Overview of the Taxation of Global Intangible Low-Taxed Income and Foreign-Derived Intangible Income: Sections 250 and 951A

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Overview

Taxation of Global Intangible Low-Taxed Income

- Public Law 115-97 (the "Act") added new section 951A to the Internal Revenue Code (the "Code").
- Section 951A requires that U.S. shareholders of any controlled foreign corporation ("CFC") include in gross income in the current taxable year their global intangible low-taxed income ("GILTI").
  - The amount of a U.S. shareholder's GILTI generally reflects the sum, across all of its CFCs, of certain CFC income, offset by the sum of certain CFC losses, in excess of a 10-percent return on tangible investment (with the return reduced by certain interest expense).
- The Act also added new section 250 to the Code, which generally allows U.S. corporate shareholders a 50-percent deduction on their GILTI, thereby subjecting GILTI to a 10.5-percent U.S. tax rate, with partial foreign tax credits available to offset some or all of the U.S. tax liability.
  - For taxable years beginning after December 31, 2025, the deduction is reduced to 37.5 percent, resulting in a 13.125-percent U.S. tax rate.

Taxation of Foreign-Derived Intangible Income

- Section 250 also provides domestic corporations a 37.5-percent deduction on their foreign-derived intangible income (“FDII”), resulting in a 13.125-percent effective tax rate on such income.
- A corporation’s FDII is generally the amount of certain income in excess of a 10-percent return on tangible investment, multiplied by the percentage of that income derived from serving foreign markets.
- The deduction for FDII is reduced to 21.875 percent for taxable years beginning after December 31, 2025, resulting in a 16.406-percent effective tax rate on FDII.

Background

Background Terminology

- U.S. shareholder
  - With respect to a foreign corporation, a **U.S. shareholder** means any U.S. person who owns at least 10 percent of the stock (measured by vote or value) of the foreign corporation.
- Controlled foreign corporation ("CFC")
  - A **CFC** is any foreign corporation that is more than 50-percent-owned (by vote or value) by U.S. shareholders.
  - A foreign corporation that is owned equally by a U.S. shareholder and foreign person (*e.g.*, certain joint ventures) is not a CFC.
- Foreign tax credit ("FTC")
  - An **FTC** is a credit against U.S. taxes for foreign income taxes paid, generally limited to the same income, to relieve double taxation of that income.
  - A U.S. shareholder may also be allowed a "deemed-paid" credit for foreign taxes paid with respect to the related income when it is included in income.
  - A section 78 gross-up amount equal to the deemed-paid credit is added to the income of the taxpayer claiming the "deemed-paid" FTC.

Background on Prior Law

- In general under prior law, the United States taxed firms on a worldwide basis, with deferral.
- U.S. tax on active foreign income of foreign subsidiaries was generally deferred until the income was distributed to the U.S. shareholder as a dividend (*i.e.*, repatriated).
  - A large portion of active foreign income earned by U.S. companies is earned through CFCs and, under prior law, was not subject to current U.S. tax.
- Passive/mobile foreign income was generally subject to current U.S. taxation under subpart F.
- FTCs, including deemed-paid FTCs, were available, subject to income limitations based on type of income and source, to avoid use of credits to reduce U.S. tax on U.S. income or on foreign income not otherwise subject to tax.
  - FTCs were assigned to one of two categories – passive or general.
  - Whether a taxpayer owed additional or residual U.S. tax depended on not only the source and type of income but also on the relative tax rates of the United States and the foreign jurisdiction.

From Prior Law to Present Law

- The Act retained many of the definitions and concepts of prior law with respect to the taxation of foreign business income but introduced rules that effectively ended deferral of income earned through foreign corporations.
  - Certain dividends from CFCs to U.S. shareholders can generally be distributed tax-free under the Act's 100-percent dividends-received deduction ("DRD"). Sec. 245A.
  - The Act expanded the scope of CFC income subject to current U.S. tax (*i.e.*, GILTI).
- Under present law, foreign business income is now (1) taxed currently at the full U.S. tax rate with full FTCs (*e.g.*, subpart F); (2) taxed currently at a reduced tax rate with partial FTCs (*e.g.*, GILTI); or (3) not taxed (*e.g.*, eligible for the section 245A DRD).
- The Act added two FTC baskets:
  - a GILTI basket and
  - a foreign branch income basket.

