Tax Insights
from International Tax Services

House and Senate tax reform proposals could significantly impact US international tax rules

November 28, 2017

In brief

The House of Representatives passed the 'Tax Cuts and Jobs Act of 2017' bill (the House bill) on November 16, 2017, by a 227 to 205 vote. The House bill includes provisions that could significantly change the US international tax rules for both US and foreign corporations. On November 14, the House Ways and Means Committee released a report (the November 14th Report) providing technical explanations of the House bill. See our Insights *Overview of Ways and Means Chairman Brady's tax reform bill* and *House passes tax reform bill with international tax provisions* for more information.

The Senate Finance Committee on November 16 approved, by a 14 to 12 vote, a Senate version of the 'Tax Cuts and Jobs Act' (the Senate Finance bill or the bill) that differs in key aspects from the House-passed tax reform bill. The Finance Committee on November 20 released the 515-page statutory text for the bill as reported, along with a 74-page section-by-section description. The Joint Committee on Taxation (JCT) previously released a description of the bill as first proposed by Senate Finance Committee Chairman Orrin Hatch (R-UT) on November 9, 2017. Today, November 28, the Senate Budget Committee approved the Senate bill 12 to 11. This sets up full Senate review of the approved tax reform bill, and the Senate could vote on the bill later this week.

The Senate Finance bill's international tax provisions are generally similar to the House bill regarding the transition to a new territorial tax regime, the imposition of a 'toll tax,' the elimination of the indirect foreign tax credit (FTC), the modification of the current subpart F anti-deferral provisions and rules regarding sourcing income from export sales of inventory, and the repeal of provisions related to investments in US property under Section 956. The Senate Finance bill, however, significantly differs from the House bill due to the introduction of a new tax on 'global intangible low-taxed income' and a minimum 'base erosion and anti-abuse tax' imposed on certain payments by a US corporation to a foreign related entity. In addition, the Senate Finance bill proposes to repeal or amend numerous other US international tax rules, such as provisions related to shipping income and repeal of the current rules related to domestic international sales corporations (DISCs).

With a few key exceptions, the Senate Finance bill's provisions would generally impact both US and foreign corporations in tax years ending after 2017. For a high-level overview of the bill's provisions, see *PwC's Insight: Finance Committee Chairman Hatch releases Senate tax reform bill*. At the end of this Insight is a comparison of the international provisions in the House bill, the Senate Finance bill, and current law.

In detail

Summary

The following highlights notable similarities and key differences between the Senate Finance bill and the House bill.

Territorial regime

100-percent DRD for the foreign-source portion of dividends

Both the House and Senate Finance bills would enact new Section 245A, which would provide a 100-percent dividend received deduction (DRD) for the foreign-source portion of dividends received by a US corporation from foreign corporations with respect to which it is a US corporate shareholder. The foreign-source portion of dividends from such 'specified 10-percent owned foreign corporations' would include only the portion of undistributed earnings and profits (E&P) that is not attributable to effectively connected income (ECI) or dividends from an 80-percent owned domestic corporation, determined on a pooling basis. The proposals would apply to distributions made (and, for purposes of determining a taxpayer's FTC limitation under Section 904, deductions with respect to taxable years ending) after December 31, 2017.

The Senate Finance bill would also add a rule providing that dividends resulting from PFIC purging distributions under Section 1291(d)(2)(B) are not treated as dividends for purposes of the DRD. The Senate Finance bill would also amend Section 864(e)(3) (pertaining to the allocation and apportionment of expenses relating to assets generating tax-exempt income) to insert a reference to new Section 245A.

The Senate Finance bill, unlike the House bill, would not allow a DRD for any dividend received by a 'US shareholder' (as defined under Section 951(b)) from a controlled foreign corporation (CFC) if the dividend is a hybrid dividend. A hybrid dividend is an amount received from a CFC for which a deduction would be allowed under Section 245A and for which the specified 10-percent owned foreign corporation received a deduction (or other tax benefit) from taxes imposed by a foreign country. If a CFC with respect to which a domestic corporation is a US shareholder receives a hybrid dividend from any other CFC with respect to which the domestic corporation is also a US shareholder, then the hybrid dividend would be treated as subpart F income of the recipient CFC for the tax year of the CFC in which the dividend was received and the US shareholder would include in gross income an amount equal to the shareholder's pro-rata share of the subpart F income.

Observation: The Senate Finance bill contains two separate provisions intended to address situations where a payor is entitled to a deduction when making a payment, but the recipient is not subject to tax on such payment under the tax laws where the recipient is a tax resident. The proposal introduces a new concept of a hybrid dividend that would deny the 100-percent DRD for foreign-source dividends paid to a US shareholder where the foreign corporate payor receives a deduction or other tax benefit. The tax policy behind this proposal is to limit the benefit arising from the arbitrage of the US and foreign tax laws with respect to payments that are treated differently under the US and foreign tax laws. This may arise from a difference in the US and foreign tax law as to the character of the instrument as equity or indebtedness, or the treatment of the payment. In such cases, the rule turns off the 100-percent DRD otherwise available to the US shareholder, thus denying a tax-free repatriation of foreign earnings to a US shareholder where the foreign earnings are viewed as not having been effectively subject to tax in a foreign country because of the deduction (or other tax benefit) provided to the payor under the foreign country's tax laws. This proposal is generally consistent with concerns discussed, and recommendations made, in the October 2015 final report issued by the OECD under Action 2 (Neutralising the Effects of Hybrid Mismatch Arrangements), at page 175, of its Base Erosion and Profits Shifting (BEPS) project relating to hybrid financial instruments. However, it does not adopt all the provisions of that report. Furthermore, the hybrid dividend proposal is consistent with European Union actions to modify the Parent-Subsidiary Directive to include an 'anti-hybrid rule' (e.g., application of the 'anti-hybrid rule' as applied to Estonia, which was reviewed by PwC in a prior Tax Alert).

With respect to a hybrid dividend paid and received by a CFC, the proposal would treat the dividend income as subpart F income to the recipient CFC. As a result, the proposed hybrid transaction rules (described below) would not apply. The inclusion of the payment as subpart F income to the recipient CFC may preclude the application of similar anti-hybrid rules adopted in the foreign countries where the CFC payor and recipient are resident, which might otherwise deny a deduction for local tax purposes to the payor or require the recipient CFC to include the payment in income.

The hybrid dividend proposal seems consistent with the core policy of a territorial tax regime to provide a full exemption for foreign earnings that were not previously included in income as subpart F income. However, as noted, the provision was not included in the House bill. It remains to be seen whether the rules related to a hybrid dividend will be in the final draft legislation of both the House and Senate.

The House bill and Senate Finance bill contain different minimum holding period requirements that must be satisfied in order to claim the 100-percent DRD provided by Section 245A. The House bill would require that the US corporate shareholder must own the stock of the distributing specified 10-percent owned foreign corporation for more than 180 days during the 361-day period beginning on the date that is 180 days before the date on which such share becomes ex-dividend. The Senate Finance bill would require the US corporate shareholder to meet the ownership requirements for more than 365 days during the 731-day period beginning on the date that is 365 days before the date on which the share becomes ex-dividend.

Observation: Allowing US corporations a 100-percent DRD with respect to dividends received from certain foreign corporations is the core feature of the international provisions of both the House bill and the Senate Finance bill.

Under the Senate Finance bill, the 100-percent DRD would be effective for tax years of a foreign corporation beginning after 2017, and for tax years of US shareholders in which or with which such tax year of the foreign corporation ends.

Transfers of specified 10-percent owned foreign corporations and transfers of property to foreign corporations

The Senate Finance bill provides a number of proposals related to the sale or transfer of a specified 10-percent owned foreign corporation and transfers of property to foreign corporations. First, similar to the House bill, the Senate Finance bill requires that, solely for purposes of determining whether there is a *loss* on the sale or exchange of stock, a US corporate shareholder is required to reduce (but not below zero) the adjusted basis of its stock in a foreign subsidiary by the amount of any portion of a dividend not subject to US tax pursuant to new Section 245A. The basis reduction provision would only apply to domestic corporations that are treated as US shareholders of a specified 10-percent owned foreign corporation.

Second, the Senate Finance bill introduces a new subpart F rule related to lower-tier CFCs. If a CFC sells the stock in a foreign corporation held for at least one year that results in a dividend under Section 964(e)(1) (i.e., gain on certain stock sales derived by upper-tier CFCs of lower-tier CFCs recharacterized as a dividend to the extent of the lower-tier's E&P), then (i) any foreign source portion of the dividend is treated as subpart F income of the selling CFC, (ii) the US shareholder is required to include its pro-rata share of the subpart F income in its gross income, and (iii) a deduction under Section 245A is allowable to the US shareholder with respect to the subpart F income in the same manner as if it were a dividend received by the shareholder from the selling CFC. The new rule also provides that any loss that occurs by this rule would not reduce the E&P of the upper-tier CFC.

Observation: While the Senate Finance bill introduces a new subpart F income inclusion, it is not entirely clear how the mechanics of the previously taxed income (PTI) or the deemed paid FTC rules would apply upon the sale or exchange of a lower-tier CFC. We expect that regulatory guidance will eventually clarify how these rules apply.

Third, like the House bill, the Senate Finance bill would require a US corporation to recapture post-2017 branch losses when substantially all of a foreign branch's assets (as defined in Section 367(a)(3)(C)) are transferred to a 10-percent owned foreign corporation.

This provision provides that the recapture amount (the transferred loss amount) is equal to the branch's previously deducted loss amount after 2017 (and before the transfer), reduced by any taxable income of the branch in subsequent years but before the close of the transfer year and any gain related to an 'overall foreign loss' (OFL) recapture amount. Separate from the House bill, the Senate Finance bill clarifies that the amount of loss included in gross income may not exceed the amount allowed as a deduction under new Section 245A. If any amount is not included in gross income for a taxable year as a result of the Section 245A limit, such amount is included in gross income in the succeeding taxable year. The new provision would only apply to situations in which the domestic

corporation is treated as a US shareholder of the transferee foreign corporation that is a specified 10-percent owned foreign corporation.

