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I. CHAPTER 1, SCOPE AND INTRODUCTION

A. Page 1, New Sec. 1.1.A. Introduction to the 2017 Tax Cuts and Jobs Act (TCAJA)

Page 1, New Sec. 1.1.A. Add the following immediately after the heading to Section 1.1:
New Sec. 1.1.A. **Introduction to the 2017 Tax Cuts and Jobs Act (TCAJA)**

The 2017 Tax Cuts and Jobs Act (TCAJA) amended many of the provisions of the Internal Revenue Code, including many provisions that impact the domestic operations of the four principal ways of operating a business: (1) sole proprietorship, including single member LLC; (2) partnership, including multimember LLCs; (3) S corporation; and (4) C corporation. The TCAJA also made significant changes to the international provisions of the Code, including the adoption of what I refer to as: (1) The "Cookie" (*i.e.*, Territoriality); (2) the "Carrot" (*i.e.*, FDII), and (3) the "Four Sticks" (*i.e.*, GILTI, BEAT, Intangibles, and amendment to section 367(a)), each of which is explored below.

In addition to materials not directly related to the TCAJA, this Supplement contains excerpts from the Conference Report to the TCAJA that relate to the particular provisions of the Code covered in the applicable chapter. *See* Joint Explanatory Text of the Committee of Conference (H. Rept. 115-466, Dec. 15, 2017) [the "TCAJA Conference Report"]. The Conference Report and other related materials is contained in Wolters Kluwer, *The Tax Cuts and Jobs Act, Law, Explanation and Analysis* (Dec. 2017) [the "Wolters Kluwer, *Explanation of the TCAJA*"].

The materials in this Supplement dealing with the TCAJA are also addressed more fully in Samuel C. Thompson, Jr., *Mergers, Acquisitions, and Tender Offers* (PLI, 2010, updated twice a year) (Chapters 9, 14, 15, 21, and 22) and Samuel C. Thompson, Jr. *Business Tax Deskbook: Corporations, Partnerships, Subchapter S, and International* (PLI, in press, 2018).

It must be emphasized that the TCAJA made numerous amendments to the Code that are not discussed in this Supplement. From the perspective of the TCAJA, this Supplement focuses on (1) the basic domestic rate structure provisions of the Code implemented by the TCAJA, and (2) the international provisions of the Code implemented by the TCAJA, with particular emphasis on the "Cookie, the Carrot, and the Four Sticks." The focus here is on the provisions of the TCAJA that are most likely to impact the tax treatment of (1) a general business (*e.g.*, a business that is not subject to special regulations or special provisions of the Code, such as insurance) and (2) the owners of such a general business.

B. Page 6, New Sec. 1.2.A. Introduction to Present Law Taxation of Outbound and Inbound Transactions: Impact of the TCAJA

Page 6, New Sec. 1.2.A. Add immediately after the heading for Sec. 1.2, the following:
New Sec. 1.2.A. **Introduction to the Impact of the TCAJA on Outbound Transactions**

1. In General

In connection with reading section 1.2, also read this following introduction to "the Cookie, the Carrot, and the Four Sticks." These provisions significantly modify many of the provisions discussed in section 1.2. The following section is adapted from Samuel C. Thompson, Jr., Introduction to the Business Related Provisions of the 2017 Tax Cuts and Jobs Act (PLI, 2018).

2. Introduction to the TCAJA's Adoption of a Territorial System and Anti-Base Erosion Provisions of the TCAJA: "The Cookie, the Carrot, and the Four Sticks"

a. Background on the Prior Deferral System and the Newly Adopted Territorial (*i.e.*, Participation Exemption) System: The Cookie

The TCAJA adopted a proposal, which has been around for a long time, to move the U.S. from its pre-TCAJA deferral system for taxing active foreign business income ("Active Foreign Income") of a foreign sub ("Foreign Sub") of a U.S. parent corporation ("U.S. Parent") to a territorial system for taxing such income. Most of the trading partners of the U.S. have territorial systems.

In the prior deferral system, which is discussed in section 1.2 of the book, the Active Foreign Income of a Foreign Sub was generally deferred from U.S. tax until the income was repatriated to the U.S. Parent in the form of dividends or otherwise, and at the time of the repatriation, the U.S. parent generally received a foreign tax credit with respect to foreign taxes paid on the repatriated income.

Under the newly adopted territorial system under Section 245A, the Active Foreign Income of the Foreign Sub is not subject to U.S. tax at the time of earning or at the time of repatriation, and on repatriation, the foreign tax credit with respect to the Active Foreign Income is not allowed.

The differences between the prior deferral system and the newly adopted territorial system can be illustrated as follows. Assume that under the prior deferral system, (1) in year 1, a newly formed Foreign Sub had $100M of Active Foreign Income on which it paid a 10% foreign tax of $10M and reinvested the $90M balance, (2) in year 2, Foreign Sub had no income or loss, and (3) on January 1 of year 3, Foreign Sub distributed to U.S. Parent, the $90M of retained Active Foreign Income. Under the former deferral system, the $100M of Active Foreign Income would have been (1) deferred from U.S. tax in years 1 and 2, and (2) subject to U.S. tax in year 3. In addition, in year 3, U.S. Parent would have received a foreign tax credit for the $10M foreign tax paid by Foreign Sub. Thus, in year 3, U.S. Parent would have (1) included the full $100M in its taxable income, (2) been taxed at the 35% U.S. rate, or $35M, and (3) taken a foreign tax credit of $10M. Thus, the net tax owed to the U.S. in year 3 would have been $25M.

Under the territorial system (otherwise known as a participation exemption system) adopted by Section 245A, the Active Foreign Income of Foreign Sub is not subject to U.S. tax at the time it is earned, or at the time it is repatriated in year 3. However, the TCAJA retains the very complex subpart F and related rules for subjecting U.S. Parent to immediate U.S. taxation on certain Passive Foreign Income (*e.g.*, dividends and interest), which is known as subpart F income,

earned by Foreign Sub. The discussion here assumes that Foreign Sub has only Active Foreign Income.

b. Brief Introduction to Section 245A

Even though Section 245A applies to certain partially owned foreign corporations, the discussion here focuses only on wholly-owned Foreign Subs, which is the normal situation. Section 245A(a) sets out the following general rule: "In the case of any dividend received from . . . [Foreign Sub] by a domestic corporation [U.S. Parent] . . . there shall be allowed as a deduction an amount equal to the Foreign-Source Portion of Such Dividend ["Foreign-Source Portion]." Under Section 245A(c)(1), the Foreign-Source Portion is "an amount which bears the same ratio to [the] dividend as— (A) Undistributed Foreign Earnings of [Foreign Sub], bears to (B) the total undistributed earnings of such foreign corporation." Section 245A(c)(3) defines Undistributed Foreign Earnings to mean, essentially, Active Foreign Income. Thus, as a general matter under Section 245A, if all of Foreign Sub's retained earnings are attributable to Active Foreign Income, then 100% of any dividend paid by Foreign Sub to Foreign Parent is deductible by Foreign Parent.

Section 245A(d) denies U.S. Parent both the foreign tax credit and the deduction for foreign taxes with respect to dividends that qualify for the Section 245A deduction.

c. Taxation of Pre-TCAJA Deferred Income

In view of the adoption of the territorial system (*i.e*., participation exemption system) in Section 245A, Section 965, which was added by the TCAJA, addresses the taxation of a Foreign Sub's pre-TCAJA deferred Active Foreign Income. It is generally believed that there may be as much as $3 trillion of such deferred Active Foreign Income. Section 965 taxes this deferred Active Foreign Income, but at reduced rates, with a taxpayer election to defer the tax. This tax is not explored in this Supplement.

d. Why Section 245 is the "Cookie"

Section 245(a) is the "Cookie," because it permits a U.S. parent corporation to avoid U.S. tax on the Active Foreign Income of its foreign subs.

e. Base Erosion Tax Abuse with a Territorial System

As indicated by the OECD's Base Erosion and Profits Shifting ("BEPS") project,[1] territorial tax systems, which predominate among OECD countries, are subject to significant base erosion, which involves, for example, payments by U.S. Parent to Foreign Sub that are deductible to U.S. Parent and not taxable (or subject to a low tax) to Foreign Sub. If this part of the transaction is successful (*i.e*., deduction in the U.S. and no or low tax in the foreign country), which is often referred to as "double non-taxation," then with a territorial system, the income could be repatriated to the U.S. without tax. This type of transaction is sometimes referred to as "round tripping." As seen below, in view of the adoption of the territorial system, the TCAJA adopts several anti-base erosion provisions.

[1] *See, e.g.,* OECD/G20, *Base Erosion and Profit Shifting Project* (2013).

3. Introduction to the TCAJA's Carrot: "Foreign-Derived Intangible Income"

To offset some of the sweetness of the Cookie, the TCAJA adopted a new deduction in Section 250 for Foreign-Derived Intangible Income (FDII). As will be seen below, this deduction is an incentive for keeping intangibles in the U.S. and is, therefore, a Carrot designed to offset some of the benefit of the Cookie.

4. Introduction to the TCAJA's Anti-Base Erosion Provisions: The Four Sticks

The discussion below sets out the legislative history of the Four Sticks:

- Section 59A, Tax on Base Erosion Payments of Taxpayers with Substantial Gross Receipts, which is otherwise referred to as the BEAT;
- Section 951A, Current Inclusion of Global Intangible Low-Taxed Income and the related deduction under Section 250, which is otherwise known as GILTI;
- The new definition of intangible property for purposes of both Section 482, which deals with transfer pricing, and Section 367, which deals with cross-border reorganizations and incorporations; and
- The amendment to Section 367 that denies non-recognition treatment for outbound transfers of property to a foreign sub where such transfer would otherwise receive non-recognition treatment under Section 351.

Each of these provisions is designed to cut back on the sweetness of the Cookie.

C. Page 23, New Sec. 1.6.D. The TCAJA's Rule for Determining Source of Income from Sales of Inventory

Page 23, New Sec. 1.6.D. Add immediately before 1.7 the following new Sec. 1.6.D:

New Sec. 1.6.D. **The TCAJA's Rule for Determining Source of Income from Sales of Inventory**

Source of income from sales of inventory determined solely on basis of production activities (sec. 4102 of the House bill, sec. 14304 of the Senate amendment, and sec. 863(b) of the Code)

HOUSE BILL

Under the provision, gains, profits, and income from the sale or exchange of inventory property produced partly in, and partly outside, the United States is allocated and apportioned on the basis of the location of production with respect to the property. For example, income derived from the sale of inventory property to a foreign jurisdiction is sourced wholly within the United States if the property was produced entirely in the United States, even if title passage occurred elsewhere. Likewise, income derived from inventory property sold in the United States, but produced

entirely in another country, is sourced in that country even if title passage occurs in the United States. If the inventory property is produced partly in, and partly outside, the United States, however, the income derived from its sale is sourced partly in the United States.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

SENATE AMENDMENT

The Senate amendment is identical to the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

D. Page 23, New Sec. 1.6.E. The TCAJA's Rule on Interest Apportionment

Page 23, New Sec. 1.6.E. Add immediately after the new Sec. 1.6.D the following new Sec. 1.6.E:

New Sec. 1.6.E **The TCAJA's Rule on Interest Apportionment**

Repeal of fair market value of interest expense apportionment (sec. 14503 of the Senate amendment and sec. 864 of the Code)

HOUSE BILL

No provision.

