

**DHG** tax



**Year End Tax Planning for Large Businesses and International Companies**  
October 28, 2019

**DHG**  
DIXON HUGHES GOODMAN LLP

**Large Businesses**

## Presenter



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## Agenda

- 163(j) Interest Expense Deduction Limitation
- Qualified Transportation Fringe Benefits
- Meals and Entertainment
- 162(m) Excessive Employee Remuneration
- Revenue Recognition
- Depreciation and Asset Expensing Planning
- Bonus depreciation with 338 elections
- Proposed 382 Regulations
- Proposed 451 Regulations

## Limitation on Business Interest

- **What is it?**

- + Business interest expense limited to 30% of Adjusted Taxable Income for years beginning after December 31, 2017
- + Adjusted Taxable Income generally equal to
  - Taxable Income before:
    - Interest
    - Taxes
    - Depreciation (before 2022)
    - Amortization (before 2022)
- + Concept of net business interest (i.e., interest income less interest expense)

## Limitation on Business Interest

- **To whom does it apply?**

- + Generally...everyone!
- + Exceptions:
  - Electing real property trades or businesses
  - Electing farming trades or businesses
  - Certain regulated utility trades or businesses

- **Latest guidance: Proposed Regulations (Nov. 26th, 2018)**

- + Effective after final publication but may be applied to tax years ending after December 31, 2017

## Limitation on Business Interest

- **What is “interest expense”?**
  - + Amounts accrued for the use of capital
  - + OID
  - + Deemed interest under IRC 467 (deferred rent)
  - + Income/loss from hedging transactions which cover interest-bearing assets and liabilities
  - + Debt issuance costs
  - + Income from factored receivables
  - + Anti-avoidance rules
  
- **What is NOT?**
  - + Floor plan financing interest

## Limitation on Business Interest

- **Notable guidance on Adjusted Taxable Income**
  - + Capitalized depreciation is not added back
  - + Deductions under IRC 179 is treated as depreciation
  - + Adjustments for gains and losses on dispositions of property; Lesser of:
    - Gain on disposition or
    - Depreciation, amortization, or depletion deductions between 12/31/17 and 1/1/22 on disposed-of property

## Limitation on Business Interest

### ORDERING RULES

- Does not include amounts disallowed by other Sections (e.g., 267)
- 263A applies first
- Future years' current interest expense is deducted before any excess business interest carryforward

### TRANSITION RULES

- Disqualified Interest under "old" 163(j) is carried forward and subject to 30% limit

## Limitation on Business Interest

- **Other Observations and Uncertainties**
  - + Calculated at the consolidated group Level
  - + Awaiting finalization of regulations
  - + Interplay with IRC 108 (cancellation of indebtedness)
  - + How can we plan around 163(j)?
    - Repatriation

## Qualified Transportation Fringe Expenses

- Cost (not value) of transportation fringe benefits no longer deductible
- Benefit exceeding \$260 per employee per month must be included in W2 wages and are deductible as compensation expense to employer

## Qualified Transportation Fringe Expenses Employer Provided Parking lots

- Notice 2018-99 issued December 10, 2018

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- Cost (not value) of employer owned or leased parking lots provided primarily for employee use is fully non-deductible, effective 1/1/2018

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- Exceptions – See safe harbor guidance
  - + Parking made available primarily to general public
  - + Partners, 2% Shareholders, Independent Contractors

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- Various examples provided by IRS of methods to allocate costs

## Meals and Entertainment

Type of Item	Pre TCJA	Post TCJA
Tickets to entertainment events	50% of ticket face value	Nondeductible
Entertainment	Nondeductible (50% if associated with the active conduct or the taxpayer's trade or business)	Nondeductible
Employee Travel Meals	50% if not lavish or extravagant 100% if reimbursed	50% if not lavish or extravagant 100% if reimbursed
Employer's cost of employer-operated eating facilities; meals provided for employer's convenience on employer's premises	100% deductible	50% deductible until 12/31/2025, then 100% nondeductible
Business meals	50% if ordinary, necessary and directly related to the active conduct of the trade or business	No change
Meals provided during entertainment	50% if not lavish or extravagant	No change