Observation: The income inclusion as a result of transferred losses from the assets of a foreign branch is generally consistent with the approach applied in the House bill. The Senate Finance bill, however, provides a cap on the recapture amount equal to the deduction amount under new Section 245A on the income inclusion as a result of the losses incurred on the transfer of the assets of a foreign branch. The reason for this limitation is not clear from the Senate Finance bill.

Fourth, the Senate Finance bill provides that where Section 1248 would apply to a sale or exchange by a domestic corporation of stock in a foreign corporation held for at least one year, the amount recharacterized as a dividend would be treated as a dividend to the US shareholder to which the 100-percent DRD of Section 245A, and corresponding provisions, apply.

Observation: Clarification that Section 1248 applies as a result of the sale or transfer of a specified 10-percent owned foreign corporation ensures that potential gain may be recharacterized as a dividend to the extent of available E&P in a lower-tier CFC.

Additional rules under the Senate Finance bill would also would amend Section 936(h)(3)(B) to explicitly include foreign goodwill and going concern value within the definition of 'intangible property' and would eliminate the active trade or business exception under Section 367(a)(3) that can apply when a US person transfers certain property to a foreign corporation.

The proposed change to the definition of 'intangible property' would apply for purposes of Sections 367 and 482. Specifically, Section 936(h)(3)(B) would be revised to state that workforce in place, goodwill (both foreign and domestic), and going concern value are intangible property within the meaning of Section 936(h)(3)(B), as is the residual category of 'any similar item' the value of which is not attributable to tangible property or the services of an individual. The proposal would clarify that the source or amount of value is not relevant to whether property that is one of the specified types of intangible property is within the definition's scope.

The repeal of the active trade or business exception would apply to transfers after 2017 and the amendment to Section 936(h)(3)(B) would apply to transfers in taxable years beginning after 2017.

Observation: The proposed repeal of the active trade or business exception and the proposed modification of the definition of 'intangible property' under Section 936(h)(3)(B) are significant.

Generally, transfers of intangible property, as defined under Section 936(h)(3)(B), by US persons to foreign corporations in certain nonrecognition transactions are subject to the deemed royalty regime under Section 367(d), while transfers of property other than Section 936(h)(3)(B) property are generally subject to immediate gain recognition under Section 367(a). The active trade or business exception under Section 367(a)(3) provides an exception to immediate gain recognition under Section 367(a). That exception generally applies nonrecognition rules when property is transferred to a foreign corporation, which is then used in the foreign corporation's active trade or business.

While the Senate Finance bill would eliminate the active trade or business exception and amend Section 936(h)(3)(B) to explicitly include foreign goodwill and going concern value, similar provisions are not included in the House bill.

The proposals in the Senate Finance bill appear intended to address the longstanding debate related to the treatment of various forms of tangible and intangible property, including the treatment of goodwill and going-concern value, under Section 367(a) and (d).

Treasury and the IRS most recently addressed these issues in proposed regulations issued in 2015 (80 FR 55568), which were issued as final regulations in December 2016 (T.D. 9803).

The regulations required that outbound transfers of foreign goodwill and going concern value in a Section 351 exchange or pursuant to a Section 368(a)(1) asset reorganization be subject to gain recognition under either Section 367(a) or Section 367(d). The regulations also significantly curtailed the active trade or business exception such that it only applies to transfers of tangible property.

In Notice 2017-38, I.R.B. 2017-30, Treasury identified these regulations as a significant tax regulation that imposes an undue financial burden on US taxpayers and/or adds undue complexity to the federal tax law, pursuant to Executive Order 13789. Treasury then later advised on October 4, 2017, that it had concluded that an exception to the regulations may be justified by both the structure of the statute and its legislative history, explaining that 'the Office of Tax Policy and IRS are actively working to develop a proposal [with respect to the final Section 367 regulations] that would expand the scope of the active trade or business exception to include relief for outbound transfers of foreign goodwill

and going-concern value attributable to a foreign branch under circumstances with limited potential for abuse and administrative difficulties, including those involving valuation.' Treasury and the IRS further indicated that they expect 'in the near term' to issue proposed regulations providing such an exception.

The proposals in the Senate Finance bill would appear to make much of the foregoing developments moot, as they altogether eliminate the active trade or business exception under Section 367(a)(3) available under current law and explicitly include foreign goodwill and going concern value within the definition of 'intangible property' under Section 936(h)(3)(B), thereby ensuring the taxation of outbound transfers of such property under Section 367. As with the final Section 367 regulations, the Senate Finance bill's proposals would reverse the longstanding treatment of foreign goodwill and going concern value under Section 367.

The proposed amendment to Section 936(h)(3)(B) would also expand the definition of 'intangible property' under Section 936(h)(3)(B) to cover assets that, unlike the assets included in the current definition, relate to the ongoing conduct of a trade or business. The amendment could also transform an individual's personal abilities or skills into a corporate asset (i.e., intangible property), contrary to judicial precedent.

Treatment of deferred foreign income upon transition to participation exemption system of taxation

As part of the transition to a territorial system, both the House and Senate Finance bills would use the mechanics under subpart F to impose a one-time 'toll tax' on the undistributed, non-previously taxed post-1986 foreign E&P of certain US-owned corporations.

Specifically, both bills would amend Section 965 to increase the subpart F income of a 'specified foreign corporation' (defined differently under each bill) for the last tax year of such corporation that begins before 2018 by the corporation's accumulated deferred foreign income. The bills would then require any US shareholder of the specified foreign corporation to include in income its pro-rata share of the increased subpart F income.

The subpart F income of the specified corporation would be increased by no less than the corporation's accumulated deferred foreign income determined as of certain measurement dates. Under the House bill, the mandatory inclusion is the higher amount as determined on measurement dates November 2, 2017 and December 31, 2017. Alternatively, under the Senate Finance bill, the mandatory inclusion is the higher amount as determined on measurement dates November 9, 2017 or December 31, 2017.

Accumulated deferred foreign income would include all post-1986 E&P, not including PTI or income that is effectively connected with the conduct of a trade or business in the United States, and disregarding any dividend distributions made by the specified foreign corporation in a taxable year ending with or including a measurement date.

Observation: The use of fixed measurement dates for quantifying the amount of offshore earnings subject to the toll tax appears to be intended to address situations where the E&P of a foreign subsidiary is reduced in contemplation of the enactment of the provision.

The interaction of the rules requiring dividends to be disregarded and the measurement dates adds additional complexity and potentially adverse collateral effects. Specifically, the relevant provisions would appear to inappropriately 'double count' or otherwise take into account the same amount of E&P for purposes of the toll charge provision when E&P is paid as a dividend from a specified foreign corporation to another specified foreign corporation (or through a chain of such corporations) or a US corporate shareholder in certain cases. This occurs because, under the 'add back' rule in both bills, pre-measurement date dividends distributed by a fiscal year specified foreign corporation to another specified foreign corporation or calendar year US shareholder may need to be 'added back' for purposes of computing the amount of accumulated deferred foreign income that is includible in the US shareholder's gross income under the bills' mandatory inclusion provisions.

For example, a US shareholder may receive a dividend from a specified foreign corporation in a tax year of the specified foreign corporation that is before the last tax year of the specified foreign corporation that is required to be taken into account under the mandatory inclusion statute, but which includes a measurement date (e.g., November 2, 2017, or November 9, 2017). In such a case, under the proposed mandatory inclusion rules in both bills, the dividend would be disregarded in determining the E&P of the specified foreign corporation as of the November 2, 2017 or November 9, 2017 measurement date, and thus may be considered in the US shareholder's mandatory inclusion, even though it was also included in the US shareholder's prior taxable year. The expected tax treatment of completed or planned dividend distributions may need to be revisited in light of these provisions.

The November 14th Report notes that the House Ways and Means Committee recognizes that the definition of post-1986 E&P in the House bill could operate to count the same earnings twice in situations in which a specified foreign corporation makes a distribution to another specified foreign corporation on or after November 2, 2017, but prior to the end of the taxable year to which Section 965 applies. The November 14th Report indicates that the Committee intends to correct this 'inappropriate result.'

Includible portion of deferred foreign income

Under the House bill, the includible portion of a specified foreign corporation's post-1986 E&P includes E&P accumulated in tax years after 1986, even if such earnings were generated during periods in which the US shareholder did not own stock in the foreign corporation. By contrast, according to the Senate Finance bill, the potential pool of includible earnings under the Senate Finance bill includes all undistributed post-1986 E&P, taking into account only periods when the foreign corporation was a specified foreign corporation.

Under the House bill, a specified foreign corporation's post-1986 E&P is increased by the amount of any 'qualified deficit' (within the meaning of Section 952(c)(1)(B)(ii)) relating to tax years beginning before 2018 if such deficit is also treated as a qualified deficit for purposes of tax years beginning after 2017. As a result, post-1986 E&P is generally reduced by E&P deficits but are not reduced by qualified deficits.

The Senate Finance bill generally allows qualified deficits to reduce the mandatory inclusion. The proposed statutory text includes a provision stating that if a taxpayer's share of E&P deficits exceeds its aggregate deferred foreign income, the taxpayer must designate the amount of E&P deficit taken into account for each E&P deficit corporation, and the portion of any deficit attributable to a qualified deficit.

Further, the Senate Finance bill would allow taxpayers to elect to preserve net operating losses (NOLs) and opt out of utilizing such NOLs to offset the mandatory inclusion. Rules are provided to coordinate the interaction of existing NOLs, overall domestic loss and FTC carryover provisions.

E&P deficit netting

The US shareholder's mandatory income inclusion under the House bill is reduced by a portion of the E&P deficits, if any, in specified foreign corporations with an accumulated E&P deficit as of the applicable measurement date, even if such corporation accumulated the deficits before being acquired by the US shareholder.

The Senate Finance bill includes similar E&P netting provisions. However, the deficits of a specified foreign corporation that are eligible for allocation under the Senate Finance bill may be limited to deficits arising after the corporation became a specified foreign corporation, consistent with the measurement of positive includible E&P under the bill.

