

Robinson+Cole

Manufacturing Law Group

Roundtable Discussion

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2017 Tax Cuts and Jobs Act: Key Provisions for Manufacturers

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Please Note

This roundtable is designed to provide accurate information about the subject matter. However, it only provides general information and does not constitute legal advice. No attorney-client relationship has been created. If legal advice or other assistance is required, let us know directly.

Preliminary Considerations

- This platform should not be used for activities prohibited by antitrust law.
- Avoid discussions leading to a restriction, or coordination, of competition between or among attendees.
- Attendees should not share information, have discussions and/or make arrangements on, among other things, pricing, market conduct, terms of sale, individual manufacturing costs and costs of sale, output, or supplier or customer relations/allocation.

Overview

On December 22, 2017, President Trump signed into law the Tax Cuts and Jobs Act, or the “Act”, a comprehensive tax reform package representing an overhaul of federal tax legislation arguably on a level not seen in more than 30 years.

Key Provisions for Manufacturers

- Reduction in Tax Rates
- Deduction for Income Earned by Pass-through Businesses
- Key International Provisions
 - Shift to Quasi-Territorial Tax System
 - Mandatory Repatriation of Deferred Foreign Income
 - Global Intangible Low-Taxed Income (“GILTI”)
 - Foreign-Derived Intangible Income (“FDII”)
 - Base Erosion Minimum Tax
 - Sourcing Rules – Cross-Border Sales of Inventory
 - Denial of Deduction for Certain Interest, Royalty Payments to Related Parties
- Immediate Expensing of Capital Expenditures

Reduction in Tax Rates

- **Corporate rate**
 - Reduction in maximum graduated rate of 35% to flat rate of 21%
 - No more graduated rates
 - Alternative minimum tax is now obsolete
- **Individual rate**
 - Temporary reduction in graduated rates that apply to ordinary income – maximum rate reduced from 39.6% to 37%
 - Sunsets in 2026
 - No change in long term capital gain rates

Deduction for Income Earned by Pass-throughs

- Noncorporate taxpayers allowed to deduct up to 20% of U.S. “qualified business income” derived from a “**qualified trade or business**” that operates as a partnership, S corporation or sole proprietorship
- Specified service trades or businesses are excluded on a phase-in basis for lower-income taxpayers
- A limitation based upon wages paid plus a capital element is phased in for taxpayers with taxable income above a threshold amount
- Deduction sunsets in 2026

Key International Provisions

Shift to Quasi-Territorial Tax System

- The Act moves the United States closer to a “territorial” tax system (as compared to the prior worldwide tax system)
- U.S. corporations (other than RICs and REITs) can deduct 100% of the foreign-source portion of dividends they receive from their foreign subsidiaries
- Available to U.S. corporations that own 10% or more, by vote or value, of a foreign corporation and meet holding period requirement
- Dividend must not have created a deduction (or other tax benefit) for foreign corporation under foreign law
- Foreign tax credit or deduction not available for dividends that qualify for deduction

Key International Provisions

Mandatory Repatriation of Deferred Foreign Income

- U.S. shareholders who own 10% or more of a foreign corporation are required to include in income their pro rata share of the foreign corporations' deferred foreign income
- A portion of the pro rata share of foreign earnings is deductible by the U.S. shareholders
- The total deduction allowed is an amount necessary to result in a 15.5% rate of tax on foreign earnings in the form of cash and cash equivalents and an 8% rate of tax on all other foreign earnings
- Can elect to pay tax liability over 8 years

Key International Provisions

Global Intangible Low-Taxed Income (“GILTI”)

- A U.S. shareholder of a “controlled foreign corporation” must include in gross income its GILTI in a manner similar to inclusions of Subpart F income
- Beginning after December 31, 2017 and before January 1, 2026, a corporate U.S. taxpayer can deduct 50% of its GILTI
- Taking into account the new corporate tax rate of 21%, the effective tax rate on GILTI for U.S. corporations is 10.5% until 2026
- GILTI is also eligible for 80% foreign tax credit, so that GILTI that is subject to at least a foreign tax of 13.125% before 2026 should not be subject to any residual U.S. tax under this provision

Key International Provisions

Foreign Derived Intangible Income (“FDII”)

- A U.S. corporation (other than a RIC or a REIT) can deduct 37.5% of its FDII until 2026, at which time the permitted deduction is reduced to 21.875%
- Very generally, FDII is the deemed intangible income that the U.S. corporation earns from making sales of property to foreign persons for foreign use and for providing services to persons or with respect to property located outside the United States
- Taking into account the new corporate tax rate of 21%, the effective tax rate on FDII is 13.125% before 2026 and 16.406% thereafter

Key International Provisions

Base Erosion Minimum Tax

- Imposes a new “alternative minimum tax” on certain corporations that, through “**base erosion payments**” significantly reduce their U.S. federal income tax liability
- In broad terms, “base erosion payments” are certain payments made by a corporation (including foreign corporations with U.S. trades or businesses) to foreign related persons that are deductible for U.S. federal income tax purposes
- If a corporation has average annual gross receipts of \$500 million or more over a 3-year period and a base erosion percentage of 3% or more, it will be subject to a minimum tax equal to the excess of 10% of such corporation’s “modified taxable income” over its regular tax liability
- For tax years beginning in 2018, the tax rate is reduced to 5%, but it climbs to 12.5% for tax years starting in 2026

Key International Provisions

Sourcing Rules – Cross-Border Sales of Inventory

- Gains, profits and income from sales of inventory produced in the United States (in whole or part) and sold outside the United States (or vice versa) is apportioned between United States and foreign sources solely based upon the **production activities** with respect to the inventory.
- Prior to the Act, income on U.S.-manufactured inventory sold abroad (or vice versa) was sourced under the “50-50” rule, whereby half was U.S.-source and half was foreign-source.
- As a result of this change, all U.S. manufactured inventory sold abroad will be U.S. source income, and no foreign tax credits will be available to U.S. manufacturers that sell their products abroad, leading to the potential for double taxation.

Key International Provisions

Denial of Deduction for Certain Related Party Interest and Royalty Payments

- U.S. taxpayers can no longer deduct “disqualified related party amounts” paid or accrued pursuant to a “hybrid transaction” or by or to a “hybrid entity”
- A disqualified related party amount is any interest or royalty payment paid or accrued to a related party, if the related party does not have a corresponding income inclusion (or is entitled to a deduction)
- A hybrid transaction has one or more payments treated as **interest or royalties** for U.S. federal income tax purposes but not so treated under foreign law where recipient is taxed or is resident
- Hybrid entity is “fiscally transparent” for U.S. federal income tax purposes but not so under foreign tax law (or vice versa)

Immediate Expensing of Capital Expenditures

- Under existing U.S. federal income tax law, a taxpayer generally is required to capitalize the cost of property and recover such costs over time through annual depreciation/amortization deductions
- For certain “qualified property” acquired and placed in service after September 27, 2017 and before January 1, 2023, the Act generally allows an additional first-year depreciation deduction of 100% of the property’s adjusted tax basis (with a phase down thereafter)
- “**Qualified property**” generally includes tangible property to which Modified Accelerated Cost Recovery System (MACRS) applies with an applicable recovery period of 20 years or less; MACRS water utility property; certain computer software; and qualified improvement property
- Applies to certain arms’ length purchases of used, as well as new, property

Questions

Thank You



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