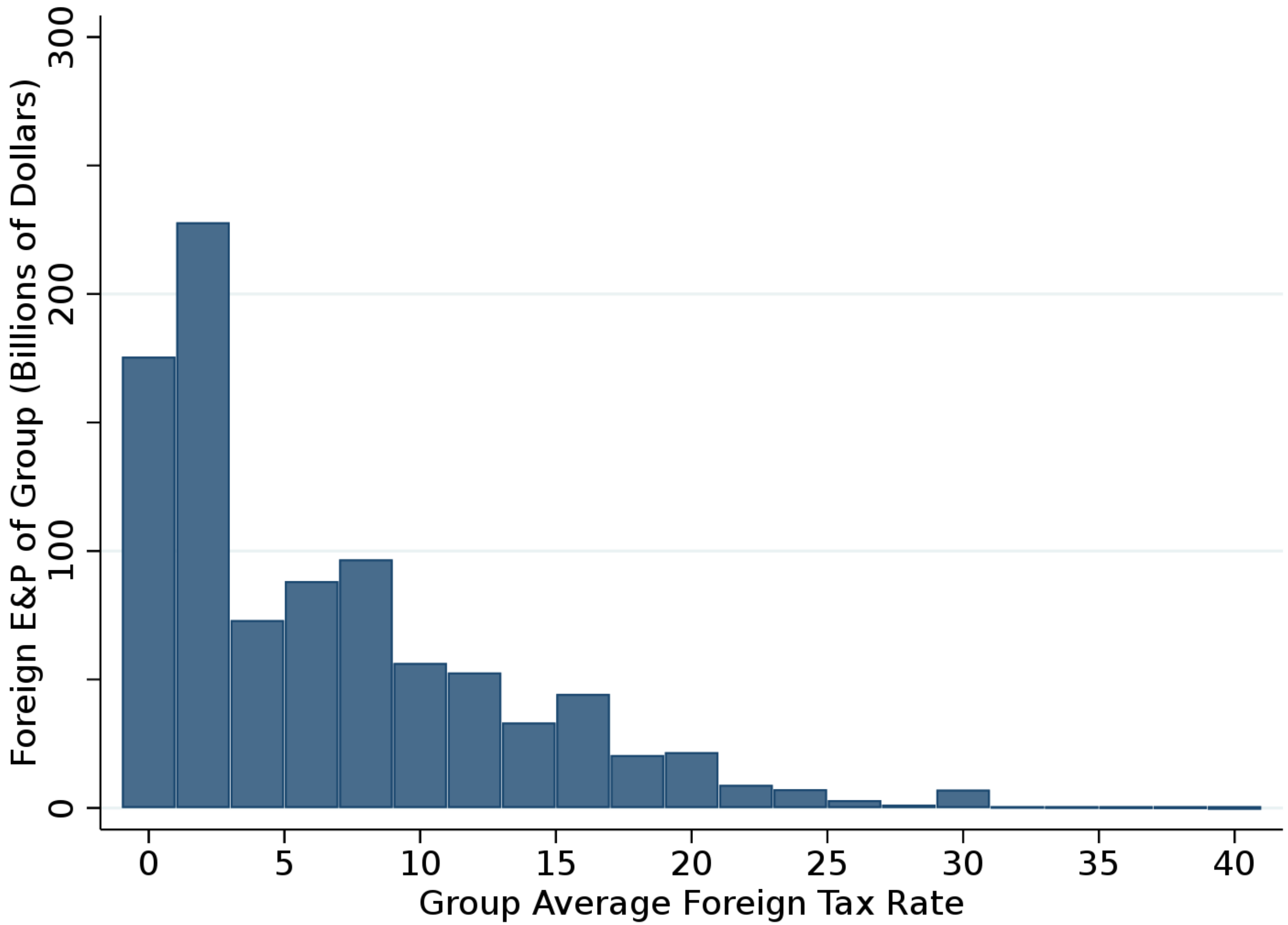
Tax Attributes of U.S. Multinational Groups and Their CFCs (Tax Year 2014)

