U.S. Tax Legislation – Corporate and International Provisions

On December 20, 2017, Congress enacted comprehensive tax legislation (the "***Act***"). This memorandum highlights some of the important provisions relating to U.S. corporate and multinational taxpayers and provides a comparison with the law that was in effect prior to the Act. Unless otherwise noted below, these provisions will be effective for tax periods beginning in 2018.

Corporate Law Provisions			
Topic	**Pre-Act Law**	**Act Law**	**Observations**
Corporate Tax Rate	Corporations were taxed at a maximum 35 percent tax rate. In addition, corporations with average gross receipts of at least $7.5 million were subject to the corporate alternative minimum tax ("***AMT***") at a rate of 20 percent.	The maximum corporate tax rate is reduced from 35 percent to 21 percent. The Act also repeals the corporate alternative minimum tax.	Assuming current distributions are made to an individual subject to tax at the highest marginal individual income tax rate, the new effective tax rates are: (i) 29.6 percent if a business is held in a pass-through entity and the pass-through deduction is available (ii) 37 percent if a business is held in a pass-through entity and the pass-through deduction is not available (iii) 36.8 percent if a business is held in an entity treated as a corporation These lower overall effective rates reduce incentives for U.S. corporations to invert, redomesticate or to engage in earnings stripping or other base erosion transactions.

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			Partnerships that intend to accumulate earnings should consider converting to corporate form to take advantage of the lower corporate tax rate both on a current basis and on the compounding of the earnings. However, if a partnership converts to a corporation, it may not be able to convert back to a pass-through entity without incurring additional corporate level tax. Individuals who own a business operating in high-tax states should consider the impact of the new state and local tax deduction limitation if such business is operated in a pass-through vehicle as opposed to a corporation which is able to fully deduct state and local taxes.
Dividends Received Deductions	Corporate shareholders were entitled to a dividends-received deduction ("***DRD***") equal to 70 percent, 80 percent, or 100 percent of the dividend, depending on ownership percentages.	The Act reduces the dividends received deduction from 70 percent to 50 percent (for corporations that own less than 20 percent of its domestic corporate subsidiary) and from 80 percent to 65 percent (for corporations that own at least 20 percent of its domestic corporate subsidiary). The 100 percent DRD for 80 percent owned corporate subsidiaries remains unchanged.	Notwithstanding the reduced corporate income tax rate, the effective tax rate on intercompany dividends remains approximately the same as under prior law.
Limitation on Interest Expense	Interest paid was generally deductible subject to certain limitations under the	The Act replaces the earning stripping rules with a new business interest expense	The new interest deduction limitation may result in an increase in preferred

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	earning stripping regime.	limitation. Under the Act, the deductibility of net interest expense is capped at 30 percent of the adjusted taxable income of the business, as computed for purposes of this rule, and excluding depreciation and amortization (*i.e.,* EBITDA) for taxable years before 2022. This limitation applies to both corporate and pass-through entities (computed at the corporate and partnership level) with annual gross receipts in excess of $25 million. Real estate businesses may elect out of the interest expense limitation, provided certain requirements are met. Disallowed interest is carried forward indefinitely.	equity issuances which provide the holder with a preferential qualified dividend rate (for individual holders) or DRD (for corporate holders). This interest deduction limitation will impact the after-tax earnings of target companies in leveraged acquisitions. This limitation will also result in an increase in alternative financing arrangements such as leasing or derivative transactions that give rise to a deductible operating expense.
Expensing of Capital Expenditures	Bonus depreciation for 50 percent of certain investments in new property.	Subject to certain exceptions, taxpayers are allowed to expense 100 percent of the cost of certain tangible personal property placed in service between September 27, 2017 and before January 1, 2023 with the depreciation percentage decreasing by 20 percent each year thereafter.	This will result in an additional incentive to purchasers to structure acquisitions as an asset purchase (or to make a Section 338(h)(10) election) but this only applies to tangible personal property and not to intangibles, such as goodwill.
Net Operating Loss ("***NOL***") Limitations	NOLs were generally not subject to deduction limitations and could be carried back two years and carried forward 20 years.	NOLs are only deductible to the extent of 80 percent of the taxpayer's taxable income in such year and can be carried forward indefinitely but cannot be carried back.	The reduced corporate tax rate and 80 percent of taxable income deduction limitation reduces present value of NOLs in acquisitions. The elimination of the NOL expiration period lessens the impact of an ownership change subject to Section 382 of the Internal Revenue Code.

