credits would only be allowed to offset US tax on foreign high return inclusions), and would not be allowed to be carried back or forward to other tax years. The provision would be effective for tax years of foreign corporations beginning after 2017, and for tax years of US shareholders in which or with which such tax years of foreign subsidiaries end. JCT estimate: According to JCT, the provision would increase revenues by $77.1 billion over 2018-2027.

2. There is a new interest deduction limitation for US companies which are members of an international financial reporting group. This is also nebulous and not what we call a "simplification" item. There is a concern about excessive leverage and deductions by US borrowers at a time when a borrower claims an interest deduction, achieves zero US withholding tax on an outbound interest payment to a related party and also enjoys a 100% participation exemption on a future dividend distribution from the lender. Under current law, corporations generally may deduct interest expense, subject to thin capitalization rules. The legislation would limit deductible net interest expense of a US corporation that is a

member of an international financial reporting group to the extent the US corporation's share of the group's global net interest expense exceeds 110 percent of the US corporation's share of the group's global earnings before interest, taxes, depreciation, and amortization (EBITDA). Disallowed interest deductions could be carried forward for 5 years. For this purpose, an international financial reporting group is a group of entities that includes at least one foreign corporation engaged in a trade or business in the US or at least one domestic corporation and one foreign corporation, prepares consolidated financial statements, and has annual global gross receipts of more than $100 million. The provision would be effective for tax years beginning after 2017. JCT estimate: According to JCT, the provision would increase revenues by $34.2 billion over 2018-2027.

3. There would be an excise tax on certain payments from domestic corporations to related foreign corporations. Deductible payments (other than interest) made by a US corporation to a related foreign corporation, includible in costs of goods sold, or includible in the basis of a depreciable or amortizable asset would be subject to a 20 percent excise tax, unless the related foreign corporation elected to treat the payments as income effectively connected with the conduct of a US trade or business. Certain exceptions would apply. Again, we see this area as one where there is a lack of clarity. However, the provision would apply only to international financial reporting groups with payments from US corporations to their foreign affiliates totaling at least $100 million annually. The provision would be effective for tax years beginning after 2018. JCT estimate: According to JCT, the provision would increase revenues by $154.5 billion over 2018-2027.

Provisions Related to Possessions of the US

1. Eligibility of domestic gross receipts from Puerto Rico for the domestic production deduction would apply retroactively to tax years beginning after December 31, 2016 and before January 1, 2018. JCT estimate: According to JCT, the provision would reduce revenues by $0.1 billion over 2018-2027.

2. Under the provision, the $13.25 per proof gallon excise tax cover-over amount paid to the treasuries of Puerto Rico and the US Virgin Islands would apply retroactively to include imports after December 31, 2016, and be extended to rum imported into the US before January 1, 2023. JCT estimate: According to JCT, the provision would reduce revenues by $0.8 billion over 2018-2027.

3. The economic development credit for taxpayers currently operating in American Samoa would retroactively apply to tax years beginning after December 31, 2016, and be extended to tax years beginning before January 1, 2023. JCT estimate: According to JCT, the provision would reduce revenues by $0.1 billion over 2018-2027.

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Other International Items

1. The bill modifies the PFIC exception for insurance companies to apply only if the foreign corporation would be taxed as an insurance company were it a US corporation and if loss and loss adjustment expenses, unearned premiums, and certain reserves constitute more than 25 percent of the foreign corporation's total assets (or 10 percent if the corporation is predominantly engaged in an insurance business and the reason for the percentage falling below 25 is solely due to temporary circumstances). The provision would be effective for tax years beginning after 2017. JCT estimate: According to JCT, the provision would increase revenues by $1.1 billion over 2018-2027.

2. This last item is particularly important as a potential treaty override by essentially "turbo charging" the Limitation on Benefits treaty concept. If a payment of FDAP income is deductible in the US and made by an entity that is controlled by a foreign parent to another entity in a tax treaty jurisdiction that is controlled by the same foreign parent, then the statutory 30% withholding tax on such income would not be reduced by any treaty unless the withholding tax would be reduced by a treaty if the payment were made directly to the foreign parent. The provision would be effective for payments made after the date of enactment. JCT estimate: According to JCT, the provision would increase revenues by $7.6 billion over 2018-2027.

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