	All Firms	Group Average Foreign Tax Rate* of: Less Than 10%	10%-21%	Greater Than 21%
	(Dollar Amounts in Billions)			
Positive E&P of CFCs	$970	$583	$252	$135
Negative E&P of CFCs	-$136	-$77	-$26	-$32
Subpart F	$78	$43	$19	$16
Total Foreign Tax	$121	$29	$41	$50
Foreign Assets	$21,672	$10,411	$7,048	$4,213
Number of CFCs	107,104	43,156	29,332	34,616
Number of Groups	14,447	8,507	1,285	4,655

Source: IRS Statistics of Income. Sample includes all firms filing Forms 1120 and 5471.

* Calculated as aggregate foreign taxes paid or accrued over E&P.

E&P of U.S. Multinational Groups by Foreign Tax Rates (Tax Year 2014)



Source: IRS Statistics of Income. Sample includes all firms filing Forms 1120 and 5471.
*Calculations exclude individual CFCs with observed tax rates greater than 40%.

Taxation of Global Intangible Low-Taxed Income

GILTI: Formula

GILTI = $\underbrace{\text{Net CFC Tested Income}}$ – $\underbrace{\text{Net Deemed Tangible Income Return}}$

= Sum of CFC Tested Income – Sum of CFC Tested Loss – [(10% × QBAI) – Certain Interest Expense]

where:

CFC Tested Income = Gross Tested Income – Allocable Deductions

CFC Tested Loss = Allocable Deductions – Gross Tested Income

QBAI = Qualified Business Asset Investment

Subpart F vs. GILTI

- GILTI is a U.S.-shareholder level amount, while subpart F income is a CFC-level amount.
- The mechanics for current U.S. taxation of GILTI rely on the rules of subpart F, even though GILTI is not a category of subpart F income.
- A GILTI inclusion is generally treated as a subpart F inclusion.
- Unlike subpart F income, no earnings and profits ("E&P") limitation exists for purposes of determining a U.S. shareholder's GILTI inclusion.

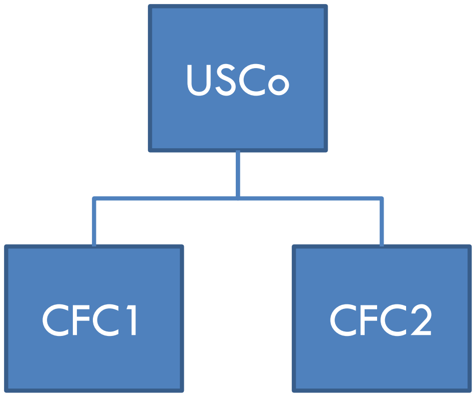
Gross Tested Income

- A CFC's **gross tested income** is its gross income determined without regard to:
  - any effectively connected income;
  - any gross income taken into account in determining subpart F income;
  - any gross income excluded from foreign base company income or insurance income because it is taxed at a foreign effective tax rate greater than 90 percent of the U.S. corporate tax rate;
  - any dividend received from a related person; and
  - any foreign oil and gas extraction income.

Tested Income and Tested Loss

- A CFC's **tested income** is the positive amount (if any) of its gross tested income less deductions (including taxes) properly allocable to such gross income.
  - A CFC with tested income is referred to as a **tested income CFC** under proposed Treasury Regulations.
- A CFC's **tested loss** is the positive amount (if any) of deductions (including taxes) properly allocable to the CFC's gross tested income less the amount of such gross income.
  - A CFC with tested loss is sometimes referred to as a **tested loss CFC** under proposed Treasury regulations.
- While U.S. shareholders may offset tested income with tested losses in computing GILTI, U.S. shareholders may not use certain other tax attributes of tested loss CFCs such as FTCs and QBAI.

Tested Income and Tested Loss: Example



	CFC1	CFC2
Gross Income	**$1,000**	**$200**
Gross Tested Income	$300	$200
Subpart F Income	$100	$0
Oil Extraction Income	$600	$0
Expenses*	**$400**	**$225**
Expenses Allocable to Gross Tested Income	$200	$225
Net Income	**$600**	**($25)**
Foreign Tax (at 20%)	**$120**	**$0**

- USCo, a domestic corporation, owns 100 percent of the outstanding stock of two CFCs, CFC1 and CFC2.
- CFC1 and CFC2 are the only CFCs with respect to which USCo is a U.S. shareholder.
- The table to the left includes more information about CFC1 and CFC2.
  - Assume that CFC1 and CFC2 each face a uniform foreign tax rate (*i.e.*, 20 percent) across all their sources of income.