It appears that a 'hovering deficit' (as defined under Treas. Reg. Section 1.367(b)-7(d)(2)) may generally be used to offset a US shareholder's increased subpart F inclusion under both bills. However, while both bills generally permit the use of 'deemed paid' foreign income taxes to offset the toll tax liability (albeit after a 'haircut' as discussed in more detail below), it appears that a US shareholder recognizing an incremental income inclusion under either bill generally is not deemed to pay foreign income taxes relating to hovering (or non-hovering) deficits.

Generally, under both bills, the US shareholder first combines its pro-rata share of foreign E&P deficits in each specified foreign corporation with an E&P deficit and then allocates the aggregate deficit amount among the specified foreign corporations with positive accumulated deferred foreign income. The allocation to each specified foreign corporation with positive accumulated deferred foreign income is proportional to the US shareholder's relative pro-rata share of positive accumulated deferred foreign income in that corporation.

***Example*:** Assume Z, a domestic corporation, is a US shareholder with respect to each of four specified foreign corporations, two of which are E&P deficit foreign corporations. The foreign corporations have the following accumulated post-1986 deferred foreign income or foreign E&P deficits as of November 2, 2017 and December 31, 2017:

Specified foreign corporation	Percentage owned	Post 1986 profit/ deficit (USD)	Pro rata share
A	60%	-$1,000	-$600
B	10%	-$200	-$20
C	70%	$2,000	$1,400
D	100%	$1,000	$1,000

On these facts, the US shareholder's aggregate foreign E&P deficit is -$620 and its aggregate share of accumulated deferred foreign income would be $2,400. The portion of the aggregate foreign E&P deficit allocable to Corporation C would be -$362 (-$620 x ($1,400 ÷ $2,400)) and the remainder of the aggregate foreign E&P deficit would be allocable to Corporation D. As a result, the US shareholder would have a net E&P surplus of $1,780.

The House bill would allow intragroup netting of E&P deficits and positive deferred foreign income among US shareholders comprising an affiliated group in which there is at least one US shareholder with a net E&P surplus and another with a net E&P deficit. The proposed statutory text in the Senate Finance bill does not appear to include a similar provision.

Observation: The allowance of netting deficits against positive E&P in the House bill is consistent with international tax discussion drafts introduced in 2011 and 2014 by former Chairman David Camp and will serve to mitigate the toll charge to a US corporate shareholder. Further, the ability under both the House and Senate Finance bills to net deficits held in a chain of foreign corporations by a US shareholder with deferred income subject to the toll charge in foreign subsidiaries held by a US shareholder in the same US group is a helpful provision.

Nevertheless, the provisions permitting the netting of deficits require additional details and clarification. The draft provisions under the House bill, for example, do not indicate whether a US corporate shareholder is to consider the deficit of a specified foreign corporation as of November 2, 2017 or December 31, 2017 for purposes of netting. Further, the provisions do not clearly address how the deficit netting provisions should be applied when the relevant specified foreign corporations have different taxable years. Moreover, the application of the netting provisions and the determination of the amount of post-1986 undistributed earnings for purposes of determining the amount of a US shareholder's deemed-paid taxes needs to be clarified, as both the House bill and Senate Finance bill provide for a reduction in the increased subpart F inclusion amount with respect to each specified foreign corporation, but no corresponding reduction in the amount of such corporation's post-1986 undistributed earnings.

Future guidance

Future guidance may address planning involving retroactive entity classification elections, changes in accounting methods, and the treatment of the post-1986 E&P of foreign corporations that have shareholders that are not US shareholders.

Expansive attribution rules used to determine affected foreign corporations

Under current law, the subpart F income of a CFC is generally included in the income of the CFC's US shareholders. Section 951(b) generally provides that a US person is a US shareholder of a foreign corporation if the person owns, within the meaning of Section 958(a), or is considered as owning by applying the rules of Section 958(b), 10 percent or more of the voting stock of the foreign corporation.

Section 958(b)(4) generally 'turns off' the constructive attribution rules under Section 318(a)(3) in determining whether a US person meets the 10-percent voting stock ownership requirement under Section 951(b). Specifically, the rule prohibits 'downward attribution' under Section 318(a)(3) if such attribution would cause a US person to own stock otherwise owned by a foreign person.

The definition of specified foreign corporation for purposes of the mandatory inclusion under the House bill includes (i) CFCs, and (ii) non-CFCs (other than passive foreign investment companies (PFICs)) with respect to which one or more domestic corporations is a US shareholder as defined in Section 951(b) but without regard to Section 958(b)(4).

Similarly, the Senate Finance bill provides that a specified foreign corporation for purposes of the mandatory inclusion means (i) any CFC, and (ii) any Section 902 corporation (as defined under Section 909(d)(5) as in effect before enactment of the bill), but not including PFICs that are not also CFCs (as under the House bill). However, the Senate Finance bill modifies the attribution rules of Section 958(b) effective for tax years of foreign corporations beginning before 2018 (discussed in more detail below), and taxable years of US shareholders in which or with which such taxable years of foreign corporations end.

Observation: The House bill provides that Section 958(b)(4) does not apply for purposes of determining whether a non-CFC has a US shareholder (and thus meets the definition of a specified foreign corporation whose E&P is subject to the toll tax). Thus, under the House bill, a foreign subsidiary of a foreign-parented group may fall within the definition of a specified foreign corporation if one of the group members is a domestic corporation, regardless of the foreign subsidiary's actual US ownership.

However, a non-CFC cannot be a specified foreign corporation under the mandatory inclusion provisions of the House bill unless it has one or more domestic corporations that is a US shareholder.

The House bill does not modify the general rule that a US person must own (directly or indirectly through foreign entities) 10 percent of the voting stock of a foreign corporation in order to be required to include in income a pro-rata share of the corporation's subpart F income. Thus, regardless of whether a corporation is a specified foreign corporation under the mandatory inclusion provisions of the bill, no part

of the increased subpart F income of such corporation should be included in the income of any US person unless such person owns (directly or indirectly through foreign entities) 10 percent of the corporation's voting stock.

The Senate Finance bill expands the definition of US shareholder under Section 951(b) to include 'any US person who owns 10 percent or more of the total *value* of shares of all classes of stock of a foreign corporation.' However, the proposal would be effective for the taxable years of foreign corporations beginning after 2017, and to taxable years of US shareholders with or within which such taxable years of foreign corporations end, and thus should not apply to the taxable year to which the mandatory subpart F inclusion applies.

Nonetheless, the different standards used by the bills to determine whether a foreign corporation is a specified foreign corporation for toll charge purposes may impact who is subject to the toll tax and the amount of deferred foreign income subject to tax under each bill.

Dividends received deduction

The House and Senate Finance bills would allow US shareholders to deduct a portion of the increased subpart F inclusion attributable to pre-measurement date deferred foreign income. Under the House bill, the deductible amount is computed in a manner that ensures that all pre-measurement date accumulated deferred foreign income is taxed at a 14-percent effective tax rate to the extent of the US shareholder's 'aggregate cash position' and a 7-percent effective tax rate to the extent the inclusion exceeds the aggregate cash position, without regard to the corporate tax rate in effect at the time of the inclusion. The Senate Finance bill uses a similar deduction mechanism to reach an effective rate of 10 percent on earnings attributable to cash assets and an effective rate of 5 percent on residual earnings.

Under the House bill, a US shareholder's aggregate cash position is the average of the sum of the shareholder's pro-rata share of the cash position of each of the shareholder's specified foreign corporations on November 2, 2017, and the last day of the two most recent tax years ending before November 2, 2017.

The Senate Finance bill measures E&P attributable to cash by taking the greater of (i) the US shareholder's pro-rata share of the cash position of all specified foreign corporations as of the last tax year beginning before 2018, or (ii) the average of (a) the cash position determined as of the close of the last taxable year of each specified foreign corporation ending before November 9, 2017 and (b) the cash position determined as of the close of the taxable year of each specified foreign corporation which precedes the taxable year described in item (a).

The purpose of averaging the aggregate cash position over different dates is to minimize the effect of extraordinary cash movements.

Under the House bill and the Senate Finance bill, the cash position of a specified foreign corporation includes:

- cash
- net accounts receivable, and
- the fair market value of actively traded personal property, commercial paper, certificates of deposit, federal and state government securities, foreign currency, and certain short-term obligations.

A catchall provision allows the Secretary of the Treasury to identify additional assets as economically equivalent to any asset described above.

Under the House bill, the cash position of certain non-corporate entities are included, whereas earnings that cannot be distributed by a specified foreign corporation due to local restrictions (so-called 'blocked income') are excluded. The House and Senate Finance bills contain rules that prevent the double counting of cash positions of specified foreign corporations, as well as provisions that empower the Secretary to disregard transactions that have a principal purpose of reducing the aggregate cash position.

The Senate Finance bill does not have a provision related to so called 'blocked income.' The Senate Finance bill also clarifies that actively traded personal property does not include 'stock in the specified foreign corporation.'

Observation: The definition of 'aggregate foreign cash position' under the House bill and the Senate Finance bill does not contain exclusions for cash or cash equivalents held due to legal or regulatory requirements, cash held to meet working capital needs, cash sourced from US operations, or cash used to fund acquisitions.

Absent further guidance, taxpayers in industries such as insurance products and financial services may be disproportionately subject to the higher effective tax rate. Further, by determining the cash position of a specified foreign corporation based on an average spanning several years, it appears the rule intends to capture a more accurate profile of the liquidity of a specified foreign corporation's E&P and diminish the effect of any transactions undertaken in contemplation of the statute's enactment.

Nevertheless, by determining the cash position based on an average over

several years, the rule would take into account amounts that may be reflected on a prior balance sheet of a specified foreign corporation but are no longer on such balance sheet due to a non-tax motivated business transaction, such as an acquisition. Thus, the averaging approach may have an adverse impact on certain taxpayers.

Limitations on assessment extended

The Senate Finance bill includes an exception to the normal limitations period for tax assessments. The rule's purpose is to ensure that the assessment period for tax underpayments related to the mandatory inclusion (including related deductions and credits) does not expire before six years from the date on which the tax return initially reflecting the mandatory inclusion was filed.

Installment payments

The House and Senate Finance bills would permit a US shareholder to elect to pay the net tax liability resulting from the mandatory inclusion in eight annual installments. Each installment payment must be made by the due date for the tax return for the tax year, determined without regard to extensions. No interest is charged on the deferred payments, provided they are timely paid.