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Treatment of Self-Created Property	Gain or loss from the disposition of self-created patents, inventions, models or designs, or secret formulas or processes were capital in nature.	Gain or loss from the disposition of self-created patents, inventions, models or designs, or secret formulas or processes (other than certain music compositions and copyrights) after 2017 will be treated as ordinary in character; not as capital gain or loss.	This may impact the acquisition structure of a business with significant self-created property because the seller will recognize ordinary income with respect to such property in an asset deal.

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International Tax Provisions			
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Shift to Quasi-Territorial Tax System	U.S. corporations were subject to U.S. tax on dividends received from foreign subsidiaries (unless the dividends were made from previously taxed income), effectively subjecting U.S. multinationals to U.S. tax on their worldwide income.	A U.S. corporate shareholder will be entitled to a 100 percent DRD for foreign source dividends (*i.e.*, the portion of a dividend equal to the ratio of the foreign corporation's undistributed foreign earnings to its total undistributed earnings) paid by 10 percent owned foreign subsidiaries (other than passive foreign investment companies). The DRD is available to C corporations other than regulated investment companies and real estate investment trusts. To avoid taxpayers achieving a double tax benefit, hybrid dividends (*i.e.*, dividends that are deductible or otherwise generate a tax benefit in the foreign jurisdiction (*e.g.*, Luxembourg PECs)) are not eligible for the DRD and earnings exempt from U.S. tax as a result of the DRD will not generate foreign tax credits. The "controlled foreign corporation" ("***CFC***") regime subjecting certain categories of undistributed passive type income earned by U.S. controlled foreign subsidiaries to current U.S. federal income taxation will remain in effect, subject to certain modifications.	This shift provides U.S. multinational companies with a limited participation exemption that reduces their incentive to accumulate earnings offshore or to invert. Sales of foreign subsidiaries remain subject to U.S. tax. These changes may result in an increase in cross-border combinations with a U.S. holding company parent. Under the Act, U.S. multinational companies should generally operate offshore through corporate subsidiaries rather than through branch form in order to take advantage of the DRD on foreign source dividend income. U.S. shareholders of a CFC are still subject to tax on the undistributed earnings of the CFC that are invested in U.S. property under Section 956 of the Internal Revenue Code. As a consequence, (i) foreign subsidiaries should continue to be excluded as guarantors or co-obligors in credit facilities with a U.S. shareholder borrower and (ii) U.S. multinational groups that intend to utilize accumulated foreign earnings to invest in the United States should repatriate the earnings first in order to avoid a Subpart F inclusion under Section 956.

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Mandatory Deemed Repatriation	U.S. shareholders of a CFC were generally not subject to U.S. tax on the CFC's undistributed non-Subpart F income.	U.S. shareholders of certain foreign corporations will be required to pay a one-time repatriation tax on their pro rata share of the foreign accumulated earnings at a 15.5 percent rate on earnings held in cash and cash equivalents and an eight percent rate on earnings held in illiquid assets. U.S. shareholders may elect to pay the tax in annual installments over eight years. Foreign tax credits resulting from the deemed distribution would be partially available to reduce the tax resulting from the deemed repatriation. The reduced tax rates under the deemed repatriation will be recaptured if the U.S. company engages in an inversion transaction within 10 years.	Anti-abuse rules may apply to taxpayers that engage in foreign accumulated earnings reduction strategies to avoid the application of the deemed repatriation rules.
Base Erosion Minimum Tax	Not addressed under prior law.	The Act imposes a new base erosion minimum tax on a U.S. corporation with average gross receipts over $500 million when more than three percent of its deductions (two percent if the affiliated group includes a bank) arise from amounts paid to a foreign related party. The base erosion minimum tax is based on the U.S. corporation's modified taxable income (adding back the amount of deductible payments made by the U.S. corporation to foreign affiliates less certain adjustments). The base erosion minimum tax rate is five percent for 2018, 10 percent for 2019 through 2025, and 12.5 percent after 2025.	These changes are intended to reduce the incentive of U.S. multinationals to shift U.S. taxable income offshore through intragroup payments, such as royalties or interest. Although the base erosion minimum tax is higher than the tax rate in many low tax and tax haven jurisdictions, the 30 percent withholding tax (exceeding the new 21 percent corporate tax rate) imposed on payments to affiliates in non-treaty jurisdictions will serve to deter base erosion transactions in such jurisdictions. Opportunities remain in low-tax treaty jurisdictions.