## The De Minimis Dilemma

- **IRC §132(e) and §119 originally created as beneficial provisions**
  - + 100% deductibility for meals deemed "De Minimis Fringe Benefits"
- **Examples of items formerly "protected" by §132(e) or §119**
  - + Coffee/snacks available to employees in breakroom
  - + Employer provided on-site cafeteria
  - + Overtime meals served on-site to employees
  - + Buffet-style coffee or breakfast served at group meetings
  - + Employee group meals that are occasional and infrequent in nature
  - + Employee "Happy Hours" that are occasional and infrequent
  - + Employee coaching or mentoring meals
  - + Employee working lunches provided in office

## De Minimis Classification

Years	Treatment of "De Minimis" Items
Before 2018	100% Deductible
Between 2018 and 2025	50% Deductible
After 2025	Fully Non-Deductible

- Prior to 2018, categorizing a meal expenditure as De Minimis was favorable
- In 2018, it is neutral and irrelevant
- Starting in 2026 (unless rules change), categorizing a meal expenditure as De Minimis will be unfavorable

## §162(m) Officers Compensation

Pre TCJA	Post TCJA
Compensation in excess of \$1 Million non-deductible Performance based compensation exempt	Performance based exemption repealed All Compensation is subject to \$1 Million limitation
CFO specifically excluded from limitation of §162(m)	CFO is now included in the 162(m) calculation
Covered Employees include CEO plus next 2 highest paid officers, excluding CFO	Includes CEO, CFO and next 3 highest paid officers (5 Total Officers)
	Once a covered employee always a covered employee Possible to have more than 5 covered employees

*(Limited grand-fathering of compensation contracts can apply. Verify and review modifications to compensation contracts.)*

## Polling Question #1

Which permanent book/tax difference do you expect to most impact your business?

- a) Non-deductibility of employer provided parking
- b) Non-deductibility of entertainment expenditures
- c) Changes to rules under §162(m)
- d) Other

## Revenue Recognition

- **GAAP Revenue Recognition Changes – ASC 606**

- + Impacts timing of revenue recognition and related expenses
- + Variable consideration
- + Often results in acceleration of recognition of revenue

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- **Tax Revenue Recognition Changes – Section 451 (TCJA)**

- + Revenue is not recognized later than in Applicable Financial Statements
- + Advance payments received may be deferred up to 1-year, not later than in Applicable Financial Statements

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- **Proposed Regulations Issued**

## Tax Revenue Recognition Modified by Tax Reform

Pre TCJA	Post TCJA
Under §451, an accrual method taxpayer includes an amount in taxable income when "all events" have occurred which fix the taxpayer's right to receive the income and the amount can be determined with reasonable accuracy	The "all events" test is satisfied no later than when an amount is recognized as revenue in the taxpayer's applicable financial statements
"All events" have occurred at the earliest time when one of the following occurs: a) An amount is received; b) The taxpayer has the right to bill an amount; or c) The amount is earned	Advance payments received must be recognized as taxable revenue no later than the end of the tax year following the year of receipt
Possible that all events have not occurred for tax purposes until after an amount is recognized for financial reporting purposes	
Rev. Proc. 2004-34 permits one-year tax deferral of revenue that is deferred for financial statement purposes	

## Revenue Recognition

- Spread unfavorable adjustments over 4 years – automatic accounting method changes
- Exclude variable consideration
- Acceleration of cost of sales not permitted for taxable income

### PLANNING ACTIONS



## Depreciation and Asset Expensing Planning

100% bonus  
depreciation deduction  
for qualifying assets

New and used property

Acquired and placed in  
service after 9/27/2017,  
subject to binding  
contract rules

Phase down begins in  
2023

Qualified Improvement  
Property not currently  
eligible

Stricter rules for (self)  
constructed property

## Depreciation and Asset Expensing Planning

- Where did you not claim 100% bonus depreciation?
- Cost Segregation and Fixed Asset Study
- File accounting method changes
- Be wary of binding contracts
- Plan for future purchases
- Consider 338 elections and bonus on used assets