*For illustrative purposes, assume $200 of CFC1's expenses are allocable to income other than gross tested income.

Tested Income and Tested Loss: Example (cont'd)

	CFC1	CFC2
Gross Income	**$1,000**	**$200**
Gross Tested Income	$300	$200
Subpart F Income	$100	$0
Oil Extraction Income	$600	$0
Expenses	**$400**	**$225**
Expenses Allocable to Gross Tested Income	$200	$225
Net Income	**$600**	**($25)**
Foreign Tax (at 20%)	**$120**	**$0**

Remember:

- CFC1 and CFC2 each face a uniform foreign tax rate of 20 percent across all sources of income.
- CFC1 paid $120 of foreign tax, but only $20 (20 percent × [$300 – $200]) would be properly attributable to tested income.

CFC1 Tested Income

	$300	Gross Tested Income
–	$200	Allocable Expenses
–	$20	Allocable Foreign Taxes
=	$80	Tested Income

CFC2 Tested Loss

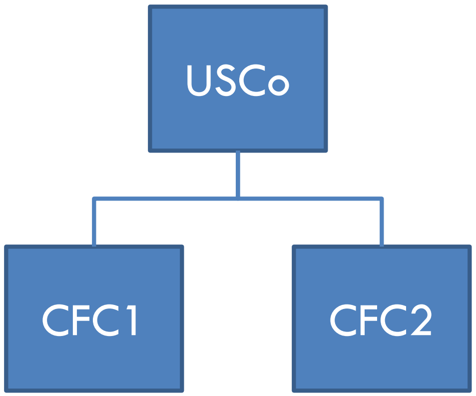
	$225	Allocable Expenses
–	$200	Gross Tested Income
=	$25	Tested Loss

Net CFC Tested Income: Definition

- **Net CFC tested income** means, with respect to any U.S. shareholder for any taxable year, the positive amount (if any) of
  - the aggregate of the shareholder's *pro rata* share of the tested income of each of its CFCs <u>less</u>
  - the aggregate of its *pro rata* share of the tested loss of each of its CFCs.

Net CFC Tested Income = Sum of CFC Tested Income – Sum of CFC Tested Loss

Net CFC Tested Income: Example



CFC1 Tested Income

= $80 Tested Income

CFC2 Tested Loss

= $25 Tested Loss

CFC1 Tested Income

	$300	Gross Tested Income
–	$200	Allocable Expenses
–	$20	Allocable Foreign Taxes
=	$80	Tested Income

CFC2 Tested Loss

	$225	Allocable Expenses
–	$200	Gross Tested Income
=	$25	Tested Loss

USCo's Net CFC Tested Income

- USCo has net CFC tested income of $55, which is USCo's pro rata share (100 percent) of CFC1's tested income of $80 less CFC2's tested loss of $25.

Qualified Business Asset Investment

- A CFC's **QBAI** is the average of the aggregate of its quarterly adjusted bases in "specified tangible property" used in its trade or business and of a type with respect to which a deduction is generally allowable under section 167 (depreciable).
  - Proposed Treasury regulations define tangible property by reference to whether the property can be depreciated under section 168 because, unlike section 167, section 168 applies only to tangible property, and there is a substantial amount of guidance delineating property subject to section 168.
- A taxpayer's adjusted basis in depreciable property generally reflects the initial basis in the property (often the purchase price) less cumulative depreciation allowances taken over time.
  - For purposes of computing QBAI, depreciation deductions are calculated using the alternative depreciation system (*i.e.*, the straight-line method).

Qualified Business Asset Investment (cont'd)

- **Specified tangible property** means any property used in the production of tested income.
- Tested loss CFCs may have a business asset investment ("BAI") but do not have tested income and, therefore, have no specified tangible property and no QBAI.