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Tax on Global Intangible Low Taxed Income ("***GILTI***") and deduction for foreign derived intangible income ("***FDII***").	Not addressed under prior law.	U.S. shareholders of a CFC will be taxed on the U.S. shareholders' GILTI in the same manner as Subpart-F income. GILTI is generally a U.S. shareholder's pro rata share of the CFC's net income (other than Subpart-F income) less a deemed 10 percent return on the CFC's aggregate basis in tangible property. GILTI will be effectively taxed at a 10.5 percent rate until 2025 and 13.125 percent thereafter. The Act also provides for a special tax regime for a U.S. corporation's foreign source intangible income under which the U.S. corporation may deduct 37.5 percent of its FDII resulting in an effective 13.125 percent tax rate.	The FDII and GILTI provisions are intended to encourage U.S. corporations to hold their intangible assets in the United States and prevent the offshoring of these assets to jurisdictions with favorable patent box regimes. However, the FDII and GILTI provisions are very broad and may have significant unintended consequences that could result in additional taxes being imposed with respect to other types of income or assets.
Anti-Hybrid Rules	Not addressed under prior law.	The Act denies deductions arising from hybrid transactions or hybrid entities that are utilized to take advantage of differing legal characterizations of a transaction or entity in the United States and a foreign jurisdiction that result in a deduction in the United States without a corresponding inclusion in the foreign jurisdiction.	This provision is consistent with anti-hybrid rules used in many EU jurisdictions and with recommendations in the OECD's Base Erosion and Profit Shifting (BEPS) Project.
Sale of Partnership Interests	A recent Tax Court case (inconsistent with a published IRS ruling from 1991) held that gain or loss from the sale of a partnership interest by a non-U.S. partner will not be treated as income "effectively connected with a U.S. trade	Gain or loss from the sale of a partnership interest by a non-U.S. partner will be treated as ECI to the extent the partner would have been allocated ECI upon a sale of all of the partnership's assets at fair market value. In addition, the Act imposes a 10 percent gross	This provision applies to both private partnerships and publicly traded partnerships such as MLPs. The IRS recently announced in Notice 2018-08 that it is delaying the imposition of a withholding obligation on publicly

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	or business" ("***ECI***").	withholding tax on the purchaser unless the transferring partner certifies that it is not a foreign person. If a purchaser fails to withhold, the partnership is liable for the withholding tax.	traded partnership units until regulations or other guidance have been issued. Although it is not entirely clear, these rules should be interpreted to similarly apply to partnership redemptions. Investment funds should consider amending their organizational documents to require foreign partners to allow the fund to withhold as required by law and to provide the fund with an indemnity in the event of a failure to withhold by a purchaser.
Changes to CFC rules	A "U.S. Shareholder" of a CFC was defined as owning 10 percent or more of the vote of a foreign corporation. The definition of U.S. Shareholder is used to determine whether a corporation is a CFC and for the inclusion of Subpart F income. In order for Subpart F income to be includible by a U.S. Shareholder, the CFC had to have been a CFC for 30 days in the taxable year.	The Act expands the definition of a "U.S. Shareholder" to a person who owns 10 percent or more of vote **or value** of a foreign corporation. This expanded definition of U.S. Shareholder will be utilized for both the determination as to whether a corporation is a CFC and for the inclusion of Subpart F income. In addition, the Act eliminates the requirement that a foreign corporation must be controlled for 30 days in a year before Subpart F income inclusions will apply.	This is intended to prevent structures that utilize "low vote/high vote" shares in order to avoid CFC status. In addition, certain shareholders will now be treated as U.S. shareholders that own greater than 10 percent in a foreign corporation due to fluctuations in the value of its stock and would be required to include Subpart F income.
Changes to certain outbound transactions	Outbound asset transfers were generally not eligible for tax-free treatment. Subject to a number of	The Act repeals the "active trade or business" exception for outbound asset transfers.	

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	requirements, an exception was provided for transactions involving the transfer of property used by the foreign transferee in an “active trade or business.” An outbound transfer of intangible property was subject to current taxation or to special super-royalty rules requiring income inclusions following the transfer. The IRS issued guidance providing that goodwill (foreign and domestic), going concern value, and workforce in place were included in the definition of intangible property for purposes of this rule.	The Act also confirms the IRS guidance and revises the definition of “intangible property” to include goodwill (foreign and domestic), going concern value, and workforce in place.	

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