KBKG TAX INSIGHT:

FIVE TAX REFORM QUESTIONS FOR MULTINATIONAL BUSINESSES TO CONSIDER

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Please spare a thought for the CPAs who finished their first year under the Tax Cuts and Jobs Act (TCJA). While the TCJA was signed into law in December 2017, CPAs from coast-to-coast faced the daunting task of figuring out all of the new rules while preparing returns for the 2018 year.

While the complications did not end with busy season, there are new strategies under TCJA that may generate substantial tax savings. Many companies with international transactions may find these new strategies fruitful.[1]

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- Transfer Pricing

How to Get Started? Five Questions Designed to Generate Tax Savings

Question 1: Can We Pay Tax at a 13.125% Rate on Some Export Income?

Answer: Strategies to increase an exporter's FDII may yield substantial tax savings

For C-Corporations, the TCJA reduces the corporate tax rate to 13.125% on Foreign-Derived Intangible Income (FDII). This 13.125% rate, rather than 21%, applies once taxable income on exports exceeds a certain deemed return on assets. Calculations are complicated, but FDII effectively serves as an incentive for companies to invest in the US to serve foreign customers.[2]

Some multinational companies, where justified, may be able to generate additional FDII income through increases to intercompany pricing of goods, services, and royalties:

- For multinationals exporting to higher-tax jurisdictions, companies can benefit from generating additional income at 13.125%, while increasing deductions overseas;
- Companies investing in US R&D or manufacturing capacity to serve foreign markets may be best placed to benefit.
- As an example, a US multinational with FDII income that can justifiably increase transfer prices by $1,000,000 to a subsidiary in a 30% tax jurisdiction may be able to realize federal income tax savings of $168,750 (30% - 13.125%= 16.875%).

There is a risk that overseas tax authorities may question intercompany price increases for goods, royalties, and service charges. US and global transfer pricing documentation should be considered to justify intercompany pricing changes to the tax authorities.

Question 2: Where is Your Export Documentation?

Answer: Companies need to maintain records of 'foreign use' to qualify for FDII rate

The IRS released proposed guidance outlining the required documents needed to support claims of 'foreign use' on March 4, 2019. Generally speaking, these requirements state that by the tax return filing date:

- Sellers need to obtain evidence that the property, royalty income, and service transaction is for a
- 'foreign person.'
- Taxpayers must "not know, or have reason to know, that the transaction will not be for foreign use."
- Sales to related parties, such as subsidiaries, do qualify as 'foreign use'' if sold or utilized by a foreign customer.

One noteworthy anti-abuse rule is a regulation to prevent 'round-trip' transactions – products exported for minor assembly and then re-imported to the US.

Question 3: Why are There Tax Losses in Some Countries?

Answer: Stop the bleeding! Consider changing transfer pricing policies to utilize losses

We find that some multinationals incur tax losses in certain jurisdictions while generating profits elsewhere. Reasons for the losses vary, but quite often inefficient or out-of-date transfer pricing policies may be a driving factor.

- Corrections to transfer pricing can help companies utilize tax losses in one jurisdiction while increasing deductions in other locations, where justified
- Supply chain changes can result in a spike in the global effective tax rate without a corresponding adjustment to transfer prices
- Tax authorities regularly conduct transfer pricing audits on companies incurring losses

In our experience, changes to transfer pricing to utilize tax losses, where warranted, can be one of the best tax savings strategies while also reducing tax audit risk. In effect, reducing overpayment of tax in profitable jurisdictions to utilize losses elsewhere.

Question 4: What Happens if We Reduce Inbound Transfer Prices?

Answer: New inbound transfer prices may lead to tax savings and reduce audit risks

For some companies purchasing from related parties, a new transfer pricing strategy may deliver additional tax savings. Before tax reform, many companies minimized their tax footprint in the US due to the 35% corporate tax rate. After tax reform:

- Lower transfer prices of goods, royalties, and service charges may reduce the global effective tax rate, especially involving transactions with countries that have comparatively higher tax rates
- The IRS has a transfer pricing audit campaign for foreign-owned subsidiaries; US subsidiaries incurring losses or generating minimal profit margins are primary targets.

Question 5: What Can We Do about the GILTI Tax?

Answer: GILTI is designed to be a global minimum tax. Section 962 may be an option.

The Global Intangible Low Tax Income ("GILTI") tax applies to many companies and individuals where an investment in a CFC is generating taxable income above a 10 percent return on deemed return on assets. The wide applicability of GILTI was a surprise to many as this tax is not directly linked to owning intangible property.

For US individual shareholders the tax is particularly punitive because individuals don't qualify for the 50 percent deduction nor the deemed-paid foreign tax credits that are available to C-Corporations. Individuals may consider whether to use an election available under IRC Section 962. This election allows an individual to elect to be taxed as a C-Corporation and make available to them these benefits. A careful and thorough analysis with an international tax advisor is necessary, however, to determine if these apparent benefits outweigh hidden costs of making this election.

While the GILTI tax may be unavoidable, understanding how intercompany-pricing plays a role in the calculation of the tax liability may offer an opportunity for some adjustments to provide savings opportunities.

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The TCJA is a monumental shift in the tax environment for companies, and tax reform rearranges the incentives for multinational companies. Transfer pricing, in turn, is an essential consideration as to where profits are generated within the company. With lower US corporate tax rates, companies would be well served by evaluating whether transfer pricing changes could lead to substantial cash savings.

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Whether you are new to transfer pricing, fighting a high-stakes transfer pricing audit, or somewhere in-between, we have the practical insights from time-tested strategies. These approaches are successfully utilized by multinational companies on a worldwide basis.

Contact us today to find out more about transfer pricing.

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[1] Please note that some regulations are still in a proposed stage and subject to change. In addition, these new regulations require complicated calculations and employ comprehensive anti-abuse rules.

[2] Practically speaking, an assessment of qualifying and non-qualifying activities, revenue allocations, expense allocations and apportionment rules all have an impact on the calculation of FDII income.