Deloitte.

SELECTUSA®

לשכת מסחר ישראל-אמריקה
ISRAEL-AMERICA
Chamber of Commerce

U.S. Tax Reform – The Impact on U.S. and Israeli Companies

Alan Cohen, Director, U.S. Tax Leader, Deloitte
Moshe Bina, Director, U.S. Tax, Deloitte

Topics
Overview of Tax Cuts and Jobs Act
International Tax Provisions
Transition Deemed Repatriation Tax
GILTI – Global Intangible Low Taxed Income
FDII – Foreign Derived Intangible Income
Macro – Micro Considerations
Base Erosion Anti-Abuse Tax (“BEAT”)
Trap for the unwary - Downward attribution of CFC status
Interest Expense Limitation (Section 163(j))
Anti-Hybrid Provisions
Multistate Considerations
Q and A and Presenter Information

Overview of Tax Cuts and Jobs Act

Deloitte.

2017 Tax Reconciliation Bill
Business taxation

	Previous law	New law	Notes & observations
Corporate income	35% top rate	21% flat rate, effective for tax years after 12/31/17	Higher than President Trump's proposal of 15% or either chamber's initial 20% rate
Corporate dividends received deduction	70% deduction; 80% if received from 20%-owned corporation	Reduced to 50% deduction and 65% deduction	
Corporate AMT	20% on alternative minimum taxable income	Repealed • Credit available to offset regular tax liability for any taxable year • AMT credit refundable for any taxable years 2018-2021 at 50% (100% beginning in 2021) of the excess of the AMT credit for the year over the amount of the credit allowable for the year against regular tax liability	With corporate income and AMT rates both set at 20% in Senate bill, taxwriters belatedly realized AMT would be the default tax system for many companies, eliminating their ability to claim many credits, including for R&D.
Manufacturing deduction (§199)	9% deduction on lesser of qualified production activity income or taxable income	Repealed	
Net operating loss deduction	2-year carryback and 20-year carryforward allowed to offset taxable income	Limited to 80% of taxable income deductible • Repeals carrybacks except for small businesses and farms in certain casualty and disaster situations • Carryforward period made indefinite	• Lower than House-proposed 90% limitation • Property and casualty insurance companies exempt from changes • Carried forward NOLs not increased for inflation as in House version

Notes: These are general summaries, and many of the provisions include exceptions and effective dates that should be read carefully. Unless otherwise stated, provisions are generally effective for tax years beginning after 12/31/17.

Deloitte.

2017 Tax Reconciliation Bill

Business taxation (cont.)

	Previous law	New law	Notes & observations
Capital expensing	MACRS/ADS with bonus depreciation, or accelerated use of AMT credits; additional first-year depreciation deduction allowed equal to 50% of adjusted basis of qualified property acquired and placed in service before 1/1/20, with phase-down for most property placed in service after 12/31/17	100% immediate expensing for qualified property through 2022, then phased down each year through 2026 (2023 = 80%, 2024 = 60%, 2025 = 40%, 2026 = 20%) • Modified rules for longer production period property and certain aircraft	Applies to new and used qualified property • acquired and placed in service after 9/27/17 • Exemption for real estate and certain public utilities • Generally exempts business with retail floor planning indebtedness
§179 expensing	Allows current deduction for eligible property; $500k limit in a given year, phased out when cost of qualifying property >$2M	Increases maximum amount of deduction to $1M and raises phaseout threshold to $2.5M • Expands definition of eligible property	
Business interest payments	Generally deductible, with some limits in Section 163(j)	Limited to business interest income + 30% of EBITDA through 2021, then 30% of EBIT • Indefinite carryforward for disallowed amounts	• Switches from House limitation to Senate limitation after 2021 • Exemption for real estate and certain public utilities, and for retail floor planning indebtedness • Exemption for businesses <$25M avg. annual gross receipts • A second worldwide test limiting interest deductibility, in the earlier House and Senate bills, was not included
Like-kind exchanges	No gain or loss recognized for wide range of property held for productive use or investment; different classes of property include (1) depreciable tangible personal property; (2) intangible or nondepreciable personal property; and (3) real property	Allowed only for real property	Exchanges of personal property permitted to be completed if begun before 12/31/17

Deloitte.