Qualified Business Asset Investment: Example

	CFC1	CFC2
CFC Tested Income / Loss	$80	($25)
BAI	$500	$600
QBAI	$500	$0

- CFC1 has tested income of $80 and QBAI of $500.
- CFC2 has a tested loss of $25 and, therefore, does not have QBAI for such taxable year.

USCo's Aggregate Pro Rata Share of QBAI

- USCo's pro rata share of QBAI is $500:

$$\begin{aligned} & 100 \text{ percent} \times \$500 \\ + \quad & 100 \text{ percent} \times \$0 \\ = \quad & \$500 \end{aligned}$$

Net Deemed Tangible Income Return

- A U.S. shareholder's **net deemed tangible income return** is the positive amount (if any) of
  - 10 percent of the aggregate of its *pro rata* share of the QBAI of each of its CFCs <u>less</u>
  - certain interest expense.

Net Deemed Tangible Income Return = [(10% × QBAI) – Certain Interest Expense]

Net Deemed Tangible Income Return: Example

	CFC1	CFC2
CFC Tested Income / Loss	$80	($25)
BAI	$500	$600
QBAI	$500	$0
Net Related-Party Interest	($100)	$100
Net Third-Party Interest*	($10)	$0

*Third-party interest expense of CFC1 is the amount of CFC1's interest expense taken into account in determining USCo's net CFC tested income for the taxable year to the extent the interest income attributable to such expense is not taken into account in determining USCo's net CFC tested income.

Net CFC Tested Income of USCo

	$80	Aggregate Tested Income
–	$25	Aggregate Tested Loss
=	$55	Net CFC Tested Income

Net Deemed Tangible Income Return of USCo

	$500	Aggregate QBAI
×	10%	Return on QBAI
–	$10	Third-Party Interest Expense*
=	$40	Net Deemed Tangible Income Return

GILTI Inclusion

	USCo
Net CFC Tested Income	$55
Net Deemed Tangible Income Return	$40

GILTI of USCo

$55 Net CFC Tested Income

– $40 Net Deemed Tangible Income Return

= $15 GILTI

GILTI and Section 250 Deduction

- Section 250(a)(1) provides that a domestic corporation is entitled to a deduction equal to the following sum:
  - 37.5 percent of its FDII, and
  - 50 percent of its GILTI inclusion and FTCs treated as deemed dividends attributable to GILTI under section 78 ("section 78 gross-up amount").
- Section 250(a)(2) provides that, if the sum of the corporation's FDII, GILTI, and section 78 gross-up amount for the year exceeds its <u>taxable income</u> for the year (not taking the section 250 deduction into account), its FDII, GILTI, and section 78 gross-up amount are proportionately reduced by that excess amount in computing the deduction for the year.
- Proposed Treasury regulations provide that <u>individuals</u> who make a section 962 election to be taxed as a corporation on subpart F and GILTI inclusions can claim the 50-percent deduction for their GILTI and section 78 gross-up amount.
- Proposed Treasury regulations also provide that a <u>corporate partner</u> can claim the section 250 deduction and adopt an aggregate approach for the partner's FDII calculation.

GILTI and Section 250 Deduction: Example

- For illustrative purposes, before taking into account FTCs and the section 78 gross-up amount, consider USCo's potential U.S. tax liability relating to GILTI.

GILTI of USCo

	$55	Net CFC Tested Income
–	$40	Net Deemed Tangible Income Return
=	$15	GILTI

- Applying section 250 to this amount would produce the following result:

USCo's Potential U.S. Tax Liability Associated with GILTI – Simplified

	$15	GILTI
–	$7.50	Section 250 Deduction (50% × $15)
=	$7.50	Income Subject to Tax
x	21%	U.S. Rate of Tax
=	$1.58	Potential U.S. Tax Liability Associated with GILTI

FTCs and GILTI: Formula

Deemed-Paid Credit =

$$
\begin{aligned}
& \text{Aggregate Tested Foreign Income Taxes} \\
\times\ & \text{Inclusion Percentage} \\
\times\ & \text{80 Percent}
\end{aligned}
$$

where:

Inclusion Percentage = GILTI/Aggregate Tested Income

FTCs and GILTI

- For any GILTI inclusion, U.S. shareholders are allowed a “deemed-paid” FTC equal to 80 percent of the aggregate tested foreign income taxes paid or accrued by their tested income CFCs, multiplied by their inclusion percentage.
  - **Tested foreign income taxes** are taxes paid or accrued with respect to tested income (but not tested loss).

