TAX IN MOTION

Foreign tax credits

Avoiding the pitfalls of double taxation

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With you today

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Agenda

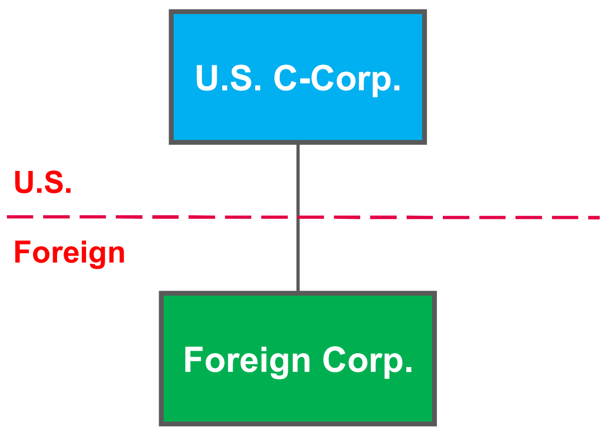
- Foreign tax credit (FTC) overview
- Definition of a foreign income tax
- New FTC regulations: Attribution requirement
- Potential foreign taxes impacted
- Planning opportunities to navigate double taxation

Learning objectives

By the end of this presentation, participants will be able to:

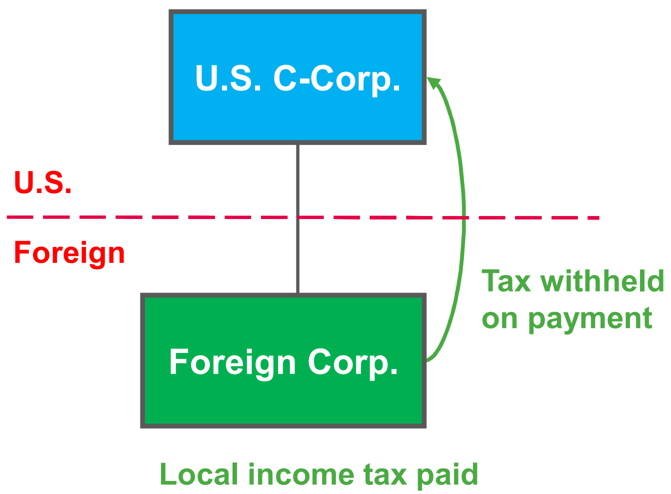
1. Communicate why foreign tax credits are important and how they can be used to minimize an effective global tax rate.
2. Articulate at a high-level comprehension of the Treasury’s 2021 final regulations and 2022 proposed regulations around the areas of cost recovery and attribution rules.
3. Identify how FTC rules may impact your multinational business.

Foreign tax credit overview



- U.S. tax system – worldwide taxation
  - U.S. tax residents are subject to tax on income earned both in the U.S. and abroad
- Foreign tax credit is primary mechanism to mitigate double taxation
- Foreign source income (FSI) limitation
  - Foreign source gross income net allocated and apportioned expenses
- Foreign tax credit vs. foreign tax deduction

Taxes eligible for foreign tax credit



- Taxes must be *foreign* and must be an *income* tax
- Withholding taxes on certain types of income qualify
- Impacts GILTI high-tax exception
- Value-, or cost-based taxes are not creditable. For example:
  - Sales taxes or VAT/GST
  - Real estate taxes
  - Stamp duty or transactional taxes

Requirements of an income tax

- Net gain requirement
  - Realization requirement
    - Based on events that trigger liability for tax
  - Gross receipts requirement
    - Not greater than the fair market value of arm's length gross receipts
  - Cost recovery requirement
    - Allow recovery of significant costs and expenses (reasonable principles)
  - *Attribution Requirement*
    - *New under 2021 FTC Regulations*
- Covered withholding tax – substitution requirement
  - Attribution requirement must be met

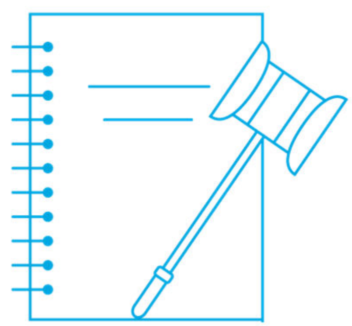
Overview of the final FTC regulations – T.D. 9959

Attribution requirement	Explanation	Examples of applicability
Income attribution based on activities	Income related to activities provided within the foreign country similar to U.S. effectively connected income concept.	Income tax regimes (i.e., Brazil) and permanent establishment or foreign branch
Income attribution based on source	Foreign tax law sourcing must be substantially similar to U.S. tax principles.	Withholding taxes (specifically with respect to non-treaty countries)
Attribution based on situs of property	SPEAKER: Mat Foreign tax based on income related to disposition of real property located in foreign country similar to U.S. FIRPTA.	Capital Gains on sale of property (i.e., real estate)
Income tax treaty coordination	Foreign tax on income covered by U.S. income tax treaty is automatically considered an income tax.	U.S. treaty network

* Whether a foreign tax meets the requirements of the net gain requirement, including the attribution requirement, is determined based solely on the terms of the foreign tax law, and not on a taxpayer's specific facts.