The net tax liability under the House bill is the excess of (i) the US shareholder's US federal income tax liability, determined by taking into account the toll tax under the mandatory inclusion statute (new Section 965(a) under both bills), over (ii) the US shareholder's US federal income tax liability, determined without regard to the application of new Section 965(a), and without regard to any income, deduction, or credit properly attributable to a dividend received by the US shareholder from any deferred foreign income corporation. Thus, the US shareholder's US federal income tax liability under (ii) must be determined without regard to any actual dividend received from a deferred foreign income corporation, any deemed paid FTCs otherwise arising from such dividends, and any expenses allocated and apportioned to such dividend income.

The calculation of a US shareholder's net tax liability under the Senate Finance bill would be computed similarly.

Under an acceleration rule contained in both bills, certain triggering events (e.g., a failure to timely pay an installment, a liquidation or sale, including by reason of bankruptcy, of substantially all of the US shareholder's assets, or a stoppage of the US shareholder's business) would accelerate the due date of all remaining installments to the date of the relevant event.

Observation: The provisions of both bills regarding the eight installment payments are generally consistent. However, the House bill requires that each installment payment be at least 12.5 percent of the overall net tax liability, whereas under the Senate Finance bill, the payments for each of the first five years equals 8 percent, the sixth equals 15 percent, the seventh is 20 percent and the remaining balance of 25 percent would be payable in the eighth year.

Observation: S corporations also would be subject to the toll tax with the net amount flowing up to their shareholders. S corporation shareholders could elect to defer payment of the toll tax until the year in which a triggering event occurs (generally a termination of S status, liquidation or sale of substantially all of the assets, or any transfer of any share of stock in such S corporation). If a shareholder elects to defer the tax, the S corporation becomes jointly and severally liable for such tax if not paid. Upon a triggering event, an S corporation shareholder may also be able to elect to defer such payment under the installment method. Another interesting aspect is that the toll tax would be included in income but the tax is deferred. However, it appears that the income associated with the toll tax would increase stock basis and the accumulated adjustment account in the year it was included in income.

Recapture from expatriated entities

The Senate Finance bill contains a proposed rule that would deny any deduction claimed with respect to the mandatory subpart F inclusion and impose a 35-percent tax on the entire inclusion if a US shareholder becomes an 'expatriated entity' within the meaning of Section 7874(a)(2) at any point within the ten-year period following enactment of the proposal.

An entity that becomes a surrogate foreign corporation that is treated as a domestic corporation under Section 7874(b) is not within this rule's scope. The additional tax is computed by reference to the year in which the US shareholder becomes an expatriated entity even though the amount due is determined by reference to the year in which the mandatory subpart F inclusion was originally reported. FTCs are denied with respect to this additional tax.

The House bill contains no similar restriction.

Reduction of deemed paid foreign taxes with respect to mandatory inclusion

The pre-2018 versions of Sections 902 and 960 would generally continue to apply for the tax year to which new Section 965, as amended by both bills, applies. Thus, for example, a corporate taxpayer that is required to

include in income under Section 965(a) its pro-rata share of the increased subpart F income of a specified foreign corporation would be able to apply Section 960 as in effect before 2018 to treat the inclusion as a dividend carrying deemed paid foreign taxes under Section 902. The deemed paid taxes should then enter the taxpayer's pool of foreign income taxes potentially eligible for credit under Section 901(a) (subject to Section 904).

However, the portion of foreign income taxes deemed paid or accrued with respect to the increased subpart F inclusion under both bills would not be creditable or deductible against the federal income tax attributable to the inclusion. The House bill would disallow 60 percent of the foreign taxes deemed paid with respect to the portion attributable to the aggregate cash position plus 80 percent of the foreign taxes paid with respect to the remainder of the mandatory inclusion. The Senate Finance bill would disallow 71.4 percent of the deemed paid taxes attributable to the inclusion attributable to the aggregate cash position, plus 85.7 percent of foreign taxes paid attributable to the remaining portion of the inclusion.

The foreign taxes that may be claimed as a credit after the application of the limitations under the House bill are eligible for a special 20-year carryforward period (rather than the normal 10-year period). The Senate Finance bill does not contain a similar proposal.

Anti-base erosion

Tax on global intangible low-taxed income

The Senate Finance bill would require a US shareholder to include in income the 'global intangible low-taxed income' (GILTI) of its CFCs. The calculation of GILTI is similar to the calculation of the foreign high return amount (FHRA) in the House bill. Despite the name, this new category does not appear to be limited to low-taxed income.

While the full amount of GILTI is includible in the US shareholder's income, rather than only 50 percent of the FHRA under the House bill, the net GILTI inclusion is reduced through a proposed 50-percent deduction in tax years beginning after December 31, 2017 and before January 1, 2026 and a 37.5-percent deduction in tax years beginning after December 31, 2025.

A US shareholder's GILTI is determined by first calculating the aggregate 'net CFC tested income,' which is the excess (if any) of the aggregate of the US shareholder's pro-rata share of the 'tested income' of each of its CFCs over the aggregate of such US shareholder's pro-rata share of the 'tested loss' of each of its CFCs.

The tested income of each CFC is the excess, if any, of (i) the US shareholder's pro-rata share of the gross income of the CFC without regard to ECI, subpart F income, income excluded from foreign base company income under the high tax exception of Section 954(b)(4), dividends received from related persons, and any foreign oil and gas extraction income and foreign oil related income; over (ii) allocable deductions (including foreign taxes). The tested loss is the inverse of tested income (i.e., the excess, if any, of the allocable deductions over the gross tested income). Thus, each CFC will, on a stand-alone basis, either have tested income or a tested loss. To prevent double counting, a CFC with a tested loss for the tax year must increase its current year E&P for subpart F purposes by the amount of the tested loss.

To arrive at GILTI, net CFC tested income is reduced by the US shareholder's net deemed tangible income return: 10 percent of the CFCs' aggregate qualified business asset investment (QBAI). QBAI is the CFCs' aggregate quarterly average basis in tangible depreciable business property.

Finally, GILTI is grossed up by 100 percent of the foreign taxes deemed paid or accrued with respect to the CFCs' gross tested income.

FTCs would be available for 80 percent of the foreign taxes imposed on the US shareholder's pro-rata share of the aggregate portion of its CFCs' tested income included in GILTI (compared to the 100 percent of such taxes by which GILTI is grossed up).

Furthermore, utilization of associated FTCs would be limited in two ways: (i) GILTI would be treated as a separate Section 904(d) category, such that FTCs deemed paid as a result of a GILTI inclusion can only reduce such an inclusion, and (ii) Section 904(c) would be amended to prevent US shareholders from carrying excess GILTI FTCs to other tax years.

The proposal also contains various rules to coordinate the GILTI inclusion with ordinary subpart F income under Section 951. A GILTI inclusion is treated as subpart F income for many, but not all, purposes of the Code, including, among others, Sections 904(h)(1), 959, 961, 962, and 1248(b)(1) and (d)(1).

The GILTI proposal would be effective for taxable years of foreign corporations beginning after December 31, 2017.

Observation: This rule would effectively subject a US shareholder to tax at a reduced rate on its CFCs' combined net income above a routine return on tangible depreciable business assets that is not otherwise subject to US tax or to foreign tax at a 12.5-percent minimum rate (taking

into account the 20% reduction in FTCs) or is not otherwise specifically excluded.

Although GILTI is similar to the FHRA proposed by the House bill, there are some notable differences. First, as discussed above, the net GILTI inclusion is reduced through a proposed 50-percent deduction (rather than a 50-percent exclusion) in tax years beginning after December 31, 2017 and before January 1, 2026 and a reduced 37.5-percent deduction in tax years beginning after December 31, 2025.

Second, the categories of CFC income that are excluded from GILTI are different in some cases from the categories of income excluded from the FHRA. In particular, the FHRA excludes dealer income under Section 954(c)(2)(C), active finance and insurance income under Section 954(h) and (i), income excluded from insurance income under Section 953(a)(2), certain commodity income, and income excluded under Section 954(c)(6) to the extent it does not reduce the FHRA of any US shareholder. GILTI excludes dividends from related persons (as defined in Section 954(d)(3)), oil and gas extraction and foreign oil related income, but does not exclude the other items excluded by the FHRA.

Third, the return on tangible assets in the Senate Finance bill is a fixed 10 percent, rather than a variable rate determined by reference to AFR and is not reduced by interest expense.

Deduction for foreign-derived intangible income

The Senate Finance bill would also add new Section 250, which for tax years beginning after 2017 and before January 1, 2026, would allow as a deduction an amount equal to 37.5 percent of a domestic corporation's foreign-derived intangible income (FDII) plus 50 percent of the GILTI amount included in gross income of the domestic corporation under new Section 951A. For tax years beginning after December 31, 2025, the deduction allowed under this new provision would be reduced to 21.875 percent and 37.5 percent, respectively. If, in any taxable year, the domestic corporation's taxable income is less than the sum of its FDII and GILTI amounts, then the 37.5 percent FDII deduction and the 50 percent GILTI deduction are reduced proportionally by the amount of the difference.

FDII is determined by reference to several newly defined terms. FDII equals deemed intangible income multiplied by a fraction: foreign-derived deduction eligible income over deduction eligible income.

Deduction eligible income is all gross income of the domestic corporation except for subpart F income, GILTI, Section 904(d)(2)(D) financial services income, dividends received from CFCs, domestic oil and gas income, and foreign branch income, reduced by allocable expenses.

Foreign-derived deduction eligible income is the portion of deduction eligible income that is derived in connection with property sold, leased, or licensed to, and services provided to, foreign persons. Proceeds from the sale, lease, or license of property to a related foreign person is only included if the related foreign person on sells the property to an unrelated foreign person, and the taxpayer establishes that the ultimate sale is for foreign use. Income from services provided to related foreign persons are included if the taxpayer establishes that the related person does not perform substantially similar activities for US persons.

Finally, a corporation's deduction eligible income, less 10 percent of QBAI is its deemed intangible income.