FTCs and GILTI (cont'd)

- As a result, there are two limitations when calculating the deemed-paid FTC with respect to GILTI.
  - Aggregate tested foreign income taxes are multiplied by 80 percent (partial credits) rather than 100 percent (full credits).
  - This amount is multiplied by the inclusion percentage to ensure, as a general matter, that U.S. corporations do not get credit for tested foreign income taxes paid with respect to their net deemed tangible income return (which is "exempt" from tax).
- FTCs in the GILTI basket cannot be carried forward or carried back.

Treatment of GILTI under Proposed Treasury Regulations

- GILTI FTC basket contains items included under section 951A and related section 78 gross-up amount.
- GILTI FTC basket is generally treated like other baskets.
  - U.S. shareholder interest expense must be allocated.
  - In order to allocate U.S. shareholder interest expense to the GILTI FTC basket, the proposed Treasury regulations treat a portion of the CFC stock as an "exempt asset" under section 864(e)(3) by treating income offset by the section 250 deduction as "exempt income."
- Proposed Treasury regulations do not address U.S. shareholder R&E, stewardship, and/or G&A expense allocation to the GILTI FTC basket.

FTCs and GILTI: Example

	USCo	CFC1	CFC2
Net CFC Tested Income	**$55**		
Tested Income / Loss		$80	($25)
Aggregate QBAI	**$500**		
CFC BAI		$500	$600
CFC QBAI		$500	$0
Net Third-Party Interest	**($10)**		
Net Third-Party Interest		($10)	$0
Aggregate Tested Foreign Income Taxes of CFCs	**$20**		
Foreign Taxes Paid		$120	$0
Tested Foreign Income Taxes		$20	$0

Remember:

- CFC1 paid $120 of foreign tax, but only $20 (20 percent × [$300 – $200]) would be properly attributable to tested income.

GILTI of USCo

	$55	Net CFC Tested Income
–	$40	Net Deemed Tangible Income Return
=	$15	GILTI

USCo's Inclusion Percentage

	$15	GILTI
÷	$80	Aggregate Tested Income
=	18.75%	Inclusion Percentage

USCo's Deemed-Paid Credit

	$20	Aggregate Tested Foreign Income Taxes of CFCs
x	18.75%	Inclusion Percentage
x	80%	Section 960(d) Haircut
=	$3	GILTI Deemed-Paid FTCs

FTCs and GILTI: Example (cont'd)

USCo's Section 78 Gross-Up Amount

	\$20	Aggregate Tested Foreign Income Taxes of CFCs
x	18.75%	Inclusion Percentage
=	\$3.75	Section 78 Gross-Up Amount

USCo's GILTI and Section 78 Gross-Up Amount Included in Income

	\$15	GILTI
+	\$3.75	Section 78 Gross-Up Amount
=	\$18.75	

USCo's Section 250 Deduction

	\$15	GILTI
+	\$3.75	Section 78 Gross-Up Amount
x	50%	Section 250 Deduction Percentage
=	\$9.38	Section 250 Deduction

FTCs and GILTI: Example (cont'd)

USCo's Tentative U.S. Tax Liability Associated with GILTI

	$18.75	GILTI + Section 78 Gross-Up Amount
–	$9.38	Section 250 Deduction
x	21%	U.S. Corporate Tax Rate
=	$1.97	Tentative U.S. Tax Liability Associated with GILTI

USCo's U.S. Tax Liability Associated with GILTI

	$1.97	Tentative Tax Liability Associated with GILTI
–	$3	GILTI Deemed-Paid FTCs
=	$0	U.S. Tax Liability Associated with GILTI

- Note: The excess GILTI deemed-paid FTCs of $1.03 ($3 – $1.97) cannot be carried forward or back to other taxable years in order to offset GILTI tax liability in such years (and cannot be used to offset any other U.S. tax liability).