## Proposed 382 Regulations

### REFRESHER:

- Sec. 382 limits ability to utilize NOLs following a change in ownership
- Change in ownership generally occurs when there is a 50% or greater change in ownership among certain 5% shareholders over a three-year period
- 382 limitation on utilization is generally the equity value at the ownership change date times the long-term tax-exempt rate
- Recognized built-in-gains (RBIG) may increase the limit
- Recognized built-in-losses (RBIL) may be subject to the limit
- Notice 2003-65 provides a “338 Approach” safe harbor that allows companies to increase RBIG under a hypothetical 338 election

## Proposed 382 Regulations

- ▶ Proposed 382(h) regulations issued September 2019
- ▶ More restrictive definitions around NUBIG and NUBIL
- ▶ Eliminates 338 approach of Notice 2003-65
- ▶ Regulations effective prospectively upon issuance in final form
- ▶ Substantial opposition building against regulations in their proposed form

## Polling Question #2

True or False: A federal NOL generated in calendar year 2017 has a 20 year carryforward period.

- a) True
- b) False

## Proposed 451 Regulations

- Proposed 451 regulations issued September 2019
- Provides additional guidance around inclusion of revenue no later than when recognized in applicable financial statements
- Provides exceptions for items where special method of accounting is used:

1	Hedging Transactions	2	Long-term contracts	3	Mark-to-market method items	4	Crop method accounting
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- Deferral safe-harbor of Rev. Proc. 2004-34 remaining in place
- No relief for cost-offset where revenue acceleration is required but cost acceleration is not permitted
- Regulations effective upon release of final regulations
- Taxpayers may rely on regulations for taxable years beginning after Dec. 31, 2017
- Rev. Proc. 2019-37 provides guidance on required method changes related to Sec. 451

### Polling Question #3

Which accounting pronouncement do you expect to have the biggest impact on your business?

- a) ASC 606 – Revenue Recognition
- b) ASC 842 – Lease Accounting
- c) Other



**International Companies**

## Presenter



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## International Tax Update: Top Issues After Tax Reform

- **Section 951A Global Intangible Low Tax Income:**
  - Revisiting the basics - Example
  - Who is impacted?
  - Regulatory Update
  - Planning Opportunities
- **Section 250 Foreign Derived Intangible Income Deduction:**
  - How does it work?
  - What qualifies?
  - Documentation Requirements
- **Section 59A Base Erosion Anti Abuse Tax**
  - Identifying base erosion payments
  - Planning opportunities

## GILTI – The Basics

- Goal of GILTI is to prevent transfer of assets/activities to low tax foreign jurisdictions and penalize taxpayers with low offshore ETR
- Applies to: US person who owns directly or indirectly 10% or more of the total combined stock of a CFC either through vote or value
- Partners with less than a 10% indirect ownership are exempt
- Effective for tax years of foreign corporations beginning after 12/31/17

## GILTI Example

Gross Income		1,200,000
<b>EXCLUSIONS:</b>		
Effectively Connected Income	(100,000)	
Subpart F Income	(50,000)	
High tax exception Sub F	-	
Related Party Dividends	-	
Total Exclusions		(150,000)
Deductions Attributable to Gross Income Less Exclusions		(500,000)
Tested Foreign Income Taxes		(50,000)
Net CFC Tested Income		500,000
QBAI	700,000	
QBAI x 10%		(70,000)
Tested Interest Expense		10,000
GILTI Inclusion		440,000

## GILTI Example

CORPORATION		
GILTI Inclusion		440,000
Tested Foreign Income Taxes - Section 78 Gross Up		50,000
GILTI Inclusion after Gross Up		490,000
Section 250 Deduction		(245,000)
Net 951A Inclusion		245,000
Tax at 21%		51,450
Potential FTC (Tested Taxes * 80%)	40,000	
GILTI Tax After FTC		11,450
INDIVIDUAL WITH NO 962 ELECTION:		
GILTI Inclusion		440,000
Tax at 37%		162,800

## GILTI - Who is Impacted

### The Usual (Intended?) Suspects

- Sophisticated MNC's with Offshore ETR < 13.5% (Google, Apple etc.)