2017 Tax Reconciliation Bill

Business taxation (cont.)

	Previous law	New law	Notes & observations
Passthrough income	Taxed at owner's individual rate	20% deduction for qualified business income through 2025, limited to greater of a) 50% of W-2 wages, or b) 25% of W-2 wages + 2.5% of capital assets • Specified personal services businesses not eligible, except for taxpayers with taxable income <\$157,500/\$315,000 (deduction phased out over next \$50k/\$100k) • Taxpayers with taxable income <\$157,500/\$315,000 not subject to wage limitation (limitation phased in over next \$50k/\$100k)	• Generally follows Senate approach but decreases deduction from 23%; when new lower top individual rate taken into account, passthrough rate is approximately equivalent to Senate-passed provision • First time that passthrough entities will be separated from individual rate schedule • Personal services businesses include healthcare, law, consulting, accounting, athletics, financial services, brokerage services, investing, investment managements, or any business where the principal asset is the reputation or skill of its employees or owners; it does not include engineering or architecture services, as in earlier proposals • Personal services business and wage income limitation significantly lowered from Senate proposal in attempt to minimize loophole for high-income individuals • Trusts and estates eligible • Expands eligibility restrictions from Senate bill to make deduction more valuable to capital intensive businesses, such as real estate • Special rules apply to certain income from PTPs and dividends from REITs

2017 Tax Reconciliation Bill
International taxation

	Previous law	New law	Notes & observations
International taxation	Worldwide regime with deferral and foreign tax credit offsets	Generally, almost full inclusion regime (at discounted rates) with 100% dividends received deduction • Available only to corporations	Generally ends use of foreign tax credits
Foreign-held earnings & profits	US tax deferred until repatriated	Deemed repatriation of previously untaxed post-1986 E&P at rate of 8% (non-cash) or 15.5% (cash & equivalents) • Applied to E&P as of 11/9/17 or 12/31/17, whichever is higher • Payable over 8 years • Claw-back of rate reduction if company inverts within 10 years after bill enactment	• Higher tax rates than in either House or Senate bill • Includes special rules for S corporations and REITs
Intangible property	N/A	20% tax on foreign-derived intangible income (FDII) with 37.5% deduction through 2025, then 21.875%	
"Base-erosion prevention" measures	Subpart F rules limit deferral for certain types of passive and mobile income	21% tax on "global intangible low-taxed income" (GILTI) with 50% deduction through 2025, then 37.5%	Follows Senate approach
		10% "minimum tax" on taxable income in excess of deductible payments to related foreign parties • Deduction denied for interest or royalties paid on certain hybrid transactions if no corresponding inclusion to related party or if related party is allowed deduction	Generally follows Senate approach

Deloitte.

Regulations on the horizon

- Quick Legislation Process

- Uncertainty in the market

- More formal regulations are anticipated in the near future.
- "Hot button" topics include:
  - **Transition Tax - Deemed Repatriation**
  - **GILTI**
  - **BEAT**
  - **Interest Limitations**
  - **Downward Attribution**
  - **Anti-Hybrid Provisions**

Clarifications On Tax Reform Will Come, Officials Say

By **Natalie Olivo**

Law360, New York (January 25, 2018, 8:59 PM EST) -- The recently enacted U.S. tax legislation has created new baskets of foreign income that don't always match up with the mechanics of the current tax system, and government officials hinted Thursday at upcoming corrections and clarifications for the law.

Dana L. Trier, a deputy assistant secretary of tax policy at the Treasury, spoke in a panel later during the conference about the department's overall approach to the tax law in its entirety, saying that one priority for guidance is IRC § 163, which covers how interest expense deductions are applied and limited at the partnership level.

"I think the answer is there's going to be a whole lot of regulations and guidance occurring, and it's going to be relatively expansive, and it's going to try to fix the disparity and these issues as much as we can," Trier said.

Multinational Corporations

Treasury Uncertain About Stock Attribution Relief for Repatriation

By Alison Bennett

The Treasury Department is still trying to determine whether it has the authority to p
relief from the impact of newly expanded stock attribution rules on U.S. multinational
companies that now have to bring home their accumulated overseas earnings and pro
Treasury official said.