FTCs and GILTI: Modified Example

How would the result differ if CFC1 and CFC2 were subject to a foreign tax rate of 5 percent (instead of 20 percent)?

- A lower foreign tax rate would not impact the CFC2 items taken into account, but it would alter the results as it relates to the CFC1 items taken into account.
- Specifically, if CFC1 were subject to a foreign tax rate of 5 percent on $600 of net income, CFC1 would pay $30 (as opposed to $120) of foreign tax, $5 of which would be properly attributable to tested income (*i.e.*, 5 percent × [$300 – $200]).
- CFC1 tested income would increase from $80 to $95 ($300 of gross tested income – $200 of allocable expenses – $5 of allocable taxes), which in turn would cause USCo's tentative GILTI inclusion amount to increase to $30.

USCo Result Comparison		
Foreign Tax Rate	**20%**	**5%**
Net CFC Tested Income	**$55**	**$70**
CFC1 Tested Income	$80	$95
CFC2 Tested Loss	($25)	($25)
NDTIR	**$40**	**$40**
Aggregate QBAI	$500	$500
Net Third-Party Interest	($10)	($10)
Tentative GILTI	**$15**	**$30**

FTCs and GILTI: Modified Example (cont'd)

The table to the right illustrates how the foreign tax rate on CFC tested income impacts USCo's U.S. tax liability associated with its GILTI as well as the USCo Group's total tax cost with respect to the related CFC tested income.

20% Foreign Tax Rate:

- Total tax paid by the USCo Group on CFC tested income is $20, all of which is foreign tax, with no residual U.S. tax.

5% Foreign Tax Rate:

- Total tax paid by the USCo Group on CFC tested income is $10.37, $5 of which is foreign tax and $5.37 of which is residual U.S. tax on GILTI.

USCo Result Comparison		
Foreign Tax Rate	**20%**	**5%**
Tentative GILTI	**$15**	**$30**
Inclusion Percentage (GILTI / Aggregate Tested Income)	**18.75%**	**31.58%**
Deemed-Paid Credit (Agg. Tested Foreign Income Taxes x Inclusion Percentage x 80%)	**$3**	**$1.26**
Agg. Tested Foreign Income Taxes	$20	$5
Section 78 Gross-Up Amount (Agg. Tested Foreign Income Taxes x Inclusion Percentage)	**$3.75**	**$1.58**
Section 250 Deduction	**$9.38**	**$15.79**
Tentative U.S. Tax Liability	**$1.97**	**$6.63**
U.S. Tax Liability (Tentative U.S. Tax Liability – Deemed-Paid Credit)	**$0**	**$5.37**

Taxation of Foreign-Derived Intangible Income

FDII: Formula

$$\text{FDII} = \underbrace{\underbrace{\text{DII}}_{\text{DEI} - \text{DTIR}}}_{= [\text{DEI} - (10\% \times \text{QBAI})]} \times \underbrace{\text{Foreign-Derived Ratio}}_{(\text{FDDEI} / \text{DEI})}$$

where:

DII = Deemed Intangible Income = DEI less DTIR

DEI = Deduction Eligible Income

DTIR = Deemed Tangible Income Return = 10% of QBAI

FDDEI = Foreign-Derived Deduction Eligible Income

Deemed Intangible Income

- A domestic corporation's **deemed intangible income** means the positive amount (if any) of its deduction eligible income less its deemed tangible income return (*i*.e., DEI – DTIR).

Deduction Eligible Income

- A taxpayer's **deduction eligible income** is the positive amount (if any) of its gross deduction eligible income less deductions (including taxes) properly allocable to such gross income.
  - Proposed Treasury regulations provide guidance with respect to the allocation and apportionment of deductions for purposes of calculating FDII.

Deemed Tangible Income Return

- A domestic corporation's **deemed tangible income return** means an amount equal to 10 percent of the corporation's QBAI.
  - The definition of the deemed tangible income return for purposes of computing FDII mirrors the definition of the net deemed tangible income return for purposes of computing GILTI, except that interest expense is not in the formula.
  - The statutory definition of QBAI for purposes of computing FDII mirrors the definition of QBAI for purposes of computing GILTI.