### The Rest:

- CFC has NOL, pays no taxes in foreign country
- CFC's with low / no QBAI
- US Parent is highly leveraged, interest expense allocated to GILTI income reduces or eliminates FTC
- S. Corp Shareholders
- Partners with 10% indirect interest

## Section 951A Regulatory Update

### PROPOSED REGULATIONS ISSUED JUNE 14, 2019:

- **Proposed High Tax Exception** – *Applies in year in which regulations are finalized*
  - + Election to exclude a “gross tested income item” of a CFC to the extent the “tentative net tested income item” is subject to foreign effective rate of tax that is greater than 90% of the current US tax rate of 21% (i.e. greater than 18.9%)
  - + **Effect: Reduction to Net CFC Tested Income**
  - + If elected, all U.S. shareholders of a CFC are bound to the HTE and it applies to all tentative gross income items of a CFC measured at the level of each qualified business unit (“QBU”) of the CFC.
  - + If election is revoked, cannot re-elect for 5 years. If re-elected, cannot revoke for 5 years.

## GILTI: Key Points

- GILTI catches many US shareholders by surprise. Projections and planning are more important than ever.
- No FTC carryforward – use it or lose it
- FTC is often significantly reduced (or eliminated) by allocations of expenses to FSI
- Tested loss CFC’s QBAI is excluded, Foreign Taxes are excluded.
- Section 962 allows an individual to be treated as a corporation but:
  - + No PTI on GILTI inclusion
  - + Compliance is complex and costly especially where there are multiple shareholders

## GILTI Takeaways

### #1 – 5471 PREP

- Start 5471 preparation ASAP after year end (preferably before extensions)

### #2 – CONSIDER PLANNING STRATEGIES

- Transfer Pricing to manage income / losses
- Increase investment in CFC QBAL
- Use a US “blocker” to protect individuals from GILTI
- Increase High Tax Subpart F income

## Foreign Derived Intangible Income Deduction (Section 250) Summary

- Section 250 FDII deduction applies to US Corporations (not flow thru entities)
- Deduction is for sales of goods and services consumed outside the US and 50% of GILTI inclusion amount
- Provides a deduction equal to **37.5%** of FDII and **50%** of GILTI Inclusion
- Deductions reduced to **21.875%** and **37.5%** respectively in 2026
- Individuals making a Section 962 election eligible for 50% GILTI deduction
- Deduction is limited to taxable income. If deduction is limited, FDII and GILTI Section 250 deductions are decreased proportionately

## FDII Definitions

<b>FDII=</b>
Ratio of Foreign Derived Deduction Eligible Income (FDDEI)
<b>to</b>
Deduction Eligible Income (DEI)
<b>Multiplied by</b>
Deemed Intangible Income (DII)
<b>Multiplied by 37.5%</b>
<b>FDII Deduction = (DII * (DEI/FDDEI)) * .375</b>

## FDII Definitions

<b>Deduction Eligible Income (DEI) =</b>	<ul style="list-style-type: none"> <li>• Gross Income</li> <li>• Subpart F Income</li> <li>• GILTI</li> <li>• Dividends received from CFC</li> <li>• Foreign branch income</li> <li>• Financial services income</li> <li>• Domestic oil and gas extraction income</li> <li>• Deductions including taxes properly allocable to gross DEI</li> </ul>
<b>Foreign Derived Deduction Eligible Income (FDDEI) =</b>	<ul style="list-style-type: none"> <li>• DEI derived in connection with:               <ul style="list-style-type: none"> <li>+ Property sold to any US person for foreign use</li> <li>+ Services provided to a person, or with respect to property not located within the US</li> </ul> </li> </ul>
<b>Deemed Intangible Income (DII) =</b>	<ul style="list-style-type: none"> <li>• Excess, if any, of DEI over Deemed tangible income return (DTIR)</li> </ul>
<b>Deemed tangible income return (DTIR) =</b>	<ul style="list-style-type: none"> <li>• QBAI x 10%</li> </ul>