SENATE AMENDMENT

The provision prohibits members of a U.S. affiliated group from allocating interest expense on the basis of the fair market value of assets for purposes of section 864(e). Instead, the members must allocate interest expense based on the adjusted tax basis of assets.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

E. Page 23, New Sec. 1.7.A. Introduction to the Individual Rate Structure Adopted by the TCAJA

Page 23, New Sec. 1.7.A. Add immediately after the heading for Sec. 1.7, the following:

New Sec. 1.7.A. **Introduction to the Individual Rate Structures Adopted by the TCAJA**

1. In General

In connection with the study of section 1.7, read also the following provisions of the Conference Report to the TCAJA and related Code sections. This section focuses only on (1) the new section 1 rate structures for individuals, (2) the retention of the tax treatment of capital gains and

dividends, (3) the increase in the standard deduction, and (4) the repeal of the deduction for the personal exemption. These provisions are likely to impact in a significant way most individuals.

2. Individual Rate Structure

TCAJA CONFERENCE REPORT

Reduction and Simplification of Individual Income Tax Rates (sec. 1001 of the House bill, sec. 11001 of the Senate amendment, and sec. 1 of the Code)

PRESENT LAW

In general

To determine regular tax liability, an individual taxpayer generally must apply the tax rate schedules (or the tax tables) to his or her regular taxable income. [*See* § 1] The rate schedules are broken into several ranges of income, known as income brackets, and the marginal tax rate increases as a taxpayer's income increases.

Tax rate schedules

Separate rate schedules apply based on an individual's filing status. For 2017, the regular individual income tax rate schedule[for married filing jointly was] as follows: * * *

TABLE 1.—FEDERAL INDIVIDUAL INCOME TAX RATES FOR 2017

Married Individuals Filing Joint Returns and Surviving Spouses

If taxable income is:	*Then income tax equals:*
Not over $18,650	10% of the taxable income
Over $18,650 but not over $75,900	$1,865 plus 15% of the excess over $18,650
Over $75,900 but not over $153,100	$10,452.50 plus 25% of the excess over $75,900
Over $153,100 but not over $233,350	$29,752.50 plus 28% of the excess over $153,100
Over $233,350 but not over $416,700	$52,222.50 plus 33% of the excess over $233,350
Over $416,700 but not over $470,700	$112,728 plus 35% of the excess over $416,700
Over $470,700	$131,628 plus 39.6% of the excess over $470,700 * * *

Capital gains rates

In general

In the case of an individual, estate, or trust, any adjusted net capital gain which otherwise would be taxed at the 10- or 15-percent rate is not taxed. Any adjusted net capital gain which otherwise would be taxed at rates over 15-percent and below 39.6 percent is taxed at a 15-percent rate. Any adjusted net capital gain which otherwise would be taxed at a 39.6-percent rate is taxed at a 20-percent rate. [*See* § 1(h)] * * *

In addition, a tax is imposed on net investment income in the case of an individual, estate, or trust. In the case of an individual, the tax is 3.8 percent of the lesser of net investment income, which includes gains and dividends, or the excess of modified adjusted gross income over the threshold amount. [*See* § 1411] The threshold amount is $250,000 in the case of a joint return or surviving spouse, $125,000 in the case of a married individual filing a separate return, and $200,000 in the case of any other individual.

Definitions

Net capital gain [See § 1222]

In general, gain or loss reflected in the value of an asset is not recognized for income tax purposes until a taxpayer disposes of the asset. On the sale or exchange of a capital asset, any gain generally is included in income. Net capital gain is the excess of the net long term capital gain for the taxable year over the net short-term capital loss for the year. Gain or loss is treated as long-term if the asset is held for more than one year.

A capital asset [see § 1221] generally means any property except (1) inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, (2) depreciable or real property used in the taxpayer's trade or business, (3) specified literary or artistic property, (4) business accounts or notes receivable, (5) certain U.S. publications, (6) certain commodity derivative financial instruments, (7) hedging transactions, and (8) business supplies. In addition, the net gain from the disposition of certain property used in the taxpayer's trade or business is treated as long-term capital gain. Gain from the disposition of depreciable personal property is not treated as capital gain to the extent of all previous depreciation allowances. [*See* § 1245] Gain from the disposition of depreciable real property is generally not treated as capital gain to the extent of the depreciation allowances in excess of the allowances available under the straight-line method of depreciation. [*See* § 1250]

Adjusted net capital gain [*See* § 1(h)(3)]

The ‘‘adjusted net capital gain'' of an individual is the net capital gain reduced (but not below zero) by the sum of the 28-percent rate gain and the unrecaptured section 1250 gain. The net capital gain is reduced by the amount of gain that the individual treats as investment income for purposes of determining the investment interest limitation under section 163(d).

Qualified dividend income [*See* § 1(h)(11)]

Adjusted net capital gain is increased by the amount of qualified dividend income.
A dividend is the distribution of property made by a corporation to its shareholders out of its after-tax earnings and profits. [*See* § 301] Qualified dividends generally includes dividends received from domestic corporations and qualified foreign corporations. The term ‘‘qualified foreign corporation'' includes a foreign corporation that is eligible for the benefits of a comprehensive income tax treaty with the United States which the Treasury Department determines to be satisfactory and which includes an exchange of information program.
In addition, a foreign corporation is treated as a qualified foreign corporation for any dividend paid by the corporation with respect to stock that is readily tradable on an established securities market in the United States. * * *

HOUSE BILL

Modification of rates
The House bill replaces the individual income tax rate structure with a new rate structure.
TABLE 2.—FEDERAL INDIVIDUAL INCOME TAX RATES FOR 2018 UNDER THE HOUSE BILL
[For married individuals filing jointly] If taxable income is: Then income tax equals: * * *
Married Individuals Filing Joint Returns and Surviving Spouses

If taxable income is:	*Then income tax equals:*
Not over $90,000	12% of the taxable income
Over $90,000 but not over $260,000	$10,800 plus 25% of the excess over $90,000
Over $260,000 but not over $1,000,000	$53,300 plus 35% of the excess over $260,000

The dollar amounts for bracket thresholds are all adjusted for inflation[.] * * * Unlike present law, which uses a measure of the Consumer Price Index for All Urban Consumers (''CPI–U''), the new inflation adjustment uses the Chained Consumer Price Index for All Urban Consumers (''C–CPI–U''). * * *

Maximum rates on capital gains and qualified dividends
The provision generally retains the present-law maximum rates on net capital gain and qualified dividends. The breakpoints between the zero- and 15-percent rates (''15-percent breakpoint'') and the 15- and 20-percent rates (''20-percent breakpoint'') are based on the same amounts as the breakpoints under present law, except the breakpoints are indexed using the C–CPI–U in taxableyears beginning after 2017. Thus, for 2018, the 15-percent breakpoint is $77,200 for joint returns[.] * * * The 20-percent breakpoint is $479,000 for joint returns[.] * * *

Therefore, in the case of an individual (including an estate or trust) with adjusted net capital gain, to the extent the gain would not result in taxable income exceeding the 15-percent breakpoint, such gain is not taxed. Any adjusted net capital gain which would result in taxable income exceeding the 15-percent breakpoint but not exceeding the 20-percent breakpoint is taxed at 15 percent. The remaining adjusted net capital gain is taxed at 20 percent. * * *

Effective date.—The provision applies to taxable years beginning after December 31, 2017.

SENATE AMENDMENT

Temporary modification of rates
The Senate amendment temporarily replaces the individual income tax rate structure with a new rate structure.
TABLE 3.—FEDERAL INDIVIDUAL INCOME TAX RATES FOR 2018 UNDER THE SENATE AMENDMENT
If taxable income is: Then income tax equals:
Married Individuals Filing Joint Returns and Surviving Spouses

If taxable income is:	*Then income tax equals:*
Not over $19,050	10% of the taxable income
Over $19,050 but not over $77,400	$1,905 plus 12% of the excess over $19,050
Over $77,400 but not over $140,000	$8,907 plus 22% of the excess over $77,400

Over $140,000 but not over $320,000 .... $22,679 plus 24% of the excess over $140,000
Over $320,000 but not over $400,000 .... $65,879 plus 32% of the excess over $320,000
Over $400,000 but not over $1,000,000 .... $91,479 plus 35% of the excess over $400,000
Over $1,000,000 .... $301,479 plus 38.5% of the excess over $1,000,000 * * *

CONFERENCE AGREEMENT

The conference agreement temporarily replaces the existing rate structure with a new rate structure.

TABLE 4.—FEDERAL INDIVIDUAL INCOME TAX RATES FOR 2018 UNDER THE CONFERENCE AGREEMENT * * *

Married Individuals Filing Joint Returns and Surviving Spouses

If taxable income is: *Then income tax equals:*

Not over $19,050 .... 10% of the taxable income
Over $19,050 but not over $77,400 .... $1,905 plus 12% of the excess over $19,050
Over $77,400 but not over $165,000 .... $8,907 plus 22% of the excess over $77,400
Over $165,000 but not over $315,000 .... $28,179 plus 24% of the excess over $165,000
Over $315,000 but not over $400,000 .... $64,179 plus 32% of the excess over $315,000
Over $400,000 but not over $600,000 .... $91,379 plus 35% of the excess over $400,000
Over $600,000 .... $161,379 plus 37% of the excess over $600,000 * * *

The provision's rate structure does not apply to taxable years beginning after December 31, 2025. * * * The conference agreement follows the House bill and generally retains present-law maximum rates on net capital gains and qualified dividends. * * *

Effective date.—The provision applies to taxable years beginning after December 31, 2017. * * *

13 For 2017, the additional amount is $1,250 for married taxpayers (for each spouse meeting the applicable criterion) and surviving spouses. The additional amount for single individuals and heads of households is $1,550. An individual who qualifies as both blind and elderly is entitled to two additional standard deductions, for a total additional amount (for 2017) of $2,500 or $3,100, as applicable.