For example, if a corporation has $100 of deduction eligible income, $20 of which is considered to be foreign-derived, and it has $500 of QBAI, its deemed intangible income would be $50 ($100 deduction eligible income - [10 percent of QBAI ($500)]). Thus, the corporation's FDII is $10 ($50 deemed intangible income) x .2 ($20 foreign-derived deduction eligible income) ÷ $100 (deduction eligible income)).

When combined with the GILTI rules, the effect of this deduction would be to subject domestic corporations to tax at a reduced rate on net income derived in connection with sales to, or services performed for, foreign customers, whether that income is earned by the corporation or its CFCs.

Observation: Together, the Senate Finance bill's proposed GILTI tax and FDII deduction provide a 'carrot and stick' approach to taxing income from exploiting intangible property (IP). If a US-parented group holds its IP offshore, any returns from exploiting that IP will be taxed at a rate of at least 10 percent, considering foreign and US tax.

If the same group holds its IP in the United States, the 37.5-percent FDII deduction for sales and services income provided to unrelated foreign persons, effectively provides an ETR of at least 12.5 percent on returns to the same IP. The small rate differential significantly decreases the advantage under current law of holding IP offshore.

Transfers of intangible property from CFCs to US shareholders

The Senate Finance bill contains a new proposal that would provide a temporary three-year holiday for repatriations of IP from CFCs to their US shareholders.

The proposal would prevent the recognition of Section 311(b) gain on

the distribution of IP from a CFC to a US shareholder by treating the IP's fair market value as equal to its basis immediately before the distribution. Where there is insufficient E&P for the distribution to be treated entirely as a dividend, the proposal would increase the basis in the stock of the distributing corporation by the amount of the distribution that would, but for this proposal, be includible in gross income. The IP's adjusted basis in the hands of the US shareholder immediately after the distribution would be reduced by that same amount.

This proposal would be effective for distributions made by a CFC to its US shareholder before the last day of the third tax year of the CFC beginning after 2017.

Observation: This proposal is designed to encourage US-based multinationals to onshore IP. Proposed Section 245A, discussed above, would provide a deduction for any dividend income recognized on the distribution of IP to the United States. This proposal would ensure that any distributions in the next three years would also avoid triggering taxable gain.

Limitations on income shifting through intangible property transfers

The Senate Finance bill contains a proposal that would address various valuation matters relating to transfers of intangible property between related parties.

The proposal would 'clarify' the Commissioner's authority to specify methods for determining the value of intangible property, both in the case of outbound restructurings of US operations and intercompany pricing allocations. The proposal would permit valuation of intangible property on an aggregate basis in the case of transfers of multiple items of intangible property if the Commissioner determines that an aggregate basis valuation method achieves a more reliable result than an asset-by-asset approach.

The Senate Finance bill would codify the 'realistic alternative principle,' which holds that a taxpayer will only enter into a particular transaction if none of its realistic alternatives is economically preferable to the transaction under consideration.

The proposals would apply to transfers in taxable years beginning after 2017. The proposals are not intended to modify the basic approach of the existing transfer pricing rules with regard to income from intangible property.

Observation: The proposed statutory clarification regarding the Commissioner's authority to value the transfer of multiple items of intangible property in one or more transactions on an aggregate basis and to apply the realistic alternative principle may be unnecessary, as the Commissioner already appears to have that authority under the Section 482 regulations. The 'clarification' may raise questions as to whether the aggregation principle, the realistic alternative principle, or both, are inconsistent with the arm's length standard under existing law.

Modification of stock attribution and definition of US shareholder

Similar to the House bill, the Senate Finance bill would make an important change to the rules that govern the attribution of stock ownership for subpart F purposes. Current Section 958(b) contains rules that attribute stock ownership to US persons for purposes of determining whether a foreign corporation is a CFC and whether the US person is a US shareholder. Among these attribution rules are rules that attribute stock owned by a 50 percent or greater shareholder of a corporation, a partner of a partnership, a beneficiary or owner of a trust, or a beneficiary of an estate to the corporation, partnership, trust, or estate respectively.

However, an exception found in current Section 958(b)(4) prevents domestic corporations, partnerships, trusts and estates from being treated as owning stock held directly or indirectly by their foreign shareholders, partners, beneficiaries, or owners. Importantly, this exception prevents the foreign subsidiaries of foreign-parented groups that are not held under US entities from being treated as CFCs. The Senate Finance bill would make this change effective for the last taxable year of a foreign corporation beginning before January 1, 2018.

Like the House bill, the Senate Finance bill would repeal Section 958(b)(4) so that the foreign subsidiaries (but not the foreign parent) of foreign-parented groups with at least one controlled US subsidiary or an interest in at least one US partnership would generally be treated as a CFC, even if they are not held under a US entity. Unlike the House bill, however, the Senate Finance bill would also modify the definition of US shareholder to include a US person who owns 10 percent of the total vote or *value* of all classes of stock of a foreign corporation. The provision would be effective for taxable years beginning after 2017.

Observation: These modifications would treat significantly more foreign corporations as CFCs and significantly more US persons as US shareholders. As a result, the subpart F income of many more foreign corporations would be currently included in the income of an increased group of direct and indirect US shareholders. Importantly, unlike the House bill, both of these changes would be made

retroactive to the last year of the CFC that begins before 2018. As a result, foreign corporations may be treated as CFCs and US persons may be treated as US shareholders in 2017 even if they are not under current law.

Hybrid Transactions and Hybrid Entities

Unlike the House bill, the Senate Finance bill would deny a US deduction for 'disqualified related party amounts' paid or accrued by a US corporation to a related foreign party pursuant to a hybrid transaction, or made by or to a hybrid entity.

A 'disqualified related party amount' is any interest or royalty payment made to a related party when there is no corresponding income inclusion under the related party jurisdiction's tax laws, or the related party is allowed a deduction with respect to the interest or royalty payment. A disqualified related party amount, however, does not include a payment that is treated as subpart F income.

A hybrid transaction is a transaction, or series of transactions, agreements, or instruments that result in a payment of interest or royalties for US federal income tax purposes, but are viewed differently for foreign tax law purposes. A hybrid entity is an entity that is fiscally transparent for US federal income tax purposes, but is not for foreign tax law purposes (i.e., the foreign country where the entity is treated as a resident or subject to tax), or vice-versa.

If enacted, the new hybrid rules would be effective after 2017.

Observation: If enacted, this proposal would eliminate hybrid debt transactions that typically allow a US corporation an interest deduction (subject to any applicable interest limitations) while the related foreign corporation typically does not have an income inclusion because the payment is viewed as a dividend and subject to low or no tax under a participation regime. There is no grandfather or transition rule for structures currently in place. The proposal is consistent with the BEPS report on hybrid transactions.

New interest expense deduction limitation

Similar to the House bill, the Senate Finance bill contains two new sets of rules for limiting interest deductions. The mechanics of these interest limitation rules in the Senate Finance bill, however, differ from the House bill. Under the Senate Finance bill, the first limitation would replace current Section 163(j) and would generally limit US net interest expense deductions to 30 percent of adjusted taxable income (ATI) (roughly equivalent to earnings before interest and tax or EBIT). The second rule under the Senate Finance bill would provide an interest deduction limitation limiting US net interest expense deductions for taxpayers that are part of a global group to the extent the US corporation's domestic indebtedness exceeds 110 percent of the indebtedness it would have if its domestic debt-to-equity ratio were the same as that of the worldwide group. Similar to the House bill, a JCT description of the Senate Finance bill provides the two new interest limitation rules apply simultaneously and taxpayers' net interest expense deductions would be limited by the limitation that results in the greatest restriction on deductibility (i.e., the 'harsher' result prevails). Unlike the House bill, disallowed interest expense amounts could be carried forward *indefinitely*. These new limitations apply to both related and unrelated party debt, as well as to debt held by US and foreign parties.

New Section 163(j)

Similar to the House bill, the Senate Finance bill would repeal current Section 163(j), and replace it with a new Section 163(j) interest limitation, which would apply broadly to the business interest of any taxpayer (regardless of form and regardless of whether the taxpayer is part of a US or foreign-parented group). Thus, new Section 163(j) would apply to both US and foreign multinational companies and would limit the deduction for net business interest to the sum of business interest income plus 30 percent of ATI. Notably, ATI under the House bill was roughly equivalent to earnings before interest, taxes, depreciation, and amortization (EBITDA); ATI under the Senate Finance bill is roughly equivalent to EBIT (i.e., it does not provide an add-back for depreciation and amortization). Additionally, the Senate Finance bill explicitly treats a consolidated group as a single taxpayer, whereas the House bill is silent. Similar to the House bill, but unlike current law Section 163(j), the Senate Finance bill does not include a safe harbor debt-to-equity ratio, and would apply to interest paid to both related and unrelated parties.

Under the Senate Finance bill, a number of industries, such as real estate or certain farms (by election), certain regulated public utilities, and others would be excluded from the limitations under new Section 163(j).

Observation: The new Section 163(j) limitation under the Senate Finance bill generally would operate as a broad limitation on interest deductibility for any US company (and a foreign corporation with a US trade or business) that incurs indebtedness. Inbound companies should consider the impact of their US subsidiaries only being able to deduct net interest expense equal to 30 percent of their ATI (in contrast to the current 50-percent limitation that only replies to related party debt). Unlike the current Section 163(j) and the House bill, the limitation will be applied to

EBIT (and not EBITDA) making the limitation much harsher than under the House bill. Furthermore, new Section 163(j) applies to all US indebtedness, not just related party indebtedness. Notably, because new Section 163(j) only applies to 'business interest,' corporations need to consider whether their interest expense and interest income is properly allocable to a trade or business. Similar to the House bill, there are no transition rules or grandfather rules in the Senate Finance bill. Accordingly, any existing indebtedness would be subject to the new limitation. The lack of any specific transition rules also creates uncertainty regarding the treatment of any interest expense that is subject to unlimited carryforward under current Section 163(j).