## FDII Example

US MANUFACTURING COMPANY		US SERVICE COMPANY	
DEI	\$1000	DEI	\$700
FDDEI	300	FDDEI	300
FDDEI Ratio	30%	FDDEI Ratio	\$1,000
QBAI	\$5,000	QBAI	-0-
DII	\$500	DII	\$1,000
Equal to: $\$1,000 - (\$5,000 \times 10\%)$		Equal to: $\$1,000 - (\$0 \times 10\%)$	
Foreign Derived Intangible Income	\$150	FDII	\$300
Equal to: $\$500 \times 30\%$		Equal to: $\$1,000 \times 30\%$	
FDII Deduction	\$56	FDII Deduction	\$113
Equal to: $\$150 \times 37.5\%$		Equal to: $\$300 \times 37.5\%$	

## FDDEI Sales

- **Sales of Intangible Property**
  - + Foreign use if intangible property is used to generate revenue from exploitation outside the US
    - If IP is used to manufacture, sell or distribute products, IP is exploited based on location of end user
- **Related Party Property Sales**
  - + Qualifies as FDDEI if:
    - Foreign RP resells property to foreign end user OR
    - Seller reasonably expects property to be used in connection with the sale of other property or the provision of services to an unrelated foreign party
    - Seller must reasonably expect > 80% of revenue earned by foreign RP will be earned from unrelated FDDEI sales
    - If unrelated party transaction does not occur before FDII filing date, taxpayer must amend tax return to claim deduction in which RP sale occurred

## FDDEI – Sales to Foreign Related Party - Examples

### EXAMPLE 1

- + US Corp sells machinery to foreign RP. Machine is used to sell manufacture products sold in US and outside US. Machine sale is FDDEI if US Corp reasonably expects >80% of manufactured products will be sold to unrelated parties outside US

### EXAMPLE 2

- + US Corp licenses IP to foreign related party. IP used to develop software sold to unrelated persons within and outside US. Royalty income is FDDEI in proportion to foreign RP's income from sales outside the US

## FDDEI Services: Four Categories



## FDDEI Services: Four Categories



A service provided for tangible property if substantially all the service is provided at the location of the property and the service. Service provider must spend at least 80% of time at location of property

## FDDEI Services: Four Categories



A service, other than a transportation or property service, provided in the physical presence of the recipient, or in the case of a business recipient, its employees. Service provider must spend at least 80% of the time providing the service in the physical presence of the recipient or its employees.

## FDDEI Services: Four Categories



A service to transport a person or property using aircraft, railroad rolling stock, a vessel, a motor vehicle or any similar mode of transportation. If origin and destination are outside the US, service is 100% foreign, if origin or destination is in US, service is 50% foreign

## FDDEI Services: Four Categories



**Any service other than a transportation service, a property service, or a proximate service.**

- Foreign Use depends on whether recipient is end consumer or business
  - + Service provided to a consumer is considered provided in the location where the consumer resides when the service is provided. Documentation must be obtained by the renderer of the service to document the location of the consumer.
  - + Whether a general service provided to a business recipient is provided outside of the US depends on the extent to which the business recipient's operations outside of the US benefit from the service – determined under any reasonable method determined by applying the principles of Treas. Reg. 1.482-9(k)

## FDDEI: Services Provided to Foreign Related Parties

- A general service provided to a foreign related party will not be a FDDEI service if the related-party service is “substantially similar” to services the related person provides to business recipients located in the US.
  - + Services are considered to be substantially similar if the related-party services are used to provide a service to persons located in the US and one of two quantitative tests are met.
    - **Benefit Test:** satisfied if 60% or more of the benefits of the related-party service are to persons located in the US.
    - **Price Test:** satisfied if 60% or more of the price paid by persons located in the US for the service are attributable to the related party service.