Foreign-Derived Ratio

- The **foreign-derived ratio** equals the corporation's foreign-derived deduction eligible income divided by its deduction eligible income (*i*.e., FDDEI/DEI).
  - Term "foreign-derived ratio" is used in proposed Treasury regulations but is not defined in the statute.
- FDDEI/DEI is used as a proxy for determining the percentage of deemed intangible income that is foreign-derived.
  - Accuracy depends on the extent to which FDII/DII = FDDEI/DEI.

Foreign-Derived Deduction Eligible Income

- A taxpayer's **foreign-derived deduction eligible income** is its deduction eligible income that is derived in connection with:
  - property that is sold by the taxpayer to any person who is not a U.S. person and that the taxpayer establishes to the satisfaction of the Secretary is for a foreign use; or
  - services provided by the taxpayer that the taxpayer establishes to the satisfaction of the Secretary are provided to any person, or with respect to property, not located within the United States.

Foreign-Derived Deduction Eligible Income (cont'd)

- **Foreign use** means any use, consumption, or disposition that is not within the United States.
- Proposed Treasury regulations elaborate on how the definition of foreign use is applied when determining foreign-derived deduction eligible income.
  - For example, under the proposed Treasury regulations, sales to related parties can generally qualify as FDDEI sales if the related party either sells the property to an unrelated party or uses the property in a sale to an unrelated party.

Additional Considerations

- Select partnership provisions
  - Proposed Treasury regulations adopt an aggregate approach for determining a domestic corporate partner's FDII attributable to the income and assets of a partnership.
  - A partnership is treated as a person for purposes of determining whether a sale to or by a partnership or a provision of services to or by a partnership is a FDDEI transaction.
- Military sales
  - Proposed Treasury regulations provide that sales to the U.S. government for resale or on-service to a foreign government under the Arms Export Control Act of 1976, as amended (22 U.S.C. 2751 et seq.), qualify for the deduction.
- Documentation
  - Taxpayers must provide documentation regarding whether a purchaser is a foreign person, whether property is sold for a foreign use, and the location of persons to whom (or property with respect to which) the taxpayer provides services is outside the United States.
    - Specific documentation requirements vary depending on the type of property sale or services as prescribed by the proposed Treasury regulations.

FDII Example: Facts

- Assume a domestic corporation ("USCo") has $250 of gross deduction eligible income, $150 of deductions allocable to that income, and QBAI of $100 for tax year 2019.
- Assume USCo has established to the satisfaction of the Treasury that $50 of its net deduction eligible income is foreign-derived deduction eligible income.

FDII Example: Deduction Eligible Income and Deemed Intangible Income

Deduction Eligible Income		\$250	Gross Deduction Eligible Income
	–	\$150	Allocable Deductions
	=	\$100	Deduction Eligible Income
Deemed Tangible Income		\$100	QBAI
Return	×	\$10%	Rate on QBAI
	=	\$10	Deemed Tangible Income Return
Deemed Intangible Income		\$100	Deduction Eligible Income
	–	\$10	Deemed Tangible Income Return
	=	\$90	Deemed Intangible Income

FDII Example: Foreign-Derived Ratio and FDII

Foreign-Derived Ratio

	\$50	Foreign-Derived Deduction Eligible Income
÷	\$100	Deduction Eligible Income
=	\$50%	Foreign-Derived Ratio

FDII

	\$90	Deemed Intangible Income
×	50%	Foreign-Derived Ratio
=	\$45	FDII

FDII Example: FDII Tax Liability

Section 250 FDII Deduction

	$45	FDII
×	37.5%	Section 250 FDII Deduction Percentage
=	$16.88	Section 250 FDII Deduction

FDII Tax Liability

	$45	FDII
–	$16.88	Section 250 FDII Deduction
×	21%	U.S. Corporate Tax Rate
=	$5.9	FDII Tax Liability

Additional Resources

- Joint Committee on Taxation, *General Explanation of Public Law 115-97* (JCS-1-18), December 2018, pp. 368-383.
- REG–104390–18 (guidance related to global intangible low-taxed income).
- REG–104464-18 (guidance related to the deduction for foreign-derived intangible income and global intangible low-taxed income).
- REG–105600–18 (guidance related to the foreign tax credit).