14 Thus, the standard deduction is the same for 2018 and 2019.

3. Increase in the Standard Deduction

TCAJA CONFERENCE REPORT

Increase in standard deduction (sec. 1002 of the House bill, sec. 11021 of the Senate amendment, and sec. 63 of the Code)

PRESENT LAW

Under present law, an individual who does not elect to itemize deductions may reduce his or her adjusted gross income (''AGI'') by the amount of the applicable standard deduction in arriving

at his or her taxable income. The standard deduction is the sum of the basic standard deduction and, if applicable, the additional standard deduction. The basic standard deduction varies depending upon a taxpayer's filing status. For 2017, the amount of the basic standard deduction is * * * $12,700 for married individuals filing a joint return and surviving spouses. An additional standard deduction is allowed with respect to any individual who is elderly or blind. The amount of the standard deduction is indexed annually for inflation. * * *

HOUSE BILL

The House bill increases the standard deduction for individuals across all filing statuses. Under the provision, the amount of the standard deduction is $24,400 for married individuals filing a joint return[.] * * * The amount of the standard deduction is indexed for inflation using the C–CPI–U for taxable years beginning after December 31, 2019. The provision eliminates the additional standard deduction for the aged and the blind.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

SENATE AMENDMENT

The Senate amendment temporarily increases the basic standard deduction for individuals across all filing statuses. Under the provision, the amount of the standard deduction is temporarily increased to $24,000 for married individuals filing a joint return[.] * * * The amount of the standard deduction is indexed for inflation using the C–CPI–U for taxable years beginning after December 31, 2018. The additional standard deduction for the elderly and the blind is not changed by the provision.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

4. Repeal of the Deduction for the Personal Exemption

TCAJA CONFERENCE REPORT

Repeal of the deduction for personal exemptions (sec. 1003 of the House bill, sec. 11041 of the Senate amendment, and sec. 151 of the Code)

PRESENT LAW

Under present law, in determining taxable income, an individual reduces AGI by any personal exemption deductions and either the applicable standard deduction or his or her itemized deductions. Personal exemptions generally are allowed for the taxpayer, his or her spouse, and any dependents. For 2017, the amount deductible for each personal exemption is $4,050. This

amount is indexed annually for inflation. The personal exemption amount is phased out in the case of an individual with AGI in excess of $313,800 for married taxpayers filing jointly[.] * * *

HOUSE BILL

The House bill repeals the deduction for personal exemptions. * * *

SENATE AMENDMENT

The Senate amendment suspends the deduction for personal exemptions. * * *
Effective date.—The provision is effective for taxable years beginning
after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment and suspends the deduction for personal exemptions. The suspension does not apply to taxable years beginning after December 31, 2025. * * *
Effective date.—The provision is effective for taxable years beginning
after December 31, 2017. * * *

F. Page 23, New Sec. 1.7.B. Introduction to the TCAJA's C Corporate Rate Structure Generally and for Intercorporate Dividends

Page 23, New Sec. 1.7.B. Add immediately after the new Sec. 1.7.A. the following:

New Sec. 1.7.B. **Introduction to the TCAJA's C Corporation Rate Structure Generally and for Intercorporate Dividends**

1. In General

In connection with the study of section 1.3, read also the following provisions of the Conference Report to the TCAJA and related Code section addressing the C corporation rate structure and rules for taxing intercorporate dividends.

2. The TCAJA's C Corporation Rate Structure Generally and for Intercorporate Dividends

TCAJA CONFERENCE REPORT

Reduction in corporate tax rate (sec. 3001 of the House bill, secs. 13001 and 13002 of the Senate amendment, and secs. 11 and 243 of the Code)

PRESENT LAW

In general [See § 11]

Corporate taxable income is subject to tax under a four-step graduated rate structure. The top corporate tax rate is 35 percent on taxable income in excess of $10 million. The corporate taxable income brackets and tax rates are as set forth in the table below.

Taxable Income Tax rate (percent)
Not over $50,000 15

Over $50,000 but not over $75,000 25
Over $75,000 but not over $10,000,000 34
Over $10,000,000 35

Dividends received deduction [See § 243]
Corporations are allowed a deduction with respect to dividends received from other taxable domestic corporations. The amount of the deduction is generally equal to 70 percent of the dividend received. In the case of any dividend received from a 20-percent owned corporation, the amount of the deduction is equal to 80 percent of the dividend received. The term ''20-percent owned corporation'' means any corporation if 20 percent or more of the stock of such corporation (by vote and value) is owned by the taxpayer. For this purpose, certain preferred stock is not taken into account. In the case of a dividend received from a corporation that is a member of the same affiliated group, a corporation is generally allowed a deduction equal to 100 percent of the dividend received.

HOUSE BILL

The provision eliminates the graduated corporate rate structure and instead taxes corporate taxable income at 20 percent. Personal service corporations are taxed at 25 percent. * * *
The provision reduces the 70 percent dividends received deduction to 50 percent and the 80 percent dividends received deduction to 65 percent. * * *
Effective date.—The provision applies to taxable years beginning after December 31, 2017.

SENATE AMENDMENT

The Senate amendment follows the House bill, but does not provide a special rate for personal service corporations.

Effective date.—The provision applies to taxable years beginning after December 31, 2018.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment, but provides for a 21-percent corporate rate effective for taxable years beginning after December 31, 2017. * * *

§ 1.2 CHAPTER 5, ORGANIZATION AND OPERATING A UNITED STATES BUSINESS: FOREIGN CONTROLLED U.S. CORPORATIONS, BRANCHES, AND PARTNERSHIPS

A. Page 187, New Sec. 5.2.D. The TCAJA's Replacement of the Prior Section 163(j) Interest Stripping Provision with the Current Section 163(j) Interest Limitation Provision

Page 187, New Sec. 5.2.D. Replace the current Sec. 5.2.D with the following Sec. 5.2.D:
New Sec. 5.2.D. **The TCAJA's Replacement of the Prior Section 163(j) Interest Stripping Provision with the Current Section 163(j) Interest Limitation Provision**

Interest (secs. 3203 and 3301 of the House bill, secs. 13301 and 13311 of the Senate amendment, and sec. 163(j) of the Code)

PRESENT LAW

Interest deduction

Interest paid or accrued by a business generally is deductible in the computation of taxable income subject to a number of limitations. Interest is generally deducted by a taxpayer as it is paid or accrued, depending on the taxpayer's method of accounting. For all taxpayers, if an obligation is issued with original issue discount (''OID''), a deduction for interest is allowable over the life of the obligation on a yield to maturity basis. Generally, OID arises where interest on a debt instrument is not calculated based on a qualified rate and required to be paid at least annually.

Investment interest expense

In the case of a taxpayer other than a corporation, the deduction for interest on indebtedness that is allocable to property held for investment (''investment interest'') is limited to the taxpayer's net investment income for the taxable year. * * *

Earnings stripping

Section 163(j) may disallow a deduction for disqualified interest paid or accrued by a corporation in a taxable year if two threshold tests are satisfied: the payor's debt-to-equity ratio exceeds 1.5 to 1.0 (the safe harbor ratio) and the payor's net interest expense exceeds 50 percent of its adjusted taxable income (generally, taxable income computed without regard to deductions for net interest expense, net operating losses, domestic production activities under section 199, depreciation, amortization, and depletion). Disqualified interest includes interest paid or accrued to: (1) related parties when no Federal income tax is imposed with respect to such interest; (2) unrelated parties in certain instances in which a related party guarantees the debt; or (3) to a real estate investment trust (''REIT'') by a taxable REIT subsidiary of that trust. Interest amounts disallowed under these rules can be carried forward indefinitely. In addition, any excess limitation (i.e., the excess, if any, of 50 percent of the adjusted taxable income of the payor over the payor's net interest expense) can be carried forward three years.

HOUSE BILL

In general

In the case of any taxpayer for any taxable year, the deduction for business interest is limited to the sum of (1) business interest income; (2) 30 percent of the adjusted taxable income of the taxpayer for the taxable year; and (3) the floor plan financing interest of the taxpayer for the taxable year. [Floor plan financing (e.g., certain indebtedness used to finance the acquisition of motor vehicles) is not addressed further here.] The amount of any business interest not allowed as a deduction for any taxable year may be carried forward for up to five years beyond the year in which the business interest was paid or accrued, treating business interest as allowed as a deduction on a first-in, first-out basis. The limitation applies at the taxpayer level. In the case of a group of affiliated corporations that file a consolidated return, the limitation applies at the consolidated tax return filing level.

Business interest means any interest paid or accrued on indebtedness properly allocable to a trade or business. Any amount treated as interest for purposes of the Internal Revenue Code is interest for purposes of the provision. Business interest income means the amount of interest includible

in the gross income of the taxpayer for the taxable year which is properly allocable to a trade or business. Business interest does not include investment interest, and business interest income does not include investment income, within the meaning of section 163(d).

Adjusted taxable income means the taxable income of the taxpayer computed without regard to (1) any item of income, gain, deduction, or loss which is not properly allocable to a trade or business; (2) any business interest or business interest income; (3) the amount of any net operating loss deduction; and (4) any deduction allowable for depreciation, amortization, or depletion. The Secretary may provide other adjustments to the computation of adjusted taxable income. * * *

It is generally intended that, similar to present law, section 163(j) apply after the application of provisions that subject interest to deferral, capitalization, or other limitation. Thus, section 163(j) applies to interest deductions that are deferred, for example under section 163(e) or section 267(a)(3)(B), in the taxable year to which such deductions are deferred. Section 163(j) applies after section 263A is applied to capitalize interest and after, for example, section 265 or section 279 is applied to disallow interest.

Application to passthrough entities

In general

In the case of any partnership, the limitation is applied at the partnership level. * * * Similar rules apply with respect to any S corporation and its shareholders.

Double counting rule

The adjusted taxable income of each partner (or shareholder, as the case may be) is determined without regard to such partner's distributive share of the nonseparately stated income or loss of such partnership. In the absence of such a rule, the same dollars of adjusted taxable income of a partnership could generate additional interest deductions as the income is passed through to the partners. * * *

Carryforward of disallowed business interest

The amount of any business interest not allowed as a deduction for any taxable year is treated as business interest paid or accrued in the succeeding taxable year. Business interest may be carried forward for up to five years. * * *

Exceptions

The limitation does not apply to any taxpayer that meets the $25 million gross receipts test of section 448(c), that is, if the average annual gross receipts for the three-taxable-year period ending with the prior taxable year does not exceed $25 million. * * *

SENATE AMENDMENT

The Senate amendment is the same as the House bill, with the following modifications.

In general

The Senate amendment makes several changes to the definition of adjusted taxable income. Specifically, the Senate amendment does not add back deductions allowable for depreciation, amortization, or depletion, but does add back any deduction under section 199, and any

deduction under section 199A with respect to qualified business income of a passthrough entity. * * * The Senate amendment permits interest deductions to be carried forward indefinitely, subject to certain restrictions applicable to partnerships, described below.