## FDDEI: Documentation Requirements

- A recipient is a **foreign person** only if the seller establishes the recipient is a foreign person by obtaining proper documentation.
- Prop. Reg. §1.250(b)-4(c). Proper documentation a recipient is a foreign person may include:
  - + A written statement by the recipient that the recipient is a foreign person;
  - + If recipient is an entity, documentation establishing that the entity is organized or created under the laws of a foreign jurisdiction;
  - + If recipient is an individual, any valid identification issued by a foreign government or agency used for identification purposes;

## FDDEI: Documentation Requirements

### EXCEPTIONS:

- *For small businesses* – For sellers who receive less than \$10,000,000 in gross receipts during a prior tax year successfully establishes the status of any recipient as a foreign person for a taxable year if the seller's shipping address for the recipient is outside the U.S.
- *For small transactions* – For sellers who receive less than \$5,000 in gross receives during a tax year successfully establishes the status of any recipient as a foreign person if the seller's shipping address for the recipient is outside the U.S.

### TIMING:

- Required documentation must be on hand no later than FDII filing date.
- Documentation cannot be obtained more than one year before the sale or service

## FDDEI: Documentation Requirements

The sale of property is for **foreign use** only if the seller establishes the property is not subject to domestic use within 3 years of the date of delivery

OR

The property is subject to manufacture, assembly, or processing outside the U.S. before the property is subject to domestic use.

- *Documentation* – Seller establishes property is for foreign use only if one of the following is obtained:
  - + Written statement from recipient that the property is for a foreign use,
  - + Binding contract between seller and recipient proving the property's use is for a foreign use,
  - + Documentation of shipment of the property to a location outside of the U.S.,

## FDII – Maximizing the Deduction

- **Data Analytics** – identifying and capturing eligible transactions
- **Documentation** – implement processes to collect required documentation
- Review supply chain, consider intercompany sales
- Review intercompany charges:
  - + Services
  - + Royalties
  - + Consider interplay with GILTI

Expense allocations and Accounting Methods

## BEAT Overview

Base Erosion and Anti-Abuse Tax (BEAT) acts as a minimum tax for corporations imposed on certain cross-border related-party payments made by large multi-nationals

- **Purpose:** Designed to penalize US taxpayers that locate high value activities, assets, and/or operations outside the US by denying them some or all the benefit of deductions for outbound payments
- Applies to US corporations:
  - + **Gross Receipts Test:** With average annual gross receipts > 500 million, and
  - + **Base Erosion Percentage Test:** Which have a “base erosion percentage” 3% or higher

## BEAT Overview

<b>Base Erosion Payment</b>	<ul style="list-style-type: none"> <li>• <u>Any amount paid or accrued from a US taxpayer to a foreign related person after 2017 for which a deduction is allowable</u> <ul style="list-style-type: none"> <li>+ Excludes amounts paid for COGS &amp; eligible services</li> <li>+ May include sales, services, royalties, etc.</li> <li>+ If payment is subject to US 30% withholding tax it is not a BEP. BEP reduced proportionately if treaty withholding rate applies</li> </ul> </li> </ul>
<b>Related Person</b>	<ul style="list-style-type: none"> <li>• Any foreign shareholder with direct, indirect, or constructive ownership of at least 25%</li> <li>• Any person related to the corporation or 25% owner under IRC §267(b) or §707(b)(1)</li> <li>• Any person related under the transfer pricing rules of §482</li> </ul>

## Strategies to beat the BEAT

- **Review of Income & Expense Categories**
  - + **Sec. 263A Capitalization** – elect to capitalize more deductible expenses (i.e. Depreciation & Amortization) into COGS
  - + **Services Cost Method Eligibility** – For companies with base erosion tax benefits in the form of services, modify transfer pricing arrangements to comport with the Services Cost Method under Sec. 482 to reduce any base erosion tax benefits for service fees.
- **Business Restructuring**
  - + **Intercompany Agreements** – Revise intercompany agreements to turn off deductions that would translate into base erosion tax benefits.
  - + **Legal Entity Rationalization** – consider check-the-box classifications on particular entities or moving particular entities in a manner to turn off applicable taxpayer tests and potential base erosion tax benefits
  - + **IP Planning** - Keep IP in US, consider repatriating IP to the US

## Polling Question #4

Which international tax provision do you expect to have the largest impact on your business?

- a) Global Intangible Low-Taxed Income (GILTI)
- b) Base Erosion and Anti-Abuse Tax (BEAT)
- c) Foreign Derived Intangible Income (FDII)
- d) None of the above



Questions?