



International tax, transfer pricing, and
customs risks in a changing environment

Managing international tax risks in a changing global environment

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Disclaimer

The information provided herein is educational in nature and is based on authorities that are subject to change. You should contact your tax adviser regarding application of the information provided to your specific facts and circumstances.

Agenda

1

Describe the broad potential effects of recent legislative and regulatory developments on you and your organization

2

Identify global trends and potential impacts on the U.S. tax landscape

3

Recognize opportunities to reduce tax obligations and mitigate tax risk in the current tax legislative environment



Recent regulatory developments



Final FTC regulations

- Proposed regulations published November 2020
 - Added “jurisdictional nexus” requirement to definition of net income tax
 - Purged all 12 occurrences of “predominant character”
 - Paving the ways for a more rigid formalistic approach
- Final regulations published January 4 – generally follow proposed regulations
 - Jurisdictional nexus requirement renamed attribution requirement
 - Enhanced operating rules
 - Incorporated into net gain requirement instead of in addition to it
 - Net income requirement renamed cost recovery requirement
 - Predominant character language removal adopted

Final FTC regulations

- Attribution requirement (AKA jurisdictional nexus requirement)
 - Residents of foreign taxing jurisdiction may be taxed on worldwide income as long as arm's length pricing standard is met on intercompany dealings
 - Nonresidents of foreign taxing jurisdiction must meet one of three nexus-based tests
 - Activities-based
 - Source-based
 - Property-based

Final FTC regulations

- Activities-based nexus
 - Attributable to nonresident's activities within the foreign taxing jurisdiction ***under reasonable principles***
 - ECI-style analysis
 - Based on functions assets and risks located in the foreign country
 - ***Not*** destination-based criteria – mere location of customers, users, or suppliers
 - Cannot be based on the activities of another unless they are an agent or pass-through

Final FTC regulations

- Source-based nexus
 - Attributable sources within the foreign taxing jurisdiction under rules that are “reasonably similar” to U.S. sourcing rules
 - Character of gross income determined under foreign law (except as prescribed by special rules related to sales of property)
 - Gross income (GI) is then sourced under the following US criteria
 - GI from services must be sourced where services are performed
 - GI from royalties must be sourced to place of use or right to use the IP
 - GI from sales of property
 - Generally must be sourced under the activities-based or property-based tests
 - Copyrighted articles (other than those sold through an electronic medium) sold as tangible property fall under source testing

Final FTC regulations

- Property-based nexus
 - Attributable to gains on sale of property located within the foreign taxing jurisdiction
 - Related solely to real property located within the foreign country under §897 principles
 - Includes shares of a corporation that holds real property
 - Includes an interest in a partnership that holds real property; **or**
 - Related to other property attributable to a PE located within the foreign jurisdiction

Final FTC regulations

- Application to “in lieu of” (withholding taxes)
 - Must be in lieu of a generally imposed net income tax that meets attribution requirement
 - Withholding tax must meet source-based attribution requirement
- Interaction with U.S. tax treaties
 - New regs do not override covered taxes in treaties
 - Must be entitled to the benefits of the treaty
 - Caveat:** lower tier CFCs are not covered by U.S. treaties

Final FTC regulations

- Attribution requirement likely to prevent credibility of:
 - Digital services/diverted profits tax
 - Income taxes that apply destination-based principles in transfer pricing law/regulations
 - Technical services withholding taxes not performed in country
 - Puerto Rico manufacturing excise tax
- Interaction with U.S. tax treaties
 - New regs do not override covered taxes in treaties
 - Must be entitled to the benefits of the treaty
 - **Caveat:** Lower tier CFCs are not covered by U.S. treaties
- Effective for tax years beginning on or after December 28, 2021 (mostly)

Final & proposed aggregate ownership regulations

- Final §958 regulations issued January 25
 - Applies to Subpart F and §956 inclusions by way of pass-through entities
 - Extends GILTI aggregate ownership treatment to Subpart F and §956
 - Will likely create tremendous K2/K3 reporting headaches for partnerships and partners alike
 - Generally effective for taxable years ending after January 25, 2022 (2023)
- Proposed PFIC Regs issued January 25
 - Extend aggregate approach to PFICs
 - Pass-through no longer a domestic controlling shareholder
 - CFC overlap rule no longer applies to owners who do not meet U.S. SH status on their own
 - Regs ask for comments regarding making PFIC elections on behalf of multiple parties