Corporate income taxes impacted

- Foreign income-based tax
  - Net Gain Requirement including realization, gross receipts, and cost recovery must be met
  - Attribution requirement requires foreign source income upon which tax is imposed must comply with accepted transfer pricing regulations and the arm’s-length principle
- Alternative and novel taxes
  - Same analysis as income-based tax required for creditability
  - Examples can include digital services taxes, alternative minimum taxes, or global minimum taxes



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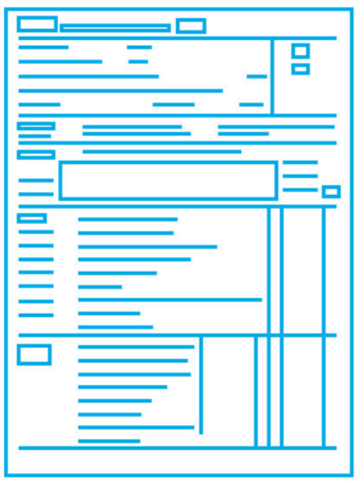
Withholding taxes impacted



- Withholding taxes on services income
  - Sourcing must follow where services are performed
  - Sourcing cannot be based on residence of payor
- Withholding taxes on royalties
  - Sourcing must follow where IP is used
  - Sourcing cannot be based on residence of payor
  - Single-country exception may apply
- Other withholding taxes
  - Sourcing must be substantially similar to U.S. sourcing principles on similar income

Impact around the globe

- Brazil income tax
- Other income tax regimes?
- Alternative tax regimes
  - Digital Services Taxes
  - Pillar Two – Global Minimum Tax
- Withholding taxes from non-treaty countries
  - Latin America, Hong Kong, Singapore, etc.
  - e.g., WHT on SaaS
- Tax on sale of foreign corporation stock
- CFCs
  - GILTI high-tax exception
  - Withholding taxes of CFCs – no treaty relief

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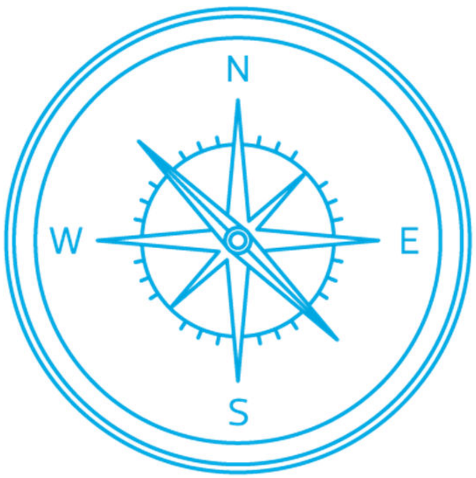
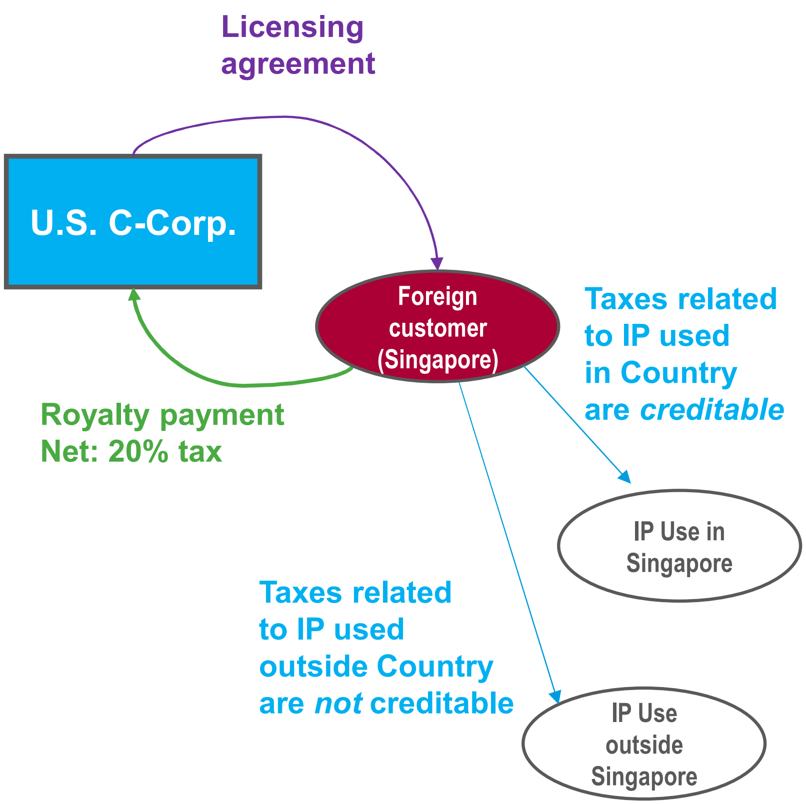
Foreign tax credit planning opportunities



