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2018 International Tax Planning: Get Ready for FDII and BEAT

International Tax Compliance and Minimization for C Corporations Will Require New Strategies and Skillful Planning
by Jason Rauhe, CPA

The landscape for understanding and capturing tax minimization opportunities provided by the Tax Cuts and Jobs Act of 2017 (TCJA) continues to take shape. This holds just as true for U.S. companies earning income from overseas operations as it does from domestic-only corporations. Since passage of the TCJA, clarifications and guidance continue to be issued.

The following information provides an update and overview of two of these provisions—the foreign-derived intangible income (FDII) deduction and the base erosion anti-abuse tax (BEAT), each of which will require your attention if you are a C corporation.

Using the FDII Deduction to Minimize U.S. Taxes

For U.S. C corporations exporting property or providing services outside of the U.S., the FDII deduction is an annual, permanent tax deduction that offers significant potential for reducing taxable income from revenue generated from overseas sales. Starting in the 2018 tax year, through 2025, an eligible C corporation will be able to deduct 37.5 percent of its FDII, producing an initial effective tax rate of 13.125 percent on certain categories of income.

C corporations that generate gross receipts from: (1) the sale, lease, license, exchange or other disposition of property to a non-U.S. party for foreign use; and/or (2) services they might provide to any person not located in the U.S. may qualify for the deduction.

The FDII deduction appears to be a win for certain C corporations, but as in the case of many other provisions of the new tax act, there are nuances and complications requiring deeper analysis. For example, at each C corporation level, the opportunity to minimize taxation by capitalizing upon FDII needs to be computed in conjunction with another new TCJA provision called GILTI (global intangible low-taxed income) that applies to certain types of income earned by U.S. shareholders of any controlled foreign corporation (CFC).

Furthermore, calculations for both GILTI and FDII are complex, requiring the collection and use of multiple sources of data plugged into a complicated formula. Beyond complex calculations, your international tax advisor can review strategies like expensing certain assets, new revenue recognition tactics or even changing methods to measure and compute adjusted tax basis using the alternative depreciation system (ADS).

Marching to the BEAT of a New Minimum International Tax for Corporations

The TCJA allows corporate shareholders of a foreign business (other than a RIC, REIT or S Corporation) a deduction for dividends in their computation of taxable income. However, TCJA launched a BEAT, a new tax intended to prevent abusive tax strategies, such as those facilitating the payment of tax-deductible expenses to foreign affiliates and then distributing profits tax-free.

BEAT applies to corporations with average annual gross receipts of $500 million or more over a three-year period, and a 3 percent or more base erosion (2 percent for banking or securities dealer groups). Determining how to define gross receipts for purposes of the base erosion minimum tax requires expertise and skillful planning as taxpayers can reduce gross receipts by returns and allowances, opportunities to annualize certain receipts, and consideration of receipts of predecessor entities.

Determining a BEAT payment is a complex undertaking requiring: (1) calculation of modified taxable income, which is taxable income adjusted by adding back any base erosion tax benefit; (2) adding back the base erosion percentage of any net operating loss; and (3) multiplying modified taxable income by a BEAT tax rate, which will be adjusted through 2026.

For tax year 2018, BEAT is 5 percent of income.

Identifying base erosion percentages requires the expertise of a tax professional who will identify base erosion payments, calculate base erosion tax benefits and determine aggregate deductions necessary for calculating whether BEAT thresholds have been exceeded.

Compliance with these (and other) provisions affecting U.S. corporations doing business overseas requires international tax planning expertise. Your tax professional can work with you to discuss impacts and opportunities as we head into the 2018 tax planning season.

To determine the impact on your particular tax situation from FDII, BEAT and GILTI, or for questions about other international tax issues, contact Jason Rauhe, CPA, at 440-605-7124 or email jrauhe@skodaminotti.com.