Status of pending legislation



Status pending legislation efforts

- The administration, as well as Democrat legislators, introduced several iterations of an overhauled international tax regime
- Legislative efforts culminated in the Build Back Better Act (BBBA) supported by the Biden administration
- BBBA ultimately ran into an impasse (driven by Senator Manchin) over the gap between the revenue raising and spending provisions in the Bill and died
- BBBA remains the best indication we have regarding the direction of U.S. international tax law
 - International tax provisions were widely accepted
 - Affected corporations and wealthy individuals are not seen in a positive light
 - Democrats remain keen on passing some form of relief and voting influence of those disadvantaged by international tax provisions is small (but this is an election year)
- The following recap of the BBBA international tax provision is for your reference

GILTI tax changes under BBBA

- GILTI – ETR increased to 15% from 10.5% and break-even foreign ETR increased to 15.8% from 13.125%, along with the substantial elimination of aggregation
 - Exempt deemed tangible return reduced from 10% to 5% of QBAI
 - Section 250 deduction decreased to 28.5% from 50%
 - Section 250 deduction no longer limited based on taxable income
 - Calculated on a tested unit and country-by-country basis
 - Tested loss offsets virtually eliminated
 - Significantly increases calculation burden (client & service provider)
 - Tested losses carry forward

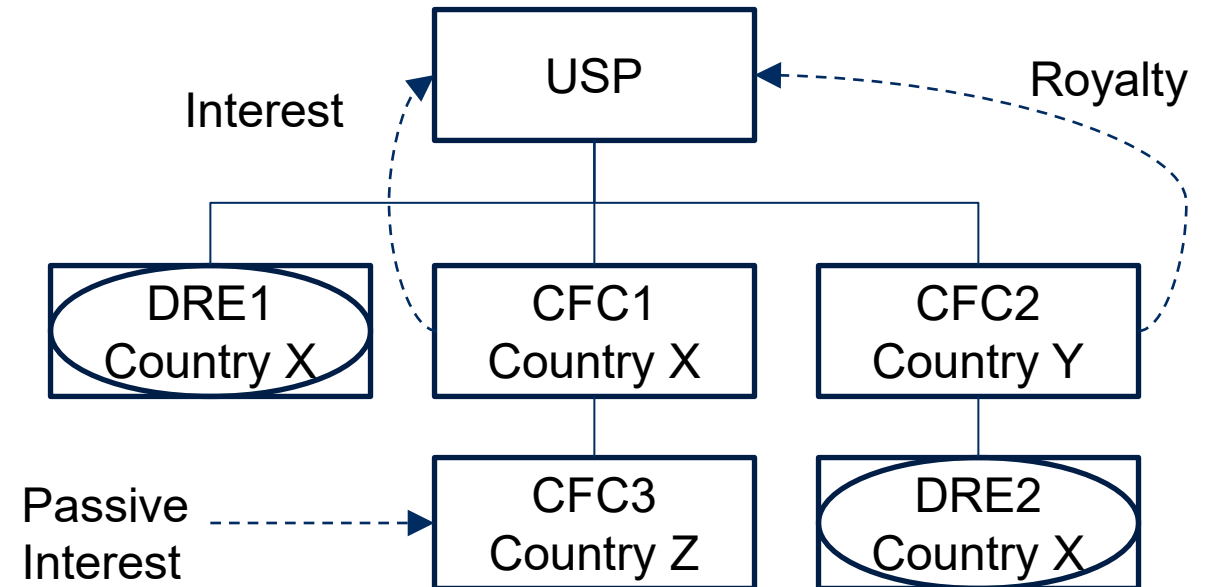
FTC tax changes under BBBA

- FTC – BBBA provides mixed bag for FTC
 - GILTI FTC impacts generally favorable to taxpayers
 - GILTI FTC haircut drops to 5% from 20%
 - GILTI FTCs carry forward for 5 years
 - Only Section 250 deduction and taxes are allocated to GILTI – no other expense allocation
 - Other FTC impacts generally unfavorable to taxpayers
 - Country-by-country/tested unit Section 904 limitation – resulting in higher global ETR
 - Prevents blending of high- and low-taxed jurisdictions even within a single entity
 - Significantly increases calculation burden (client & service provider)
 - Carryback eliminated