Application to passthrough entities

The Senate amendment requires a partner in a partnership to ignore the partner's distributive share of all items of income, gain, deduction, or loss of the partnership when calculating adjusted taxable income (rather than merely ignoring the nonseparately stated income or loss, as in the House bill). The Senate amendment takes a different mathematical approach from the House bill to calculating a partner's interest limitation, though both provisions have the same practical effect. In the Senate amendment, the limit on the amount allowed as a deduction for business interest is increased by a partner's distributive share of the partnership's excess taxable income. The excess taxable income with respect to any partnership is the amount which bears the same ratio to the partnership's adjusted taxable income as the excess (if any) of 30 percent of the adjusted taxable income of the partnership over the amount (if any) by which the business interest of the partnership, reduced by floor plan financing interest, exceeds the business interest income of the partnership bears to 30 percent of the adjusted taxable income of the partnership. This allows a partner of a partnership to deduct additional interest expense the partner may have paid or incurred to the extent the partnership could have deducted more business interest. The Senate amendment requires that excess taxable income be allocated in the same manner as nonseparately stated income and loss. As in the House bill, rules similar to these rules also apply to S corporations.

The Senate amendment provides a special rule for carryforward of disallowed partnership interest. In the case of a partnership, the general carryforward rule described in the discussion of the House bill does not apply. Instead, any business interest that is not allowed as a deduction to the partnership for the taxable year is allocated to each partner in the same manner as nonseparately stated taxable income or loss of the partnership. The partner may deduct its share of the partnership's excess business interest in any future year, but only against excess taxable income attributed to the partner by the partnership the activities of which gave rise to the excess business interest carryforward. Any such deduction requires a corresponding reduction in excess taxable income. Additionally, when excess business interest is allocated to a partner, the partner's basis in its partnership interest is reduced (but not below zero) by the amount of such allocation, even though the carryforward does not give rise to a partner deduction in the year of the basis reduction. However, the partner's deduction in a future year for interest carried forward does not reduce the partner's basis in the partnership interest. In the event the partner disposes of a partnership interest the basis of which has been so reduced, the partner's basis in such interest shall be increased, immediately before such disposition, by the amount that any such basis reductions exceed any amount of excess interest expense that has been treated as paid by the partner (i.e., excess interest expense that has been deducted by the partner against excess taxable income of the same partnership). This special rule does not apply to S corporations and their shareholders.

Exceptions

The Senate amendment exempts certain categories of taxpayers or trades or businesses from the interest limitation. First, any taxpayer that meets the $15 million gross receipts test of section

448(c) is exempt from the interest limitation. * * *

CONFERENCE AGREEMENT

The conference agreement generally follows the Senate amendment, with the following modifications. Under the conference agreement, for taxable years beginning after December 31, 2017 and before January 1, 2022, adjusted taxable income is computed without regard to deductions allowable for depreciation, amortization, or depletion. Additionally, because the conference agreement repeals section 199 effective December 31, 2017, adjusted taxable income is computed without regard to such deduction. The conference agreement follows the House in exempting from the limitation taxpayers with average annual gross receipts for the three-taxable year period ending with the prior taxable year that do not exceed $25 million.* * *

Effective date.—The provision applies to taxable years beginning after December 31, 2017.

§ 1.3 CHAPTER 6, ORGANIZATION AND OPERATION OF FOREIGN BRANCHES BY U.S. PERSONS: IMPACT OF FOREIGN TAX CREDIT, SOURCING RULES, AND FOREIGN CURRENCY RULES

A. Page 305, New Sec. 6.5.B.6. The TCAJA's Separate Foreign Tax Credit Basket for Foreign Branch Income

Page 305, New Sec. 6.5.B.6. Add immediately before Section C the following new section:

New Sec. 6.5.B.6. **The TCAJA's Separate Foreign Tax Credit Basket for Foreign Branch Income**

Separate foreign tax credit limitation basket for foreign branch income (sec. 14302 of the Senate amendment and sec. 904 of the Code)

HOUSE BILL

No provision.

SENATE AMENDMENT

The provision requires foreign branch income to be allocated to a specific foreign tax credit basket. Foreign branch income is the business profits of a United States person which are attributable to one or more QBUs in one or more foreign countries. Under this provision, business profits of a QBU shall be determined under rules established by the Secretary. Business profits of a QBU shall not, however, include any income which is passive category income.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

§ 1.4 CHAPTER 7, ORGANIZATION OF FOREIGN CORPORATIONS AND FOREIGN PARTNERSHIPS

A. Page 369, New Sec. 7.3.A The TCAJA's Amendment to Section 367 for Outbound Transfers of a Trade or Business

Page 369, New Sec. 7.3.A. Add immediately after the heading for Section 7.3 the following: :

New Sec. 7.3.A. **The Fourth Anti-Base Erosion Stick: Full Recognition under Section 367 for Outbound Section 351 Transactions**

1. In General

As will be discussed in Chapter 10, Controlled Foreign Corporations, of this supplement, the TCAJA adopted the Cookie (i.e., Territoriality), the Carrot (FDII), and the Four Sticks: (1) the BEAT, (2) GILTI, (3) amendment to the definition of the term intangible, and (4) full recognition under Section 367(a) for outbound transfers of assets in a non-recognition transaction, including a Section 351 transaction involving the organization of a foreign corporation. The legislative history of the provision of the TCAJA relating to Section 351 and related provisions is set out here and in Chapter 10 of this Supplement. .

2. The Fourth Stick: Full Recognition under Section 367 for Outbound Section 351 Transactions

Special rules relating to * * * transfers involving [section 367(a)(3) of the Code: "Exception for Transfers of Certain Property Used in the Active Conduct of a Trade or Business"] Code

HOUSE BILL

*** * ***

Repeal of active trade or business exception

Section 367 is amended to provide that in connection with any exchange described in section 332, 351, 354, 356, or 361, if a U.S. person transfers property used in the active conduct of a trade or business to a foreign corporation, such foreign corporation shall not, for purposes of determining the extent to which gain shall be recognized on such transfer, be considered to be a corporation. [For example, a domestic corporation that transfers assets of an active trade or business to a foreign sub in exchange for stock of the sub, has recognition treatment notwithstanding the fact that the transaction otherwise falls within the non-recognition treatment available under section 351.]

Effective date.—The provisions relating to * * * the repeal of the active trade or business exception [is] effective for transfers after December 31, 2017.

CONFERENCE AGREEMENT

The provision in the conference agreement retains elements of both the House Bill and the Senate amendment, [including the *Repeal of active trade or business exception*[.]

§ 1.5 CHAPTER 8, TREATMENT OF ACTUAL AND IMPUTED DIVIDENDS TO U.S. CORPORATE SHAREHOLDERS OF FOREIGN CORPORATIONS; THE INDIRECT FOREIGN TAX CREDIT, LOOK-THROUGH RULES, RESOURCING RULES, AND FOREIGN CURRENCY RULES

A. Page 410, Replace Section 8.3, Indirect Foreign Tax Credit, with the following: The TCAJA's Repeal of the Indirect Foreign Tax Credit

Page 410, New Sec. 8.3. Delete all of Section 8.3 and add the following new Section 8.3: g:

New Sec. 8.3. **The TCAJA's Repeal of the Indirect Foreign Tax Credit Transactions**

Repeal of section 902 indirect foreign tax credits; determination of section 960 credit on current year basis (sec. 4101 of the House bill, sec. 14301 of the Senate amendment, and secs. 902 and 960 of the Code)

HOUSE BILL

The provision repeals the deemed-paid credit with respect to dividends received by a domestic corporation that owns 10 percent or more of the voting stock of a foreign corporation. A deemed-paid credit is provided with respect to any income inclusion under subpart F. The deemed-paid credit is limited to the amount of foreign income taxes properly attributable to the subpart F inclusion. Foreign income taxes under the proposal include income, war profits, or excess profits taxes paid or accrued by the CFC to any foreign country or possession of the United States. The proposal eliminates the need for computing and tracking cumulative tax pools. * * *

Additionally, the provision provides rules applicable to foreign taxes attributable to distributions from previously taxed earnings and profits, including distributions made through tiered-CFCs.

The Secretary is granted authority under the proposal to provide regulations and other guidance as may be necessary and appropriate to carry out the purposes of this proposal. * * *

SENATE AMENDMENT

The Senate amendment is the same as the House bill, except with respect to certain conforming amendments.

CONFERENCE AGREEMENT

The conference agreement follows the House bill with the following modifications. The conference agreement applies the existing language of section 78, which treats the gross-up as a dividend to the domestic corporation, to foreign income taxes deemed paid under section 960(a), (b), and (d) (without regard to the phrase '80 percent of' in section 960(d)(1), except with respect

to section 245 and new section 245A (*i.e.*, the deemed dividend would not receive the benefit of the participation exemption). The conference agreement further revises new section 250(a)(1)(B) to apply the deduction with respect to inclusions under new section 951A to the section 78 gross-up. * * *

The conference agreement makes certain conforming amendments to sections 901(m), 904, 907, and 909[.] * * *

Effective date.—The provision applies to taxable years taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of United States shareholders in which or with which such taxable years of foreign corporations end.

§ 1.6 CHAPTER 9, SECTION 482: TRANSACTIONS BETWEEN COMMONLY CONTROLLED CORPORATIONS

A. Page 450, New Sec. 9.5.D.3. The TCAJA's Amendment to Definition of Intangible: Section 367, 482, and 936

Page 496, New Sec. 9.5.D.3. Add immediately before Sec. E, the following:

New Sec. 9.5.D.3. **The TCAJA's Amendment to the Definition of Intangible: Section 367, 482, and 936**

Limitations on income shifting through intangible property transfers (sec. 14222 of the bill and secs. 367, 482, and 936 of the Code)

[Note: this section is also in Chapter 10, Controlled Foreign Corporations.]

HOUSE BILL

No provision.

SENATE AMENDMENT

The provision addresses recurring definitional and methodological issues that have arisen in controversies[2] in transfers of intangible property for purposes of sections 367(d) and 482, both of which use the statutory definition of intangible property in section 936(h)(3)(B). The provision revises that definition and confirms the authority to require certain valuation methods. It does not modify the basic approach of the existing transfer pricing rules with regard to income from intangible property.

[2] *Veritas v. Commissioner*, 133 T.C. No. 14 (December 10, 2009), non-acq., IRB 2010–49 (December 6, 2010). (stating that including goodwill and going concern value within the definition would ''expand[]'' that definition, and that ''taxpayers are merely required to be compliant, not prescient''); *Amazon v. Commissioner*, 148 T.C. No. 8 (2017) (holding that ''workforce in place, going concern value, goodwill, and what trial witnesses described as 'growth options' and corporate 'resources' or 'opportunities' '' all fell outside the definition under present law).

Under the provision, 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 flush language at the end of that subparagraph is removed, to make clear 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 scope of the definition.

The provision clarifies the authority of the Secretary to specify the method to be used to determine the value of intangible property, both with respect to outbound restructurings of U.S. operations and to intercompany pricing allocations,[3] by amending 482 as well as the grant of regulatory authority under section 367 regarding the use of aggregate basis valuation and the application of the realistic alternative principle.