- Assess impact of foreign tax liabilities and withholding taxes
- Transaction flow planning
- Royalty single-country exception
- Consider alternative character and/or sourcing of earning streams
- Revisit foreign revenue streams
- Permanent establishment analysis
- Transfer pricing
- Entity classification analysis (check-the-box)

Royalty single-country exception

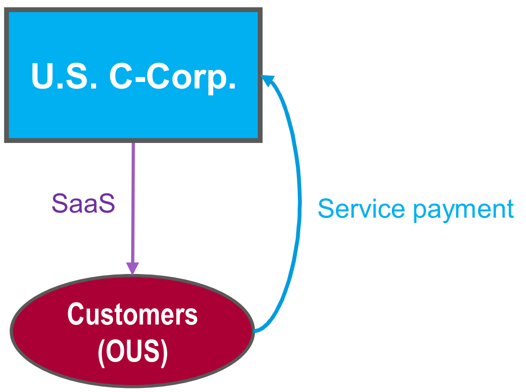


Single-country exception

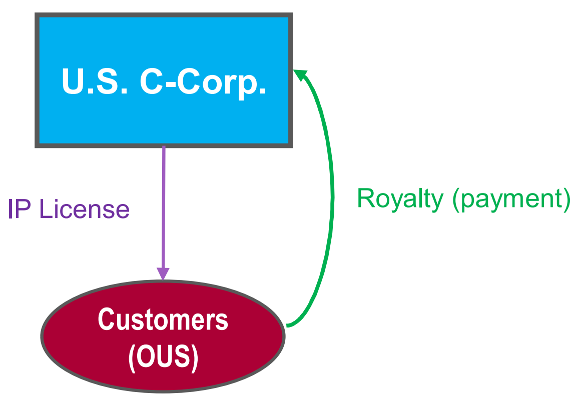
- New limited exception to the source-based attribution requirement.
- The single-country exception can be applied where:
  - The income subject to the tested foreign tax is characterized as gross royalty income, and
  - The payment giving rise to such income is made pursuant to a single-country license.
- Proper documentation
  - Written license agreement must be in place and executed no later than the date on which the royalty is paid (with a transitory rule applicable).
- Can be applied to direct licensing agreements with third party customers.
- Can also be applied in the context of a foreign CFC or foreign disregarded entity royalty structure as well.

Foreign tax credit: examining character and source opportunities

Transaction characterized as a service – FTCs not creditable



Transaction characterized as a license – FTCs creditable



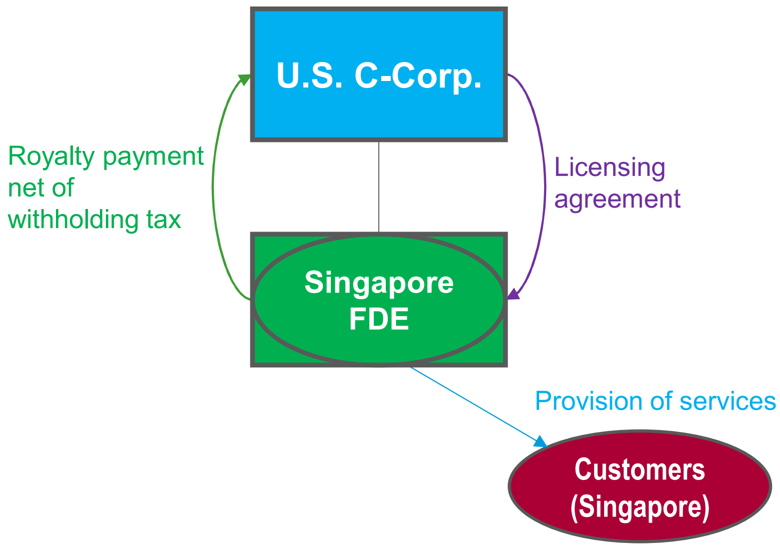
Character of transaction impacts credit of foreign tax

U.S. Income sourcing rules follow the character of the transaction

- e.g., Services are sourced where services are performed, while royalties are sourced where the IP is exploited