Example – current FTC regime

USP's FTC limitation categories

- GILTI – aggregate of CFC1 and CFC2 (including DRE2)
- General – interest and royalty income
- Passive – CFC3 FPHCI
- Foreign branch – DRE1



Example – under Build Back Better FTC regime

USP's FTC limitation categories

GILTI Basket

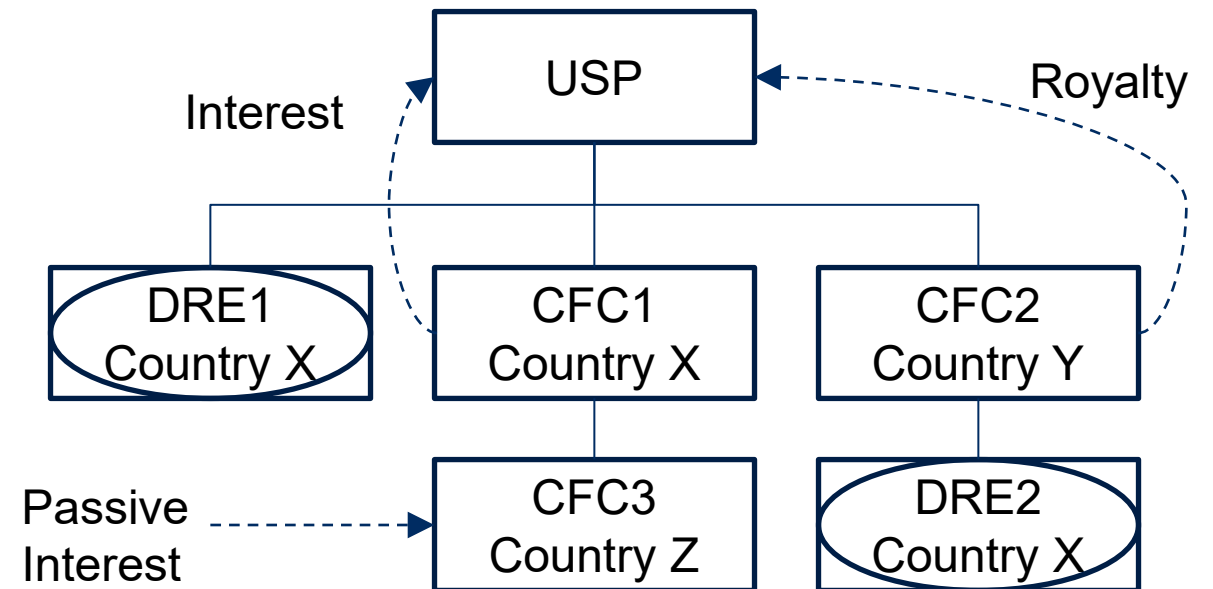
- Country X (assigned from CFC1 and DRE2 via CFC2)
- Country Y (assigned from CFC2)

General Basket

- Country X (assigned from DRE1)
- USP taxable unit (interest and royalty income)

Passive Basket

- Country Z (FPHCI assigned from CFC3)



FDII tax changes under BBBA

- FDII – ETR increased to 15.8% from 13.125%
 - Section 250 deduction decreased to 28.5% from 37.5%
 - Deemed tangible income return still 10% of QBAI (unlike GILTI)
 - Limitation based on taxable income eliminated (also applies to GILTI)

BEAT tax changes under BBBA

- BEAT – mixed bag that generally breaks in favor of taxpayers
 - Rate increases – 12.5% in 2023; 15% in 2024; 18% in 2025 (12.5% scheduled in 2025)
 - Certain payments included in COGS and inventory are tainted payments
 - 3% base erosion threshold for application of BEAT eliminated in 2025 **BUT**
 - Payments subject to U.S. tax (referencing old Section 163(j) rules) or foreign tax >15% are excluded
 - Added parity to treatment of credits for BEAT and regular tax purposes

Other international tax changes under BBBA

- Eliminates special rule allowing CFCs to adopt 1-month deferral Y/E (11/30/2022)
- Reinstates section 958(b)(4) precluding downward from a foreign party from U.S. shareholder and CFC determination
- Generally effective for years beginning after 12/31/2022, but BEAT applicable for years beginning after 12/31/2021