Worldwide ratio limitation

Similar to the new Section 163(n) in the House bill, the Senate Finance bill also introduces a provision for the purpose of limiting the deductibility of interest paid by US corporations that are members of a worldwide group based on the leverage of the US group compared to the worldwide group. The House bill calculates the interest expense deduction limitation based off income statement numbers and includes earnings from foreign entities in the calculation if such entities are part of the consolidated group for financial statement purposes. The Senate Finance bill, on the other hand, determines the limitation on the basis of balance sheet numbers and includes debt and equity of the worldwide affiliated group (i.e., US and foreign corporations connected in a 'chain' of 50 percent or more ownership). More specifically, under the Senate Finance bill, the interest expense deduction of any domestic corporation that is a member of a worldwide affiliated group is reduced by the product of the domestic corporation's net interest expense multiplied by the debt-to-equity differential percentage of the worldwide affiliated group. Net interest expense is determined by interest paid or accrued during the taxable year over the amount of interest income included in gross income during the taxable year. The debt-to-equity differential percentage is the excess of domestic indebtedness of the group (i.e., the total indebtedness of the US members that exceeds 110 percent of the total indebtedness those members would hold if their total indebtedness to total equity ratio were proportionate to the ratio of total indebtedness to total equity in the worldwide affiliated group) divided by the total indebtedness of all US members of the worldwide affiliated group. The Senate Finance bill excludes from the debt-to-equity differential percentage all intragroup debt and equity interests. Additionally, the Senate Finance bill provides that tax concepts are used to compute the debt-to-equity ratios for determining the debt-to-equity differential percentage. Specifically, the Senate Finance bill provides an asset's adjusted tax basis is used to compute equity, and a debt's issue price plus its original issue discount previously accrued under Section 1272 is used for computing indebtedness. Regulatory authority is granted to provide additional guidance on the computation of debt and equity interests may be provided by the Secretary of Treasury.

Senate Bill – Section 163(n):

Under the Senate proposal, the disallowance for a deduction for interest paid/accrued by a US Corporation that is a member of a worldwide affiliated group ("WWAG") is equal to:

Numerator: Excess Domestic Indebtedness

$$\text{Net Tax Interest Expense of US Corp}^{2} \times \left(\frac{\text{Total US Group Debt} - \left(110\% \times \frac{\text{WWAG Debt}}{\text{WWAG Equity}^{3}} \times \text{Total US Group Equity}^{1}\right)}{\text{Total US Group Debt}} \right)$$

Debt-to-Equity Differential Percentage

[1] Total US Group Equity = money and all other assets – total indebtedness. May not be less than zero and does not include intragroup debt or equity interests. Section 163(n)(3)(C)-(D).

[2] Net Tax Interest Expense of US Corp = Interest paid or accrued by US Corp for tax purposes – Interest includible in income of US Corp for tax purposes. May not be less than zero. Section 163(n)(4)(B).

[3] WWAG Equity = WWAG money and all other assets – WWAG indebtedness. May not be less than zero and does not include intragroup debt or equity interests. Section 163(n)(3)(C)-(D).

Observation: Although the mechanics are different (i.e., the House bill determines the limitation based on income statement values and the Senate Finance bill uses balance sheet values), the worldwide ratio limitation under both bills applies what is essentially a proportionate worldwide leverage test to determine a limitation on the amount of net interest expense that may be deducted for US federal income tax purposes. The House bill and a JCT description of the Senate Finance bill each provide that a corporation must compute its interest expense limitation under both new Section 163(j) and the worldwide ratio limitation of new Section 163(n), and reduce its interest expense deduction by the harsher of the two limitations. The Senate Finance bill, however, does not explicitly provide for this result, though it does provide Treasury regulatory authority to coordinate new Section 163(n) with the limitation provided under new Section 163(j). Unlike the House bill, which provided a five-year carryforward, under the Senate Finance bill, any amount disallowed would be carried forward indefinitely.

Notably, by imposing the harsher limitation computed under new Section 163(j) or (n), both the House bill and the JCT description of the Senate Finance bill deviate from the 'best practices' identified in the final report issued by the OECD under Action 4, Limiting Base Erosion Involving Interest Deductions and Other Financial Payments. In that report, the recommended approach for countries was to limit the deduction of net interest expense based on a fixed ratio between 10 percent and 30 percent of EBITDA, and provide a group ratio rule that could potentially allow for more, but not less, of the corporation's interest expense to be deductible. With the Senate Finance bill using 30 percent of EBIT, rather than EBITDA, and both bills limiting deductible interest to the lesser of the limitations computed, there are significant deviations from the OECD's recommended best practices.

Base erosion and anti-abuse tax

Unlike the House bill, the Senate Finance bill effectively imposes an alternative minimum tax on US corporate taxpayers with annual gross receipts in excess of $500 million on certain deductible payments to foreign related parties to the extent such payments exceed 4 percent or more of the corporation's deductible expenses (determined without regard to Sections 172, 245A, and 250). The tax is imposed to the extent that 10 percent of modified taxable income (MTI) (roughly taxable income plus deductible foreign related party payments) exceeds the corporation's regular tax liability determined after the application of certain credits allowed against the regular tax.

The base erosion and anti-abuse tax (BEAT) applies to an applicable taxpayer. An applicable taxpayer is a 'taxpayer' other than a RIC, REIT, or S corporation that satisfies the $500 million threshold for gross receipts, and the 4 percent base erosion percentage. It is not clear whether an applicable taxpayer can be a foreign corporation subject to net income taxation on income derived in connection with a US trade or business.

For tax years beginning after 2025, the BEAT tax rate would increase from 10 percent to 12.5 percent and would reduce the regular tax liability by all allowable credits, unless overall federal revenues exceed a set level.

Unlike the House bill, deductible payments do not include cost of goods sold unless the payment is made to a surrogate foreign corporation or a foreign corporation that is a member of the same expanded affiliated group as a surrogate foreign corporation, as those terms are defined under Section 7874. A surrogate foreign corporation is generally a foreign corporation that acquired or acquires a US corporation and the US corporation's former shareholders own at least 60 percent but less than 80 percent of the vote or value of the foreign acquiring corporation.

Unlike the House bill, under the Senate Finance bill deductible payments include interest expense. For this purpose, limitations on the deductibility of interest expense are treated as reducing interest paid to unrelated parties before reducing interest paid to related parties. Deductions attributable to payments that are subject to tax under Sections 871 or 881 and with respect to which tax has been withheld under Sections 1441 or 1442 are not taken into account in computing modified taxable income. The exclusion will not apply, however, to the extent that the full rate of tax withheld under Sections 1441 or 1442 has been reduced by an applicable tax treaty.

In addition, deductions with respect to amounts paid or incurred for services at cost with no markup and that meet the requirements under Section 482 for the services cost method (without regard to the requirement that services not contribute significantly to fundamental risks of business success or failure) are not considered.

Observation: While the BEAT's policy objectives may be similar to the House bill's objectives for the excise

tax, that is, to reduce the ability of multinational companies to erode the US tax base through related party deductible payments, the mechanics for computing the BEAT are different in a number of respects. First, under the House bill, unless a foreign corporation elects for the income to be treated as ECI, a 20-percent excise tax is imposed on any specified payment. In contrast, under the Senate Finance bill, payments are not subject to an additional tax. Because the BEAT is equal to the excess of 10 percent of MTI over regular tax liability, it effectively operates as an alternative minimum tax to ensure a 10-percent minimum effective tax rate on a US corporate taxpayer (without regard to the relevant base erosion payments). Second, unlike the House excise tax, there may be situations in which there is no BEAT amount, in contrast to the excise tax which is always imposed under the House bill with respect to relevant payments (unless the recipient elects to treat the payment as ECI). Under the Senate Finance bill, there is no election to treat the income as ECI, and no ability to claim FTCs with respect to foreign taxes paid with respect to the deductible amounts that create the BEAT. Consequently, because the amount is not treated as ECI, there is no additional branch profits tax exposure like in the House excise tax provision. Third, the excise tax applies to all payments described therein, while the Senate Finance bill contains a threshold 4 percent base erosion amount before the BEAT applies. This aspect of the BEAT in the Senate Finance bill could treat similarly situated taxpayers very differently. Potentially impacted taxpayers may wish to consider their own circumstances and the corresponding impact of the House excise tax bill in comparison to the Senate BEAT provision to determine which provision may impose the greater tax.

The provision is effective for payments paid or accrued in taxable years beginning after 2017.

Sale of partnership interest

Under the Senate Finance bill, gain from the sale or exchange of a partnership interest is treated as ECI to the extent the partnership is engaged in a US trade or business and the foreign partner would have had ECI had the partnership sold all of its assets in a taxable sale at fair market value and allocated the gain or loss to the foreign partner in the same manner as non-separately stated income and loss (i.e., generally the partner's distributive share). The Senate Finance bill applies to a foreign partner that *directly or indirectly* owns an interest in a partnership that is engaged in a US trade or business. If the partnership holds any US real property interests (USRPIs) at the time of the sale or exchange, the amount that is treated as ECI under the provision is reduced by the amount treated as ECI by reason of Section 897 (rules related to dispositions of USRPIs). The term sale or exchange includes any transaction where gain or loss is realized from the sale or exchange of such interest. A new provision would be added to Section 1446 (which generally requires a partnership to withhold tax on effectively connected taxable income allocable to a foreign partner) to require the transferee of a partnership interest to withhold 10 percent of the amount realized on the acquisition of a partnership interest if any portion of the gain (if any) is treated as ECI under the new provision unless the transferor certifies that it is not a foreign person. At the request of the transferor or transferee, the Secretary of the Treasury may prescribe a reduced amount of withholding tax if the Secretary determines that the reduced amount will not jeopardize the collection of tax on the amount of gain treated as ECI. If the transferee fails to withhold, the partnership is required to withhold from the transferee partner an amount equal to the amount the transferee was required to withhold.

The provision is effective for sales and exchanges on or after November 27, 2017.