With respect to aggregate basis valuation, the provision requires use of that method of valuation in the case of transfers of multiple intangible properties in one or more related transactions if the Secretary determines that an aggregate basis achieves a more reliable result than an asset-by-asset approach. The provision is consistent with the position that the additional value that results from the interrelation of intangible assets can be properly attributed to the underlying intangible assets in the aggregate, where doing so yields a more reliable result. This approach is also consistent with Tax Court decisions in cases outside of the section 482 context, where collections of multiple, related intangible assets were viewed by the Tax Court in the aggregate.[4] Finally, it is also consistent with the cost-sharing regulations.[5]

The provision codifies use of the realistic alternative principles to determine valuation with respect to intangible property transactions. The realistic alternative principle is predicated on the notion that a taxpayer will only enter into a particular transaction if none of its realistic alternatives is economically preferable to the transaction under consideration. For example, under the existing regulations provide the IRS with the ability to determine an arm'slength price by reference to a transaction (such as the owner of intangible property using it to make a product itself) that is different from the transaction that was actually completed (such as the owner of that same intangible property licensing the manufacturing rights and then buying the product from the licensee).

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[3] Secs. 367(d) and 482.

[4] *See, e.g.,* Kraft Foods Co. v. Commissioner, 21 T.C. 513 (1954) (thirty-one related patents must be valued as a group and the useful life for depreciation should be based on the average of the patents' useful lives); Standard Conveyor Co. v. Commissioner, 25 B.T.A. 281, p. 283 (1932) (''[I]t is evident that it is impossible to value these seven patents separately. Their value, as in the case of many groups of patents representing improvements on the prior art, appears largely to consist of their combination.''); Massey-Ferguson, Inc. v. Commissioner, 59 T.C. 220 (1972) (taxpayer who abandoned a distribution network of contracts with separate distributorships was entitled to an abandonment loss for the entire network in the taxable year during which the last of the contracts was terminated because that was the year in which the entire intangible value was lost).

[5] *See* Treas. Reg. sec. 1.482–7(g)(2)(iv) (if multiple transactions in connection with a cost sharing arrangement involve platform, operating and other contributions of resources, capabilities or rights that are reasonably anticipated to be interrelated, then determination of the arm's length charge for platform contribution transactions and other transactions on an aggregate basis may provide the most reliable measure of an arm's-length result).

Effective date.—The provision applies to transfers in taxable years beginning after December 31, 2017. No inference is intended with respect to application of section 936(h)(3)(B) or the authority of the Secretary to provide by regulation for such application with respect to taxable years beginning before January 1, 2018.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

§ 1.7 CHAPTER 10, CONTROLLED FOREIGN CORPORATIONS

A. Page 496, New Sec. 10.4.C. TCAJA's Modification of the Attribution Rules for Determining CFC Status

Page 496, New Sec. 10.4.C. Add immediately before Sec. 10.5, the following:

New Sec. 10.4.C. **The TCAJA's Modification of the Attribution Rules for Determining CFC Status**

Modification of stock attribution rules for determining CFC status (sec. 4205 of the House bill, sec. 14214 of the Senate amendment, and secs. 318 and 958 of the Code)

HOUSE BILL

The provision amends the ownership attribution rules of section 958(b) so that certain stock of a foreign corporation owned by a foreign person is attributed to a related U.S. person for purposes of determining whether the related U.S. person is a U.S. shareholder of the foreign corporation and, therefore, whether the foreign the corporation is a CFC. In other words, the provision provides ''downward attribution'' from a foreign person to a related U.S. person in circumstances in which present law does not so provide. The pro rata share of a CFC's subpart F income that a U.S. shareholder is required to include in gross income, however, continues to be determined based on direct or indirect ownership of the CFC, without application of the new downward attribution rule.

It also conforms the reporting requirements of section 6038 to require that entities that are treated as CFCs by reason of the rules on constructive ownership are within the scope of the reporting requirements.

Effective date.—The provision is effective for taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

SENATE AMENDMENT

The Senate amendment is similar to the House bill, except that it does not adopt the change to the reporting requirements of section 6038 and has a different effective date. Furthermore, the Senate Finance Committee explanation states that the provision is not intended to cause a foreign corporation to be treated as a controlled foreign corporation with respect to a U.S. shareholder as

a result of attribution of ownership under section 318(a)(3) to a U.S. person that is not a related person (within the meaning of section 954(d)(3)) to such U.S. shareholder as a result of the repeal of section 958(b)(4).

Effective date.—The provision is effective for the last taxable year of foreign corporations beginning before January 1, 2018 and each subsequent year of such foreign corporations and for the taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment. In adopting this provision, the conferees intend to render ineffective certain transactions that are used to as a means of avoiding the subpart F provisions. One such transaction involves effectuating ‘‘de-control’’ of a foreign subsidiary, by taking advantage of the section 958(b)(4) rule that effectively turns off the constructive stock ownership rules of 318(a)(3) when to do otherwise would result in a U.S. person being treated as owning stock owned by a foreign person. Such a transaction converts former CFCs to non-CFCs, despite continuous ownership by U.S. shareholders.

Effective date.—The provision is effective for the last taxable year of foreign corporations beginning before January 1, 2018 and each subsequent year of such foreign corporations and for the taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

B. Page 496, New Sec. 10.4.D. TCAJA's Modification of the Definition of U.S. Shareholder

Page 496, New Sec. 10.4.D. Add immediately after the new Sec. 10.4.C, the following:

New Sec. 10.4.D. **The TCAJA's Modification of the Definition of U.S. Shareholder**

Modification of definition of United States shareholder (sec. 14215 of the Senate amendment and sec. 951 of the Code)

HOUSE BILL

No provision.

SENATE AMENDMENT

The provision expands the definition of U.S. shareholder under subpart F to include any U.S. person who owns 10 percent or more of the total value of shares of all classes of stock of a foreign corporation.

Effective date.—The provision is effective for taxable years of foreign corporations beginning after December 31, 2017, and for taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

C. Page 496, New Sec. 10.4.E. TCAJA's Elimination of the 30 Day Rule

Page 496, New Sec. 10.4.E. Add immediately after the new Sec. 10.4.D, the following:

New Sec. 10.4.E. **The TCAJA's Modification of the Attribution Rules for Determining CFC Status**

Elimination of requirement that corporation must be controlled for 30 days before subpart F inclusions apply (sec. 4206 of the House bill, sec. 14216 of the Senate amendment, and sec. 951(a)(1) of the Code)

HOUSE BILL

The provision eliminates the requirement that a corporation must be controlled for an uninterrupted period of 30 days before subpart F inclusions apply.

Effective date.—The provision is effective for taxable years of foreign corporations beginning after December 31, 2017, and for taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

Effective date.—The provision is effective for taxable years of foreign corporations beginning after December 31, 2017, and for taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.

D. Pages 500 to 523, Modification to Section 10.7., Subpart F Income, in View of the TCAJA

Pages 500 to 523, Modification to Section 10.7. In view of the enactment of the "Cookie, the Carrot, and the Four Sticks" by the TCAJA, make the following modifications to Section 10.7:

- Keep in mind that the TCAJA retained subpart F for dealing with passive income, even though as a result of the TCAJA, subpart F no longer deals with foreign base company sales income and foreign base company services income;
- Do not read the discussion of Foreign Base Company Sales Income, pages 515 to 522; and
- Do not read the discussion of Foreign Base Company Services income, pages 522-523. and

The "Cookie, the Carrot, and the Four Sticks" are addressed next.

E. Page 523, New Sec. 10.7.F Introduction to the "Cookie, the Carrot and the Four Sticks"

Page 523, New Sec. 10.7.F. Add immediately before Section 10.8 the following:

New Sec. 10.7.F. **Introduction to the TCAJA's Cookie, Carrot and Four Sticks**

1. In General

As indicated previously the Cookie, is Territoriality, the Carrot is FDII, and the Four Sticks are (1) the BEAT, (2) GILTI, (3) amendment to the definition of the term intangible, and (4) full recognition under Section 367(a) for outbound transfers of assets in a Section 351 transaction. The legislative history of these provisions is set out in this section.

2. The Cookie: Territoriality

Establishment of Participation Exemption System for Taxation of Foreign Income
Deduction for foreign-source portion of dividends received by domestic corporations from specified 10-percent owned foreign corporations (sec. 4001 of the House bill, sec. 14101 of the Senate amendment, and new sec. 245A of the Code)

HOUSE BILL

In general

The provision generally establishes a participation exemption system for foreign income. This exemption is provided for by means of a 100-percent deduction for the foreign-source portion of dividends received from specified 10-percent owned foreign corporations by domestic corporations that are United States shareholders of those foreign corporations within the meaning of section 951(b) (referred to here as ''participation DRD''). * * *

SENATE AMENDMENT

In general

The provision allows an exemption for certain foreign income. This exemption is provided for by means of a 100-percent deduction for the foreign-source portion of dividends received from specified 10-percent owned foreign corporations by domestic corporations that are United States shareholders of those foreign corporations within the meaning of section 951(b) (referred to here as ''DRD'').

A specified 10-percent owned foreign corporation is any foreign corporation (other than a PFIC that is not also a CFC) with respect to which any domestic corporation is a U.S. shareholder.

Foreign-source portion of a dividend

The DRD is available only for the foreign-source portion of dividends received by a domestic corporation from specified 10-percent owned foreign corporations. The foreign-source portion of any dividend is the amount that bears the same ratio to the dividend as the undistributed foreign earnings bears to the total undistributed earnings of the foreign corporation. Undistributed earnings are the amount of the earnings and profits of a specified 10-percent owned foreign

corporation as of the close of the taxable year of the specified 10-percent owned foreign corporation in which the dividend is distributed and not reduced by dividends distributed during that taxable year. Undistributed foreign earnings are the portion of the undistributed earnings attributable to neither income described in section 245(a)(5)(A) nor section 245(a)(5)(B), without regard to section 245(a)(12). * * *

Foreign tax credit disallowance
No foreign tax credit or deduction is allowed for any taxes paid or accrued with respect to a dividend that qualifies for the DRD. For purposes of computing the section 904(a) foreign tax credit limitation, a domestic corporation that is a U.S. shareholder of a specified 10-percent owned foreign corporation must compute its foreign-source taxable income by disregarding the foreign-source portion of any dividend received from that foreign corporation for which the DRD is taken, and any deductions properly allocable or apportioned to that foreign-source portion or the stock with respect to which it is paid.

Holding period requirement
A domestic corporation is not permitted a DRD in respect of any dividend on any share of stock that is held by the domestic corporation for 365 days or less during the 731-day period beginning on the date that is 365 days before the date on which the share becomes ex-dividend with respect to the dividend. * * *

CONFERENCE AGREEMENT

In general
The provision in the conference agreement generally follows the provision in the Senate amendment, with some changes, as described below, and allows an exemption for certain foreign income by means of a 100-percent deduction for the foreign-source portion of dividends received from specified 10-percent owned foreign corporations by domestic corporations that are United States shareholders of those foreign corporations within the meaning of section 951(b) (referred to here, as above, as ‘‘DRD’’).