- U.S. rules provide guidance on whether a transaction is a service, license or sale of the IP or a copy of the IP
- Foreign transaction characterization rules are often less specific and follow the label given to the transaction in the contract
- Planning opportunity
  - Many LatAm and AsiaPac countries withhold on payments for services that benefit their jurisdictions. They also withhold on license payments.
  - The difference for U.S. tax is that the services withholding is not creditable, while the license withholding may be (given one-country rule)
  - With specific changes to contract language SaaS type offering to LatAm and AsiaPac could allow creditable foreign taxes.
  - Contractual changes would be minimal and transparent from a business standpoint

Planning opportunities: foreign royalties



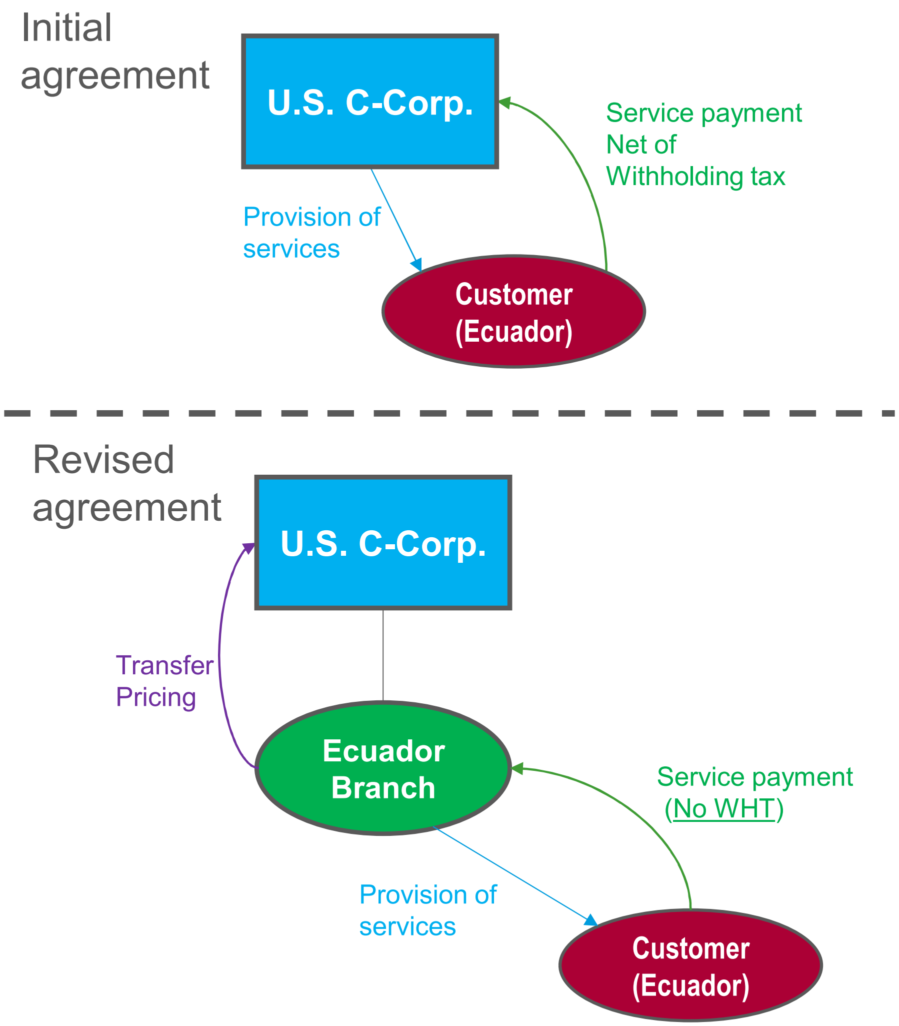
Facts:

- U.S. C-Corp. with Foreign Disregarded Entity in Singapore ("Singapore FDE")
- Singapore FDE provides services to local customers using U.S. IP
- Use of U.S. IP documented in intercompany license agreement
- Singapore FDE pays royalty and levies 10% withholding tax
- No treaty between U.S. and Singapore
- Singapore tax law asserts the right to tax royalty payments based on the Residence of the Payer

Planning options:

- Review structure and transfer pricing
- Restructure intercompany arrangement
- Revise intercompany licensing agreement to meet single-country exception

Planning opportunities: foreign services



Facts:

- U.S. C-Corp contracting with a customer in Ecuador to provide construction and installation services
- Ecuador applies 25% withholding tax on services payments made to nonresidents and sourcing is based on the residence of the payor
- No treaty between U.S. and Ecuador

Planning options:

- Refine agreement to outline services vs. product sales
- Revise agreement and establish Ecuador branch

Considerations:

- Administrative costs of Ecuador branch
- Legal protections
- Indirect taxes such as VAT/GST and customs
- Payroll costs and personnel requirements
- Foreign bank account requirements

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THANK YOU FOR YOUR TIME AND ATTENTION

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