Observation: The provision would codify a revenue ruling issued by the IRS (Revenue Ruling 91-32) and effectively overrule the recently issued *Grecian Magnesite* case, which held that gain on the sale of a partnership interest is generally not ECI (subject to exceptions for certain types of assets and certain types of sales). Notably, this provision could override nonrecognition transactions, as it applies to gain realized rather than gain recognized. By referring to 'direct or indirect' ownership, the provision could apply to tiers of partnerships to the extent one partnership in the chain is engaged in a US trade or business. Although the transferee only has to withhold when there is gain on the disposition of the partnership interest that would be treated as ECI, the amount of withholding is still based on the amount realized, as opposed to the gain recognized which could cause over withholding. Similar to FIRPTA withholding, there appears to be a possibility for reduced withholding when the withholding tax exceeds the tax liability as long as the reduced withholding does not impact the amount of tax ultimately collected. It remains to be seen whether a form similar to Form 8288-B (reduced FIRPTA withholding) will be created by the IRS. Although the amount treated as ECI is reduced by the amount treated as ECI under the FIRPTA provisions, because the withholding tax is based on the amount realized, it seems that this could create a withholding tax when no withholding tax would otherwise

be due under FIRPTA (to the extent the partnership had both US trade or business assets and USRPIs). FIRPTA withholding only applies to a disposition of a partnership interest if 50 percent or more of the gross value of the partnership's assets are USRPIs and 90 percent or more of the gross value are USRPIs plus cash and cash equivalents.

Shipping income

Unlike the House bill which contains no modifications to the taxation of transportation income, the Senate Finance bill would introduce a new category of taxable ECI described as passenger cruise gross income. Passenger cruise gross income includes all income derived from the operation of a commercial vessel from a covered voyage (i.e., a cruise on which passengers embark and/or disembark a vessel in the United States). The income subject to this new provision broadly includes both the cruise revenue itself as well as incidental amounts received with respect to on- or off-board activities, and services or sales provided during the voyage, such as gambling revenue. Effectively connected passenger cruise gross income is limited to only the portion of income derived from a voyage that occurs in US territorial waters, based on a time-spent ratio, with any part of a day in US territorial waters treated entirely as one US day. Under the proposal, if passenger cruise gross income is effectively connected with a US trade or business, such income would be subject to US net taxation, as well as branch profits tax.

The Senate Finance bill would also modify current rules related to gross income derived from the international operation of aircraft. Under the Senate Finance bill, new limitations would apply to the reciprocal exemption under current Section 883(a)(2) if (i) the foreign corporation operating the aircraft is headquartered in a foreign country whose residents are not entitled to a reduction in or exemption from tax under Sections 881 or 882, (ii) that foreign country has fewer than two arrivals and departures per week, from major passenger airline carriers headquartered in the United States, and (iii) the foreign corporation earns more than $1 billion of gross operating revenue annually.

Both transportation income modifications would be effective for taxable years beginning after 2017.

Observation: The description of the passenger cruise proposal seems to encourage cruise lines to start and end cruises outside of the United States. Such operational changes by cruise lines could have a detrimental effect on tourism industries in US locations where they currently have a significant presence, particularly Florida, Alaska, and Texas, including potentially shifting jobs to non-US jurisdictions.

The aircraft provision appears to be targeted at supporting the ongoing government subsidy dispute between major US carriers and certain Middle Eastern carriers, which may potentially lead to future complaints being filed with the World Trade Organization. The Senate Finance bill differs from an initial JCT description report that indicated the provision would apply to non-treaty country residents, which, as currently worded, is not the result. Additionally, the Senate Finance bill fails to define certain new terms, which may lead to uncertainty in the application of the rule.

Other new proposals

In addition, the Senate Finance bill would:

- Modify the current anti-deferral rules to eliminate foreign base company oil related income as a category of foreign base company income, include an inflation adjustment for the de minimis exception under Section 954(b)(3), repeal the inclusion based on withdrawal of previously excluded subpart F income from qualified investment, permanently extend Section 954(c)(6), eliminate the requirement that a foreign corporation must be a CFC for 30 days in order for its US shareholders to have subpart F inclusions, and exclude domestic corporations from the application of Section 956.
- Deny favorable rates under Section 1(h) on dividends paid from surrogate foreign corporations.
- Repeal Section 902. FTCs would only be available under Section 960 to the extent foreign taxes are imposed on the item of income (e.g., subpart F income) included in a US shareholder's gross income.
- Introduce new FTC limitation rules related to foreign branch income from a qualified business unit.
- Repeal the rules related to DISC and IC-DISC entities.
- Introduce an election to accelerate interest income related to worldwide interest allocation rules.
- Modify the PFIC rules as applied to certain income derived by a qualifying insurance corporation.
- Repeal the fair market value method for allocating and apportioning interest expense under Section 864(e).
- Modify sourcing rules related to certain US possessions.
- Modify sourcing rules for the sale of inventory.

Next steps

The tax reform legislation being considered in the Senate remains open to significant changes as Congress attempts to overcome political hurdles that could affect the prospects for reform of the US international tax system.

The Senate is expected to consider floor amendments to the Senate Finance bill during the week of November 27th before a final Senate vote is held on the legislation. We will monitor potential modifications to legislation as the bill is considered for vote by the Senate. Once the Senate has approved its tax reform bill, the House and Senate must reconcile differences between the two bills and then vote to pass a final bill in identical form before tax reform legislation can be signed into law by President Trump.

The takeaway

The Senate Finance bill would significantly change many fundamental aspects of US international taxation. Recapping some of the important highlights of the Senate Finance bill:

- The bill provides for a 100-percent DRD for foreign-source dividends from specified 10-percent owned foreign corporations.
- Imposes a one-time 'toll tax' on pre-effective date foreign E&P taxed at 10 percent on cash and cash equivalents
- and 5 percent on all other E&P.
- Makes permanent the CFC look-through provision under Section 954(c)(6).
- Expands the stock attribution rule for purposes of determining whether a foreign corporation is treated as a CFC.
- Adds a new GILTI income inclusion for US shareholders.
- Adds a BEAT tax related to certain deductible intercompany payments.
- Adds a deduction for US taxpayers for a portion of the income considered to be derived from the sale of property to a foreign person for use outside the United States, and services rendered for any person, or with respect to property, located outside the United States.
- Imposes new rules related to limiting interest expense deduction.

Some of these changes could impose significant additional burdens on both US and foreign taxpayers. Companies should endeavor to understand the proposals as the bill could quickly become the template for tax reform in Congress. Taxpayers should also consider participating in the legislative process by commenting on specific proposals that might affect their business and industry.

See also:

PwC Tax Insight: Overview of House Ways and Means Chairman Brady's tax reform bill

Let's talk

For a deeper discussion of how this might affect your business, please contact:

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Comparison of House bill, Senate Finance bill, and current law

Proposal	TCJA - House	TCJA - Senate	Current Law
Corporate tax rates	20% rate beginning after December 31, 2017.	20% rate beginning after **December 31, 2018**.	35% rate
International tax regime	'Territorial' system	'Territorial' system	'Worldwide' system
	100% deduction for foreign-source portion of dividends received by US corporate shareholders from foreign corporations with respect to which it is a US corporate shareholder, subject to 6-month holding period requirement.	100% deduction for foreign source portion of dividends received by US corporate shareholders from certain foreign corporations, subject to 1-year holding period requirement.	No foreign dividend exemption.
		Not available for any dividend received by a US shareholder from a controlled foreign corporation (CFC) if the dividend is a hybrid dividend.	
Limitation on losses	A domestic corporation is required to reduce the basis of its stock in a foreign subsidiary by the amount of any exempt dividend received, but only for purposes of determining the amount of a loss on the sale or exchange of the stock.	Appears to be same as the House bill, but recapture amount limited to amount of deduction allowed to the taxpayer for foreign dividends received in taxable year of the transfer, and any excess is carried forward to future years.	Gain recognized by a US shareholder on the sale or exchange of stock in a foreign corporation is generally treated as a dividend distribution to the extent of the foreign corporation's E&P.
	Post-2017 branch losses subject to recapture when substantially all of assets of a foreign branch are transferred to a foreign corporation; recapture amount is not gain-limited.		Gain must be recognized on an outbound transfer of the assets of a foreign branch with previously deducted losses.
Repatriation 'toll charge'	Previously untaxed earnings (accumulated post-1986 deferred foreign income – "DFI") of certain foreign corporations (determined as of 11/2/17 or 12/31/17, whichever is higher) are added to subpart F income. 14% effective rate for the portion of the inclusion equal to the US shareholder's aggregate foreign cash and cash-equivalent assets;	Previously untaxed earnings (accumulated post-1986 DFI) of certain foreign corporations **(determined as of 11/9/17 or 12/31/17, whichever is higher**) are added to subpart F income. 10% effective rate for the portion of the inclusion equal to the US shareholder's aggregate	Ordinary corporate tax rates up to 35% on the amount repatriated. US tax liability of domestic corporate shareholders of foreign corporations can be offset by deemed paid foreign tax credits.

Proposal	TCJA - House	TCJA - Senate	Current Law
	7% effective rate for the remainder of the inclusion. A portion of foreign income taxes deemed paid or accrued with respect to the increased subpart F inclusion – 60% of the foreign taxes otherwise deemed paid with respect to the portion attributable to the aggregate cash position plus 80% of the foreign taxes otherwise deemed paid with respect to the remainder of the mandatory inclusion – would not be creditable or deductible. Foreign taxes associated with the remainder of the inclusion can be credited or carried forward for up to 20 years. Toll charge can be paid over 8 years in equal annual installments.	foreign cash and cash-equivalent assets; and **5%** effective rate for the remainder of the inclusion. A portion of the foreign income taxes deemed paid or accrued with respect to the increased subpart F – 71.4% of the foreign taxes otherwise deemed paid with respect to the portion attributable to the aggregate cash position plus 85.7% of the foreign taxes otherwise deemed paid with respect to the remainder of the mandatory inclusion – would not be creditable or deductible. Senate bill does not contain provisions for treatment of excess credits (presumably carried forward for up to 10 years). Toll charge can be paid over 8 years according to a schedule (8% per year for the first 5 years, 15% in the sixth year, 20% in the seventh year, and the remaining 25% in the eight year). Imposes a 35% tax rate (without deductions or foreign tax credits) on the entire inclusion if a US shareholder becomes an expatriated entity within 10 years of proposal's enactment.	
Foreign tax credit	Repeals deemed paid tax credit for dividends received from a foreign corporation. Retains deemed paid tax credit for subpart F inclusions. Proposal eliminates need for computing	Same as the House bill.	A taxpayer can generally take a credit or deduction for foreign taxes paid or accrued. US shareholder may be deemed to pay foreign income taxes paid by a