A specified 10-percent owned foreign corporation is any foreign corporation (other than a PFIC that is not also a CFC) with respect to which any domestic corporation is a U.S. shareholder. The term ‘‘dividend received’’ is intended to be interpreted broadly, consistently with the meaning of the phrases ‘‘amount received as dividends’’ and ‘‘dividends received’’ under sections 243 and 245, respectively. For example, if a domestic corporation indirectly owns stock of a foreign corporation through a partnership and the domestic corporation would qualify for the participation DRD with respect to dividends from the foreign corporation if the domestic corporation owned such stock directly, the domestic corporation would be allowed a participation DRD with respect to its distributive share of the partnership’s dividend from the foreign corporation.

The DRD is available only to C corporations that are not RICs or REITs.

Foreign-source portion of a dividend
The DRD is available only for the foreign-source portion of dividends received by a domestic corporation from specified 10-percent owned foreign corporations. The foreign-source portion of

any dividend is the amount that bears the same ratio to the dividend as the undistributed foreign earnings bears to the total undistributed earnings of the foreign corporation. Undistributed earnings are the amount of the earnings and profits of a specified 10-percent owned foreign corporation as of the close of the taxable year of the specified 10-percent owned foreign corporation in which the dividend is distributed and not reduced by dividends distributed during that taxable year. Undistributed foreign earnings are the portion of the undistributed earnings attributable to neither income described in section 245(a)(5)(A) nor section 245(a)(5)(B), without regard to section 245(a)(12).

Hybrid dividends * * *

Foreign tax credit disallowance
No foreign tax credit or deduction is allowed for any taxes paid or accrued with respect to any portion of a distribution treated as a dividend that qualifies for the DRD.

For purposes of computing the section 904(a) foreign tax credit limitation, a domestic corporation that is a U.S. shareholder of a specified 10-percent owned foreign corporation must compute its foreign-source taxable income (and entire taxable income) by disregarding the foreign-source portion of any dividend received from that foreign corporation for which the DRD is taken, and any deductions properly allocable or apportioned to that foreign-source portion or the stock with respect to which it is paid.

Holding period requirement
A domestic corporation is not permitted a DRD in respect of any dividend on any share of stock that is held by the domestic corporation for 365 days or less during the 731-day period beginning on the date that is 365 days before the date on which the share becomes ex-dividend with respect to the dividend. * * *

3. The Carrot: Foreign-Derived Intangible Income (FDII)

Deduction for foreign-derived intangible income and global intangible low-taxed income (sec. 14202 of the Senate amendment and new sec. 250 of the Code)

HOUSE BILL

No provision.

SENATE AMENDMENT

In general
The provision provides domestic corporations with reduced rates of U.S. tax on their foreign-derived intangible income (''FDII'') and global intangible low-taxed income (''GILTI'').

[As will be seen, the reduced rates are implemented through a deduction for FDII, which is addressed here, and GILTI, which is addressed below. As an economic matter, the deduction in Section 250 for GILTI reduces the detriment that would otherwise be associated with GILTI (i.e., the Second Stick), whereas the deduction in Section 250 for FDII provides an incentive (*i.e.*, a Carrot) for keeping intangibles in the U.S.]

GILTI is defined in section 14201 of the Senate amendment and new section 951A, while a domestic corporation's FDII is the portion of its intangible income, determined on a formulaic basis, that is derived from serving foreign markets. For taxable years beginning after December 31, 2017, and before January 1, 2019, the effective tax rate on FDII is 21.875 percent and the effective U.S. tax rate on GILTI is 17.5 percent under the Senate amendment. For taxable years beginning after December 31, 2018, and before January 1, 2026, the effective tax rate on FDII is 12.5 percent and the effective U.S. tax rate on GILTI is 10 percent. For taxable years beginning after December 31, 2025, the effective tax rate on FDII is 15.625 percent and the effective U.S. tax rate on GILTI is 12.5 percent.

Deduction for FDII and GILTI

Deduction for FDII and GILTI and taxable income limitation

In the case of domestic corporations for taxable years beginning after December 31, 2017, and before January 1, 2026, the provision generally allows as a deduction an amount equal to the sum of 37.5 percent of its FDII plus 50 percent of its GILTI (if any). For taxable years beginning after December 31, 2025, the deduction for FDII is reduced to 21.875 percent and the deduction for GILTI is lowered to 37.5 percent.

If the sum of a domestic corporation's FDII and GILTI amounts exceeds its taxable income determined without regard to this provision, then the amount of FDII and GILTI for which a deduction is allowed is reduced by an amount determined by such excess. The reduction in FDII for which a deduction is allowed equals such excess multiplied by a percentage equal to the corporation's FDII divided by the sum of its FDII and GILTI. The reduction in GILTI for which a deduction is allowed equals the remainder of such excess.

FDII

The FDII of any domestic corporation is the amount which bears the same ratio to the corporation's deemed intangible income as its foreign-derived deduction eligible income bears to its deduction eligible income. In other words, a domestic corporation's FDII is its deemed intangible income multiplied by the percentage of its deduction eligible income that is foreign-derived. * * *

Deduction eligible income

Deduction eligible income means, with respect to any domestic corporation, the excess (if any) of the gross income of the corporation—determined without regard to certain exceptions to deduction eligible income—over deductions (including taxes) properly allocable to such gross income (referred to in this document as ''deduction eligible gross income''). The exceptions to deduction eligible income are: (1) the subpart F income of the corporation determined under section 951; (2) the GILTI of the corporation; (3) any financial services income (as defined in section 904(d)(2)(D)) of the corporation; (4) any dividend received from a CFC with respect to which the corporation is a U.S. shareholder; and (5) any domestic oil and gas extraction income of the corporation; and (6) any foreign branch income (as defined in section 904(d)(2)(J)) of the corporation. * * *

Deemed intangible income

The domestic corporation's deemed intangible income means the excess (if any) of its deduction eligible income over its deemed tangible income return. The deemed tangible income return means, with respect to any corporation, an amount equal to 10 percent of the corporation's qualified business asset investment (''QBAI''). * * *

For purposes of computing its FDII, a domestic corporation's QBAI is the average of the aggregate of its adjusted bases, determined as of the close of each quarter of the taxable year, in specified tangible property used in its trade or business and of a type with respect to which a deduction is allowable under section 167. The adjusted basis in any property must be determined using the alternative depreciation system under section 168(g), notwithstanding any provision of law (or any other section of the Senate amendment) which is enacted after the date of enactment of this provision (unless such later enacted law specifically and directly amends this provision's definition).

Specified tangible property means any tangible property used in the production of deduction eligible income. If such property was used in the production of deduction eligible income and income that is not deduction eligible income (*i.e.*, dual-use property), the property is treated as specified tangible property in the same proportion that the amount of deduction eligible gross income produced with respect to the property bears to the total amount of gross income produced with respect to the property. In other words, the percentage of a domestic corporation's adjusted basis in dual-use property that is included in QBAI equals the deduction eligible gross income produced with respect to the property divided by the total gross income produced with respect to the property.

Foreign-derived deduction eligible income
Foreign-derived deduction eligible income means, with respect to a taxpayer for its taxable year, any deduction eligible income of the taxpayer that is derived in connection with (1) property that is sold by the taxpayer to any person who is not a United States person and that the taxpayer establishes to the satisfaction of the Secretary is for a foreign use 1522 or (2) services provided by the taxpayer that the taxpayer establishes to the satisfaction of the Secretary are provided to any person, or with respect to property, not located within the United States. Foreign use means any use, consumption, or disposition that is not within the United States.

For purposes of the provision, the terms ''sold,'' ''sells'', and ''sale'' include any lease, license, exchange, or other disposition.

Property or services provided to domestic intermediaries * * *

Special rules with respect to related party transactions * * *
Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment, with clarifications and modifications that include the following:

- The deduction for FDII and GILTI is available only to C corporations that are not RICs or REITs.
- The deduction for GILTI applies to the amount treated as a dividend received by a domestic corporation under section 78 that is attributable to the corporation's GILTI amount
under new section 951A.
- The exclusions from deduction eligible income are clarified.
- The definition of deemed tangible income return is clarified.

Illustration of effective tax rates on FDII and GILTI
Under a 21-percent corporate tax rate, and as a result of the deduction for FDII and GILTI, the effective tax rate on FDII is 13.125 percent and the effective U.S. tax rate on GILTI (with respect to domestic corporations) is 10.5 percent for taxable years beginning after December 31, 2017, and before January 1, 2026. Since only a portion (80 percent) of foreign tax credits are allowed to offset U.S. tax on GILTI, the minimum foreign tax rate, with respect to GILTI, at which no U.S. residual tax is owed by a domestic corporation is 13.125 percent. If the foreign tax rate on GILTI is zero percent, then the U.S. residual tax rate on GILTI is 10.5 percent. Therefore, as foreign tax rates on GILTI range between zero percent and 13.125 percent, the total combined foreign and U.S. tax rate on GILTI ranges between 10.5 percent and 13.125 percent. At foreign tax rates greater than or equal to 13.125 percent, there is no residual U.S. tax owed on GILTI, so that the combined foreign and U.S. tax rate on GILTI equals the foreign tax rate.

For domestic corporations in taxable years beginning after December 31, 2025, the effective tax rate on FDII is 16.406 percent and the effective U.S. tax rate on GILTI is 13.125 percent. The minimum foreign tax rate, with respect to GILTI, at which no U.S. residual tax is owed is 16.406 percent.

Effective date.—The provision is effective for taxable years beginning
after December 31, 2017.

4. The First Stick: the BEAT

Base erosion using deductible cross-border payments between affiliated companies (sec. 4303 of the House bill and new secs. 4491 and 6038E of the Code; sec. 14401 of the Senate amendment and secs. 6038A and 6038C and new secs. 59A and 59B of the Code)

HOUSE BILL

In general
This provision imposes an excise tax on certain amounts paid by U.S. payors to certain related foreign recipients to the extent the amounts are deductible by the U.S. payor. However, the excise tax does not apply if the foreign recipient elects to be subject to U.S. income tax on the amounts received. In calculating the U.S. income tax liability imposed under such an election, deemed expenses are allowed as a deduction. A foreign tax credit of 80% of applicable foreign

credits are allowed against the U.S. tax liability imposed by this provision if an election is made.
* * *

SENATE AMENDMENT

In general
Under the provision, an applicable taxpayer is required to pay a tax equal to the base erosion minimum tax amount for the taxable year. The base erosion minimum tax amount is the excess of 10 percent of the modified taxable income of the taxpayer for the taxable year over an amount equal to the regular tax liability (defined in section 26(b)) of the taxpayer for the taxable year reduced (but not below zero) by the excess of an amount equal to the credits allowed under Chapter 1 less the credit allowed under section 38 (general business credits) for the taxable year allocable to the research credit under section 41(a). For taxable years beginning after December 31, 2025, two changes are made, (A) the 10-percent provided for above is changed to 12.5-percent, and (B) the regular tax liability is reduced by the aggregate amount of the credits allowed under Chapter 1 (and no other adjustment is made).