Global trends & potential impact on the U.S. tax landscape



BEPS 2.0 update

Pillar One

- Formulaic revised profit allocation and nexus rules – a new taxing right
- Scope is EUR 20 billion multinational consolidated turnover with 10% profitability
- 25% of deemed profit above 10% margin subject to reallocation
- Revenue resourced to end user market countries
- Contemplates agreement to remove digital services taxes

- October 2021 agreement
- Agreed by Inclusive Framework of 136 countries
- G7 political agreement and endorsed by G20
- Timeline is 2023 for both Pillars One and Two

Pillar Two

- Global minimum tax of 15%
- Applies to multinational groups with consolidated turnover of EUR 750 million
- Countries may lower threshold for local headquarter companies
- Additional "top up" amounts of tax payable by parent entity in local jurisdiction under inclusion rule

“A race to the middle?”

Pillar questions remain

- Pillar One implementation contemplates a multilateral convention agreement – what are the chances of U.S. Senate approval or use of an alternative solution?
- Digital services taxes have been agreed to be removed, but definitional questions remain, will some survive resulting in double tax?
- Will ultimate U.S. GILTI be Pillar Two approved?
- Lots of work still needs to be on mechanics, definitions and process for both Pillars – is the 2023 timeline realistic?



EU directives...

- ATAD 2 hybrid mismatch rules causing some uncertainty of application across the countries as to application to GILTI and check-the-box entities
- ATAD 3 – abusive use of shell companies to obtain tax benefits – 2022?
- Revival of the CCCTB (EU consolidated return) due to the added complexities of ATAD and Pillar Initiatives?
- EU VAT reform is on the table
- EU Commission announced it will present a new framework for business taxation in the EU by 2023



Europe...

UK

- Look for new targeted investment incentive proposals post-Brexit and -pandemic
- Aiming for investor-friendly and skilled job economy
- Decarbonization funding proposals expected

Netherlands

- Potential to subject royalties and interest to withholding tax in Dutch transparent structures with U.S.
- ATAD 2 hybrid mismatch rules – Dutch Tax Authority uncertainty for U.S. flow-through entities



Americas...

Mexico

- No APA for maquiladoras
- Disallow VAT credits for activities carried out outside of Mexico

Canada

- Expect lifting of pandemic administration employee concessions
- Holding onto 3% digital tax on services



Asia Pacific...

China

- Simplification of unilateral APA process
- 100% and 75% additional research deduction
- New and extended preferential tax policy for certain locations (15% tax rate and other benefits)

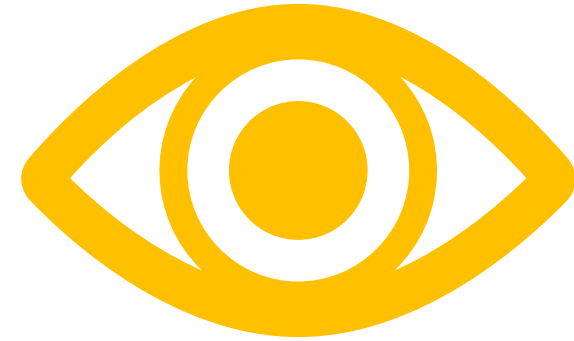
Australia

- Proposed 17% rate for patent box regime
- Proposed simplification to corporate tax residency test



Also worth watching...

- Explosion of global cryptocurrency popularity and tax authority focus
- Worldwide carbon tax legislation is picking up steam
- Shift to regional tax hub structures due to pandemic and supply chain challenges
- What will the OECD be up to next?
- Next steps in U.S. tax policy?



Preparing for an uncertain (tax) future



Preparing for an uncertain (tax) future

Cannot see the forest for the trees. . .

- Take a holistic look at your global footprint and economic drivers
 - Where are your operations (assets, functions, risks)?
 - Where do you currently pay tax and how much?
 - Where is cash generated and where is it needed?
 - Where are your cross-border transactions (tangible & intangible/third party & related party)?
 - Do you rely on an exemption/election to avoid double tax or a foreign tax credit?

Preparing for an uncertain (tax) future

An ounce of prevention is worth a pound of cure . . .

- Model your tax outcomes, project out 3-5 years
- Invest in a software/calculation tool depending on the size and complexity of your organization
- Understand what tax attributes you have and when/how you will utilize them (carryovers, credits, losses, etc.)
- Build out iterations based on hypothetical changes and worst-case scenarios



Thank you

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