Proposal	TCJA - House	TCJA - Senate	Current Law
	and tracking cumulative tax pools.		foreign corporation when US shareholder receives a dividend from a foreign corporation or includes earnings of a foreign corporation in gross income.
	No foreign tax credit or deduction permitted for any taxes paid or accrued with respect to any dividend subject to the new deduction for foreign dividends.		
Foreign tax credit limitation	Adds separate basket for the foreign high return inclusion.	Adds separate baskets for foreign branch income and Global Intangible Low-Taxed Income (GILTI).	Amount of credit is subject to a limitation based on the taxpayer's foreign source income. Limitation applied separately with respect to passive category income and general category income ('baskets').
Subpart F	A domestic entity is treated as constructively owning stock held by a foreign person for purposes of determining whether the related US person is a US shareholder of the foreign corporation and, therefore, whether the foreign corporation is a CFC; applies to taxable years beginning after December 31, 2017.	Same as House bill, but applies to taxable years beginning **before January 1, 2018**.	A US shareholder in a CFC must generally include its pro rata share of subpart F income earned by the CFC in the US shareholder's gross income.
	The 30-day requirement is eliminated.	Same as House bill	A US shareholder is a US person that owns at least 10% of the total combined voting power of all classes of stock entitled to vote of the CFC.
	Foreign base company oil related income is excluded from the definition of subpart F income.	Same as House bill	A foreign corporation is a CFC if it is more than 50% owned by one or more US shareholders. For this purpose a domestic entity is generally not treated as constructively owning

Proposal	TCJA - House	TCJA - Senate	Current Law
			stock held by its foreign owner.
	The $1 million threshold for the de minimis exception is indexed to inflation.	Same as House bill	Under the 30-day requirement, subpart F inclusions do not apply unless a foreign corporation is a CFC for an interrupted period of 30 days during the taxable year.
	The look-thru rule is made permanent.	Same as House bill	Under high tax exception, if an item of foreign base company income or insurance income has been taxed by a foreign country at a rate of at least 90% of the maximum US tax rate, then item is not treated as subpart F income.
		Expands definition of US shareholder to include any US person who owns at least 10% of the total value of shares of all classes of stock of the CFC.	Under the de minimis exception, if a CFC's gross foreign base company income and gross insurance income is less than the lesser of 5% of gross income or $1 million, none of the CFC's gross income is treated as foreign base company income or insurance income.
		A hybrid dividend paid by a CFC to a related CFC with the same corporate US shareholder is treated as Subpart F income.	Under the look-thru rule, certain dividends, interest, rents, and royalties from a related CFC are not treated as foreign personal holding company under section 954(c)(6) for taxable years beginning before January 1, 2020.
Investments in US property	A corporate US shareholder is not subject to an inclusion based on a CFC's investment in US property.	Same as House bill.	US shareholder in a CFC generally must include its pro rata share of a CFC's investment in US property to extent of

Proposal	TCJA - House	TCJA - Senate	Current Law
			CFC's undistributed earnings.
Sourcing of income from the sale of inventory	Gain from the sale of inventory property produced by the taxpayer is sourced based on the location at which the inventory is produced.	Same as House bill.	Gain from sale of inventory property produced by taxpayer is sourced in part based on where inventory is produced and in part based on location of title passage.
Transfers of property from US to foreign corporation	No change from current law.	Repeals the active trade or business exception.	In general, an exchange in which a US person transfers property to a foreign corporation is not eligible for non-recognition treatment. Under the active trade or business exception, certain property transferred to a foreign corporation for use in the active conduct of a trade or business outside of the United States is eligible for non-recognition.
Transfers of Intangible Property from CFCs to US Shareholders	No change from current law.	Applies to distributions by a CFC of certain intangible property to a US shareholder before the last day of the CFC's third taxable year beginning after December 31, 2017.	A shareholder recognizes ordinary income on a distribution out of a corporation's E&P.
		Fair market value of the property distributed is treated as not exceeding its adjusted basis.	Distributions in excess of E&P reduce a shareholder's basis in the stock of distributing corporation, and distributions in excess of stock basis are treated as gain from the sale or exchange of property.
		US shareholder's adjusted basis in the stock of a CFC is increased by amount of distribution that would otherwise be included in shareholder's gross income.	A distributing corporation recognizes gain on a distribution of appreciated property.

Proposal	TCJA - House	TCJA - Senate	Current Law
		Shareholder's basis in property distributed is reduced by amount of increase.	
			A shareholder's basis in distributed property is equal to its fair market value.
Definition and valuation of intangible property	No change from current law.	Clarifies definition of intangible property within meaning of section 936(h)(3)(B) to include workforce in place, goodwill (both foreign and domestic), and going concern value. Clarifies IRS authority to specify the method for valuation of intangible property. Codifies the 'realistic alternative principle,' which holds that a taxpayer will only enter into a particular transaction if none of its realistic alternatives is economically preferable to the transaction under consideration.	The meaning of intangible property is defined for a number of purposes under section 936(h)(3)(B), but this definition is unclear.
Dividends from surrogate foreign corporations	No change from current law.	An individual shareholder is not eligible for a reduced rate under section 1(h) on dividends from a corporation which is a surrogate foreign corporation under section 7874(a)(2)(B) but is not treated as a domestic corporation under section 7874(b).	Individual shareholders are entitled to a reduced rate of tax on qualified dividend income. Qualified dividend income includes dividends from certain foreign corporations.
Foreign high returns/Intangible income	A US shareholder in a CFC must include 50% of its 'foreign high return amount' (FHRA) in gross income.	A US shareholder in a CFC must include its global intangible low-taxed income (GILTI) in gross income.	Subpart F (see above)

Proposal	TCJA - House	TCJA - Senate	Current Law
	A US shareholder's FHRA is equal to amount by which its aggregate pro rata share of 'net CFC tested income' exceeds a specified return.	A US shareholder's GILTI is equal to amount by which its aggregate pro rata share of net CFC tested income exceeds a specified return.	Transfer pricing rules govern the allocation of profits to a foreign affiliate holding intangible assets.
	Specified return is a percentage (7% plus the short-term AFR) of the shareholder's aggregate pro rata share of CFC qualified business asset investment (QBAI), and is reduced by interest expense taken into account in determining net CFC tested income.	Specified return is equal to 10% of shareholder's aggregate pro rata share of QBAI.	
		A domestic corporation can deduct 50% of GILTI included in gross income and 37.5% of its foreign-derived intangible income.	
Related party payments	Imposes a 20% excise tax on certain amounts paid by a US corporation to a foreign corporation if both corporations are part of the same international financial reporting group.	Imposes minimum tax equal to excess of (i) 10% of taxable income determined without regard to base erosion payments (i.e., deductible payments to a related foreign person); over (ii) regular tax liability. Rate above is increased to 12.5% for taxable years beginning after December 31, 2025.	A foreign corporation engaged in a trade or business in the US is taxed on its effectively connected income (ECI).
	Excise tax does not apply to amounts treated by foreign recipient as ECI; foreign recipient can elect to treat payments from a US corporation that would otherwise be subject to excise tax as ECI.	Modified taxable income is reduced by payments to the extent they are subject to the 30% tax on FDAP income.	Fixed or determinable annual or periodical (FDAP) income received by a foreign corporation from US sources is subject to a 30% gross basis withholding tax which may be reduced under a US income tax treaty.
	The excise tax does not apply to FDAP income to the extent the income is subject to the 30% withholding tax.	Denies a deduction for interest or royalties paid or accrued to a related party in connection with a hybrid transaction a hybrid entity, to the extent that the related party does not have	

Proposal	TCJA - House	TCJA - Senate	Current Law
		a corresponding inclusion or is allowed a deduction with respect to the amount paid for foreign tax purposes.	
Limitation on deductibility of interest for members of international group (new section 163(n))	Limits amount of net interest expense that may be deducted by a domestic corporation that is a member of an **international financial reporting group.**	Limits amount of net interest expense that may be deducted by a domestic corporation that is a member of a **worldwide affiliated group**.	NA
	Deduction limited to a percentage of group's net interest expense determined based on domestic corporation's share of group's EBITDA, and effectively limiting US person's interest deduction to 110% of that percentage of group's total interest expense.	Limitation reduces interest expense deduction by product of domestic corporation's net interest expense multiplied by debt-to-equity differential percentage of worldwide affiliated group.	
	Where applicable, taxpayer disallowed interest deductions pursuant to whichever provision denies a greater amount of interest deductions (between revised sec 163(j) and new sec 163(n)).	Where applicable, taxpayer disallowed interest deductions pursuant to whichever provision denies a greater amount of interest deductions (between revised sec 163(j) and new sec 163(n)).	
		No deduction allowed for any interest paid by a "hybrid entity" pursuant to a "hybrid transaction".	
	Disallowed interest can be carried forward for 5 years.	Disallowed interest can be carried forward indefinitely.	
Limitation on deductibility of business interest	Deduction for net interest expense attributable to a trade or business limited to 30% of the business's adjusted taxable income (defined similar to EBITDA).	Deduction for net interest expense attributable to a trade or business limited to 30% of business's adjusted taxable income (defined similar to EBIT, i.e., without addback of depreciation and amortization).	If taxpayer's debt-to-equity ratio exceeds 1.5 to 1, certain related party interest payments are disallowed to extent of the taxpayer's excess interest expense (i.e., amount by which net interest expense exceeds 50% of adjusted taxable income).

Proposal	TCJA - House	TCJA - Senate	Current Law
	Would apply to related and third party debt.	Would apply to related and third party debt.	
	Disallowed interest can be carried forward for 5 years.	Disallowed interest can be carried forward indefinitely.	Disallowed interest can be carried forward indefinitely and excess limitation (i.e., excess of 50% of adjusted taxable income over net interest expense) can be carried forward for 3 years.
Allocation of Interest Expense	No change from current law.	Members of a US affiliated group must allocate interest expense based on the adjusted tax basis of assets.	Members of a US affiliated group can allocate interest expense based on fair market value or adjusted tax basis of assets.

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