To determine its modified taxable income, the applicable taxpayer computes its taxable income for the year without regard to any base erosion tax benefit of a base erosion payment or base erosion percentage of any allowable net operating loss deduction. * * *

CONFERENCE AGREEMENT

The provision in the conference agreement follows the Senate amendment with some changes, as follows.

In general
Under the provision, an applicable taxpayer is required to pay a tax equal to the base erosion minimum tax amount for the taxable year. The base erosion minimum tax amount is the excess of 10 percent of the modified taxable income of the taxpayer for the taxable year over an amount equal to the regular tax liability (defined in section 26(b)) of the taxpayer for the taxable year reduced (but not below zero) by the excess (if any) of the credits allowed under Chapter 1 against such regular tax liability over the sum of: (1) the credit allowed under section 38 for the taxable year which is properly allocable to the research credit determined under section 41(a), plus (2) the portion of the applicable section 38 credits not in excess of 80 percent of the lesser of the amount of such credits or the base erosion minimum tax amount (determined without regard to this clause (2)). For taxable years beginning after December 31, 2025, two changes are made, (A) the 10-percent provided for above is changed to 12.5-percent, and (B) the regular tax liability is reduced by the aggregate amount of the credits allowed under Chapter 1 (and no other adjustment is made). * * *

To determine its modified taxable income, the applicable taxpayer computes its taxable income for the year without regard to any base erosion tax benefit with respect to any base erosion payment or the base erosion percentage of any allowable net operating loss deduction allowed under section 172 for the taxable year.

Base erosion payments

A base erosion payment means any amount paid or accrued by a taxpayer to a foreign person that is a related party of the taxpayer and with respect to which a deduction is allowable under Chapter 1. Such payments include any amount paid or accrued by the taxpayer to the related party in connection with the acquisition by the taxpayer from the related party of property of a character subject to the allowance of depreciation (or amortization in lieu of depreciation). * * *

Base erosion payments do not include any amount that constitutes reductions in gross receipts including payments for costs of goods sold. However, base erosion payment includes any amount that constitutes reductions in gross receipts of the taxpayer that is paid or accrued by the taxpayer with respect to: (1) a surrogate foreign corporation which is a related party of the taxpayer, but only if such person first became a surrogate foreign corporation after November 9, 2017, or (2) a foreign person that is a member of the same expanded affiliated group as the surrogate foreign corporation. A surrogate foreign corporation has the meaning given in section 7874(a)(2), but does not include a foreign corporation treated as a domestic corporation under section 7874(b).

A base erosion payment does not include any amount paid or accrued by a taxpayer for services if such services meet the requirements for eligibility for use of the services cost method described in Treas. Reg. sec. 1.482–9, as in effect as of the date of enactment of TCAJA, without regard to the requirement that the services not contribute significantly to fundamental risks of business success or failure and only if the payments are made for services that have no markup component. * * *

A base erosion tax benefit means: (i) any deduction allowed under Chapter 1 for the taxable year with respect to a base erosion payment, (ii) in the case of a base erosion payment with respect to the purchase of property of a character subject to the allowance for depreciation (or amortization in lieu of depreciation), any deduction allowed in Chapter 1 for depreciation or amortization in lieu of depreciation with respect to the property acquired with such payment, or (iii) any reduction in gross receipts with respect to a payment described above with respect to a surrogate foreign corporation (as defined there) in computing gross income of the taxpayer for the taxable year.

Any base erosion tax benefit attributable to any base erosion payment on which tax is imposed by sections 871 or 881 and with respect to which tax has been deducted and withheld under sections 1441 or 1442, is not taken into account in computing modified taxable income as defined above. The amount not taken into account in computing modified taxable income is reduced under rules similar to the rules under section 163(j)(5)(B) [as in effect before the enactment of the TCAJA.].

The base erosion percentage means for any taxable year, the percentage determined by dividing the aggregate amount of base erosion tax benefits of the taxpayer for the taxable year by the aggregate amount of the deductions allowable to the taxpayer under Chapter 1 for the taxable year, taking into account base erosion tax benefits described above and by not taking into account any deduction allowed under sections 172, 245A or 250 for the taxable year, any deduction for amounts paid or accrued for services to which the exception for the services cost method (as described above) applies[.]

Applicable taxpayers and related parties
Applicable taxpayer means with respect to any taxable year, a taxpayer: (A) which is a corporation other than a regulated investment company, a real estate investment trust, or an S corporation; (B) the average annual gross receipts of the corporation for the three-taxable-year period ending with the preceding taxable year are at least $500 million, and (C) the base erosion percentage (as defined above) of the corporation for the taxable year is three percent or higher. * * *

Information reporting requirements * * *

Effective date.—The provision applies to base erosion payments paid or accrued in taxable years beginning after December 31, 2017.

5. The Second Stick: GILTI

Current year inclusion of foreign high return amounts or global intangible low-taxed income by United States shareholders (sec. 4301 of the House bill, sec. 14201 of the Senate amendment, and secs. 78 and 960 and new sec. 951A of the Code)

[Note that notwithstanding the inclusion for GILTI under Section 951A, a deduction is allowed under Section 250, discussed above, which also provides a deduction for Foreign Derived Intangible Income (FDII)]

HOUSE BILL

In general
Under the provision, a U.S. shareholder of any CFC must include in gross income for a taxable year an amount equal to 50 percent of its foreign high return amount (''FHRA'') in a manner generally similar to inclusions of subpart F income. FHRA means, with respect to any U.S. shareholder for the shareholder's taxable year, the shareholder's net CFC tested income less an amount equal to the excess (if any) of (1) the applicable percentage of the aggregate of the shareholder's pro rata share of the qualified business asset investment (''QBAI'') of each CFC with respect to which it is a U.S. shareholder over (2) the amount of interest expense taken into account in determining the shareholder's net CFC tested income. The applicable percentage is the Federal short-term rate (determined under section 1274(d) for the month in which such shareholder's taxable year ends) plus seven percentage points. * * *

SENATE AMENDMENT

In general
Under the provision, a U.S. shareholder of any CFC must include in gross income for a taxable year its global intangible low taxed income (''GILTI'') in a manner generally similar to inclusions of subpart F income. GILTI means, with respect to any U.S. shareholder for the shareholder's taxable year, the excess (if any) of the shareholder's net CFC tested income over

the shareholder's net deemed tangible income return. The shareholder's net deemed tangible income return is an amount equal to 10 percent of the aggregate of the shareholder's pro rata share of the qualified business asset investment (''QBAI'') of each CFC with respect to which it is a U.S. shareholder. * * *

Net CFC tested income means, with respect to any U.S. shareholder, the excess of the aggregate of the shareholder's pro rata share of the tested income of each CFC with respect to which it is a U.S. shareholder over the aggregate of its pro rata share of the tested loss of each CFC with respect to which it is a U.S. shareholder. Pro rata shares are determined under the rules of section 951(a)(2). * * *

The tested income of a CFC means the excess (if any) of the gross income of the corporation—determined without regard to certain exceptions to tested income—over deductions (including taxes) properly allocable to such gross income (referred to in this document as ''tested gross income''). The exceptions to tested income are: (1) the corporation's ECI under section 952(b); (2) any gross income taken into account in determining the corporation's subpart F income; (3) any gross income excluded from foreign base company income or insurance income by reason of the high-tax exception under section 954(b)(4); (4) any dividend received from a related person (as defined in section 954(d)(3)); and (5) any foreign oil and gas extraction income (as defined in section 907(c)(1)).

The tested loss of a CFC means the excess (if any) of deductions (including taxes) properly allocable to the corporation's gross income—determined without regard to the tested income exceptions—over the amount of such gross income.

Qualified business asset investment

QBAI means, with respect to any CFC for a taxable year, the average of the aggregate of its adjusted bases, determined as of the close of each quarter of the taxable year, in specified tangible property used in its trade or business and of a type with respect to which a deduction is generally allowable under section 167. The adjusted basis in any property must be determined using the alternative depreciation system under current section 168(g), notwithstanding any provision of law (or any other section of the Senate amendment) which is enacted after the date of enactment of this provision (unless such later enacted law specifically and directly amends this provision's definition).

Specified tangible property means any property used in the production of tested income. If such property was used in the production of both tested income and income that is not tested income (i.e., dual-use property), the property is treated as specified tangible property in the same proportion that the amount of tested gross income produced with respect to the property bears to the total amount of gross income produced with respect to the property.

For purposes of determining QBAI, the Secretary is authorized to issue anti-avoidance regulations or other guidance as the Secretary determines appropriate, including regulations or other guidance that provide for the treatment of property if the property is transferred or held temporarily, or if avoidance was a factor in the transfer or holding of the property.

Coordination with subpart F
Although GILTI inclusions do not constitute subpart F income, GILTI inclusions are generally treated similarly to subpart F inclusions. Thus they are generally treated in the same manner as amounts included under section 951(a)(1)(A) for purposes of applying sections 168(h)(2)(B), 535(b)(10), 904(h)(1), 959, 961, 962, 993(a)(1)(E), 996(f)(1), 1248(b)(1), 1248(d)(1), 6501(e)(1)(C), 6654(d)(2)(D), and 6655(e)(4). However, the Secretary may provide rules for coordinating the GILTI inclusion with provisions of law in which the determination of subpart F income is required to be made at the CFC level. * * *

Deemed-paid credit for taxes properly attributable to tested income
For any amount of GILTI included in the gross income of a domestic corporation, the corporation's deemed-paid credit equals 80 percent of the product of the corporation's inclusion percentage multiplied by the aggregate tested foreign income taxes paid or accrued, with respect to tested income, by each CFC with respect to which the domestic corporation is a U.S. shareholder.

The inclusion percentage means, with respect to any domestic corporation, the ratio (expressed as a percentage) of such corporation's GILTI amount divided by the aggregate amount of its pro rata share of the tested income of each CFC with respect to which it is a U.S. shareholder (referred to as ''aggregate tested income'' in the formulas below). * * *

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment provision, with clarifications and modifications that include the following.

