International Tax Reform: You're Not in Kansas Anymore

By Kate Russell, CPA
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Tax reform has been making headlines for the past few months, but you may have overlooked the drastic changes it will have on international tax and foreign transactions. There are many significant changes that affect both individuals and businesses and it is important to understand how you may be affected.

Below are some key international highlights from the new tax law.

Informational Reporting Filing Penalty Increased

The late filing penalty for informational reporting required under IRC 6038A for U.S. Corporations has increased from $10,000 to $25,000 for taxable years beginning after December 31, 2017.

Transition Tax

There is a new, one-time tax on accumulated offshore earnings. It is required by U.S. persons or Corporations owning 10% (directly or indirectly) of a foreign subsidiary. It is effective on the foreign subsidiary's last tax year beginning before 2018, which could affect 2017 tax return filings. The taxpayer must pay a tax on the amount of post-1986 untaxed earnings, reduced by certain deficits and offset by a reduced foreign tax credit. The tax rates are 15.5% on cash and cash equivalent assets and 8% on non-cash assets. The net tax liability can be spread over a period of up to eight years.

Global Intangible Low Taxed Income (GILTI)

This new category of income ends the deferral of tax on foreign earnings. Under the new law, a U.S. shareholder of any controlled foreign corporation has to include in gross income its GILTI amount. Generally, this GILTI amount is income earned by foreign corporations in which a U.S. person owns 10% (directly or indirectly). GILTI is treated as an inclusion of Subpart F income for the shareholder. Only an 80% foreign tax credit is available for amounts included in income as GILTI.

Foreign Derived Intangible Income (FDII) Deduction

This is a new deduction that could be very beneficial for U.S. C Corporations selling, licensing, or leasing property for use outside the U.S. It is the amount of a U.S. corporation's intangible income derived from serving non-U.S. markets. Intangible income is income derived from services provided to any person not located within the U.S. or with respect to property not located in the U.S. The services may be performed within or outside the U.S., but cannot be in a foreign branch of a domestic corporation. It is in effect for taxable years beginning after December 31, 2017. It creates a 37.5% deduction for such income, yielding an effective tax rate of 13.125% (rather than 21%).

Subpart F Changes

The new law made several changes to the taxation of Subpart F income of U.S. shareholders of controlled foreign corporations. The new law expands the definition of U.S. shareholder to include U.S. persons who own 10% or more of the total value of shares of all classes of stock (not just voting shares) of the foreign corporation. In addition, the requirement that a corporation must be controlled for 30 days before Subpart F inclusions apply has been eliminated.

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Foreign Tax Credit Changes

The new law also made several changes to the foreign tax credit. It repealed indirect foreign tax credits, created a separate limitation for foreign branch income, and changed the rules for sourcing income from sales of inventory.

With these significant changes to the law, it is expected that more regulations and guidance will become available in the coming months. MichaelSilver will continue to keep you updated as important clarifications are available. If you have questions on how international tax reform affects you or your business, or if you would like to discuss tax planning strategies, please reach out to the MichaelSilver tax experts at 847-982-0333.

Kate Russell, CPA serves as a Tax Supervisor. Throughout her career, she has gained a wealth of knowledge in multiple areas of taxation and has worked primarily with business clients to formulate tax strategies. Kate received her Bachelor of Science in Business from Minnesota State University, Mankato, with a Major in Accounting.