Net deemed tangible income return
The conference agreement modifies, along lines similar to an approach taken in the House bill provision, the calculation of net deemed tangible income return for purposes of determining GILTI. Net deemed tangible income return is, with respect to any U.S. shareholder for a taxable year, the excess (if any) of 10 percent of the aggregate of its pro rata share of the QBAI of each CFC with respect to which it is a U.S. shareholder over the amount of interest expense taken into account in determining its net CFC tested income for the taxable year to the extent that the interest expense exceeds the interest income properly allocable to the interest expense that is taken into account in determining its net CFC tested income. * * *

Computation of tested income and tested loss
For purposes of computing deductions (including taxes) properly allocable to gross income included in tested income or tested loss with respect to a CFC, the deductions are allocated to such gross income following rules similar to the rules of section 954(b)(5) (or to which such deductions would be allocable if there were such gross income).

Calculation of pro rata shares
For purposes of determining pro rata shares in the computation of a U.S. shareholder's GILTI amount, a person is treated as a U.S. shareholder of a CFC for any taxable year of such person only if the person owns (within the meaning of section 958(a)) stock in the foreign corporation

on the last day in the taxable year of the foreign corporation on which the foreign corporation is a CFC.

Qualified business asset investment
For purposes of determining a CFC's QBAI and its adjusted basis in specified tangible property, the adjusted basis is determined by allocating the depreciation deduction with respect to the property ratably to each day during the period in the taxable year to which the depreciation relates. In addition, if a CFC holds an interest in a partnership at the close of the CFC's taxable year, the CFC takes into account its distributive share of the aggregate of the partnership's adjusted bases (determined as of such date in the hands of the partnership) in tangible property held by the partnership to the extent that the property [1] is used in the trade or business of the partnership, [2] is of a type with respect to which a deduction is allowable under section 167, and [3] is used in the production of tested income (determined with respect to the CFC's distributive share of income with respect to the property). The CFC's distributive share of the adjusted basis of any property is the CFC's distributive share of income with respect to the property.

Regulatory authority to address abuse
The conferees intend that non-economic transactions intended to affect tax attributes of CFCs and their U.S. shareholders (including amounts of tested income and tested loss, tested foreign income taxes, net deemed tangible income return, and QBAI) to minimize tax under this provision be disregarded. * * *

6. The Third Stick: Definition of Intangible

Limitations on income shifting through intangible property transfers (sec. 14222 of the bill and secs. 367, 482, and 936 of the Code)

[Note: this section is also in Chapter 9, Section 482.]

HOUSE BILL

No provision.

SENATE AMENDMENT

The provision addresses recurring definitional and methodological issues that have arisen in controversies[6] in transfers of intangible property for purposes of sections 367(d) and 482, both of which use the statutory definition of intangible property in section 936(h)(3)(B). The provision revises that definition and confirms the authority to require certain valuation methods. It does not

[6] *Veritas v. Commissioner*, 133 T.C. No. 14 (December 10, 2009), non-acq., IRB 2010–49 (December 6, 2010). (stating that including goodwill and going concern value within the definition would ''expand[]'' that definition, and that ''taxpayers are merely required to be compliant, not prescient''); *Amazon v. Commissioner*, 148 T.C. No. 8 (2017) (holding that ''workforce in place, going concern value, goodwill, and what trial witnesses described as 'growth options' and corporate 'resources' or 'opportunities' '' all fell outside the definition under present law).

modify the basic approach of the existing transfer pricing rules with regard to income from intangible property.

Under the provision, 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 flush language at the end of that subparagraph is removed, to make clear 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 scope of the definition.

The provision clarifies the authority of the Secretary to specify the method to be used to determine the value of intangible property, both with respect to outbound restructurings of U.S. operations and to intercompany pricing allocations,[7] by amending 482 as well as the grant of regulatory authority under section 367 regarding the use of aggregate basis valuation and the application of the realistic alternative principle.

With respect to aggregate basis valuation, the provision requires use of that method of valuation in the case of transfers of multiple intangible properties in one or more related transactions if the Secretary determines that an aggregate basis achieves a more reliable result than an asset-by-asset approach. The provision is consistent with the position that the additional value that results from the interrelation of intangible assets can be properly attributed to the underlying intangible assets in the aggregate, where doing so yields a more reliable result. This approach is also consistent with Tax Court decisions in cases outside of the section 482 context, where collections of multiple, related intangible assets were viewed by the Tax Court in the aggregate.[8] Finally, it is also consistent with the cost-sharing regulations.[9]

The provision codifies use of the realistic alternative principles to determine valuation with respect to intangible property transactions. The realistic alternative principle is predicated on the notion that a taxpayer will only enter into a particular transaction if none of its realistic alternatives is economically preferable to the transaction under consideration. For example, under the existing regulations provide the IRS with the ability to determine an arm's length price by reference to a transaction (such as the owner of intangible property using it to make a product itself) that is different from the transaction that was actually completed (such as the

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[7] Secs. 367(d) and 482.

[8] *See, e.g., Kraft Foods Co. v. Commissioner*, 21 T.C. 513 (1954) (thirty-one related patents must be valued as a group and the useful life for depreciation should be based on the average of the patents' useful lives); *Standard Conveyor Co. v. Commissioner*, 25 B.T.A. 281, p. 283 (1932) (''[I]t is evident that it is impossible to value these seven patents separately. Their value, as in the case of many groups of patents representing improvements on the prior art, appears largely to consist of their combination.''); *Massey-Ferguson, Inc. v. Commissioner*, 59 T.C. 220 (1972) (taxpayer who abandoned a distribution network of contracts with separate distributorships was entitled to an abandonment loss for the entire network in the taxable year during which the last of the contracts was terminated because that was the year in which the entire intangible value was lost).

[9] *See* Treas. Reg. sec. 1.482–7(g)(2)(iv) (if multiple transactions in connection with a cost sharing arrangement involve platform, operating and other contributions of resources, capabilities or rights that are reasonably anticipated to be interrelated, then determination of the arm's length charge for platform contribution transactions and other transactions on an aggregate basis may provide the most reliable measure of an arm's-length result).

owner of that same intangible property licensing the manufacturing rights and then buying the product from the licensee).

Effective date.—The provision applies to transfers in taxable years beginning after December 31, 2017. No inference is intended with respect to application of section 936(h)(3)(B) or the authority of the Secretary to provide by regulation for such application with respect to taxable years beginning before January 1, 2018.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

7. The Fourth Stick: Full Recognition under Section 367 for Outbound Section 351 Transactions

Special rules relating to * * * transfers involving [section 367(a)(3) of the Code: "Exception for Transfers of Certain Property Used in the Active Conduct of a Trade or Business"] Code

HOUSE BILL

*** * ***

Repeal of active trade or business exception

Section 367 is amended to provide that in connection with any exchange described in section 332, 351, 354, 356, or 361, if a U.S. person transfers property used in the active conduct of a trade or business to a foreign corporation, such foreign corporation shall not, for purposes of determining the extent to which gain shall be recognized on such transfer, be considered to be a corporation. [For example, a domestic corporation that transfers assets of an active trade or business to a foreign sub in exchange for stock of the sub, has recognition treatment notwithstanding the fact that the transaction otherwise falls within the non-recognition treatment available under section 351.]

Effective date.—The provisions relating to * * * the repeal of the active trade or business exception [is] effective for transfers after December 31, 2017.

CONFERENCE AGREEMENT

The provision in the conference agreement retains elements of both the House Bill and the Senate amendment, [including the *Repeal of active trade or business exception*[.]

§ 1.8 CHAPTER 15, INTRODUCTION TO ACQUISITIVE CROSS BORDER REORGANIZATIONS (INCLUDING INVERSIONS) AND SPIN-OFFS

A. Page 687, New Sec. 15.6.E. TCAJA's Amendment Relating to Surrogate Foreign Corporations

Page 687, New Sec. 15.6.E. Add at the bottom of the page the following new Sec. 15.6.E:

New Sec. 15.6.E.. **The TCAJA's Amendment Relating to Surrogate Foreign Corporations**

Shareholders of surrogate foreign corporations not eligible not eligible for reduced rate on dividends (sec. 14225 of the Senate amendment and sec. 1 of the Code)

HOUSE BILL

No provision.

SENATE AMENDMENT

Any individual shareholder who receives a dividend from a corporation which is a surrogate foreign corporation as defined in section 7874(a)(2)(B), other than a foreign corporation which is treated as a domestic corporation under section 7874(b), is not entitled to the lower rates on qualified dividends provided for in section 1(h).

Effective date.—The provision is effective for dividends paid in taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment with a modification. The modification is that the provision applies to dividends received from foreign corporations that first become surrogate foreign corporations after date of enactment.
Effective date.—The provision is effective for dividends received after date of enactment.

B. Page 741, New Sec. 15.11.F.12. Chamber of Commerce Successful Challenge to Section 385 Regs in Texas District Court

Page 741, New Sec. 15.11.F.12. Add at the bottom of the page the following:
New Sec. 15.11.F.12. **Chamber of Commerce Successful Challenge to Section 385 Regs in Texas District Court**

In *Chamber of Commerce of the United States v. IRS*,[10] which was issued on October 6, 2017, the Texas District Court found that the section 385 regulations were unlawfully issued without adherence to the APA's notice-and-comment requirements. As of the writing of this section in early August 2018, this case is still on appeal.

C. Page 741, New Sec. 15.11.F.13. The Trump Treasury Finalizes the Section 385 Regulations

Page 741, New Sec. 15.11.F.13. Add after the new Sec. 15.11.F.12 the following:
New Sec. 15.11.F.13. **The Trump Treasury Finalizes the Section 385 Regulations**

[10] *Chamber of Commerce of the United States v. IRS*, 2017 U.S. Dist. LEXIS 166985 (W.Dist. Texas (Oct. 6, 2017).

The Section 385 Regulations, which were promulgated in the last days of the Obama Administration, were finalized in substantially the same form by the Trump Administration in 2018. The Summary in the preamble to the Final Section 385 Regs provides:

> SUMMARY: This document contains final and temporary regulations under section 385 of the Internal Revenue Code (Code) that establish threshold documentation requirements that ordinarily must be satisfied in order for certain related-party interests in a corporation to be treated as indebtedness for federal tax purposes, and treat as stock certain related-party interests that otherwise would be treated as indebtedness for federal tax purposes. The final and temporary regulations generally affect corporations, including those that are partners of certain partnerships, when those corporations or partnerships issue purported indebtedness to related corporations or partnerships.

These final and temporary regulations are divided into the following sections:

> Section 1.385-1 General provisions;
> Section 1.385-2 Treatment of certain interests between members of an expanded group;
> Section 1.385-3 Transactions in which debt proceeds are distributed or that have a similar effect;
> Section 1.385-3T Certain distributions of debt instruments and similar transactions (temporary); and
> Section 1.385-4T Treatment of consolidated groups.

D. Page 741, New Sec. 15.11.F.14 The TCAJA's Replacement of the Prior Section 163(j) Interest Stripping Provision with the Current Section 163(j) Interest Limitation Provision

[This provision is set out in chapter 5, of this Supplement, page 187. The revised Section 163(j) will take pressure off of the section 385 regulations.]