International Tax Provisions

Transition Deemed Repatriation Tax

Transition deemed repatriation tax

- Under tax reform, the United States is moving from a system whereby foreign earnings were generally taxed upon receipt of a dividend (deferral) to a system whereby, for most US MNCs, a significant portion of foreign earnings will be included on a US tax return currently

- The transition tax is required to transition to the new system. The transition tax requires 10% direct and indirect shareholders to pay tax on the amount of post- 1986 untaxed earnings (reduced by certain deficits and offset by a reduced FTC) at a reduced rate of tax

- Corporate transition tax rate:

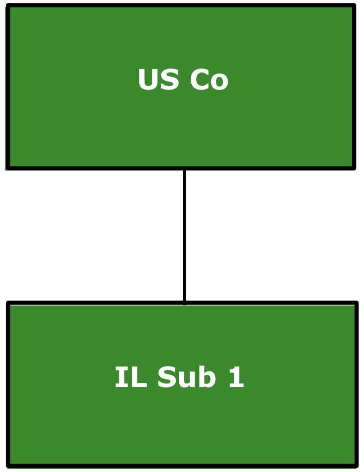
  – 15.5 percent on cash and cash-equivalent assets; and

  – 8 percent on non-cash assets

- There is an election to pay the transition tax in increasing installments over eight years

Transition deemed repatriation tax example

Basic structure



Deloitte.

Transition deemed repatriation Tax example

Analysis

	Accmulated E&P	Tax Pool
IL Sub 1	1,200.00	130.00
Total	1,200.00	130.00

Aggregate Cash	12/31/2015	12/31/2016	FY15-16 Average	12/31/2017	
A/R Net of A/P	1,000.00	500.00	750.00	1,100.00	
Aggregate Cash	100.00	100.00	100.00	100.00	E.g., stocks, bonds, Treas. bills, bank certs. of dep., bankers' acceptances, corp. comrcl. paper
Equivalents	-	-	-	-	& other money mkt. instruments
Aggregate Cash Balance	1,100.00	600.00	850.00	1,200.00	

Cash Balance (higher of average of 12/31/15 1,200.00 and 12/31/16 balance, or 12/31/17 balance)

Residual 1,200.00

Total E&P

Transition deemed repatriation Tax example

Analysis (cont.)*

Total E&P Inclusion	1200.00	Step 1: Determine E&P
Deduction Allowed for Cash	-668.57	Step 2A: Calculate Deemed Deduction for Cash
Deduction Allowed for Non-Cash	0.00	Step 2B: Calculate Deemed Deduction for Non-Cash
Subtotal	531.43	Step 3: Determine Inclusion
Section 78 Gross-Up for Cash	57.59	Step 4A: Calculate Gross up by Cash Tax Credit
Sec. 78 Gross-Up for Non-Cash	0.00	Step 4B: Calculate Gross up by Non-Cash Tax Credit
Total Taxable Income	589.02	Step 5: Determine Taxable Income
Tax at 35%	206.16	Step 6: Determine Tax at 35%
Foreign Tax Credit	-57.59	Step 7: Reduce by FTC
Net Tax	148.57	Net Tax
ETR	12.4%	

Section 78: Any taxes deemed paid by a domestic corporation for the taxable year generally needs to be included in the gross income of such corporation for such year.

*Please note that this example assumes a calendar year taxpayer

GILTI–Global Intangible Low-Taxed Income

Deloitte.

GILTI–Global Intangible Low-Taxed Income

- GILTI is a new category of income that ends the deferral of taxation on a significant portion of foreign earnings. Under the GILTI regime, for many US MNCs a significant portion of foreign earnings are now taxed currently at a reduced rate

- GILTI income is generally income earned by foreign corporations in which a US person owns 10 percent (directly or indirectly). The income, minus a specified tangible property return, is included in the income of the US shareholders. A US domestic corporation shareholder will generally be able to take a deduction on the GILTI amount and is entitled to a reduced foreign tax credit

  - **The deduction is 50 percent of the GILTI amount, limited to taxable income, from 2018 to 2025, and 37.5 percent starting in 2026**

  - When combined with the 21 percent corporate income tax rate, the effective US tax rate on GILTI is 10.5 percent for the years 2018 through 2025 and

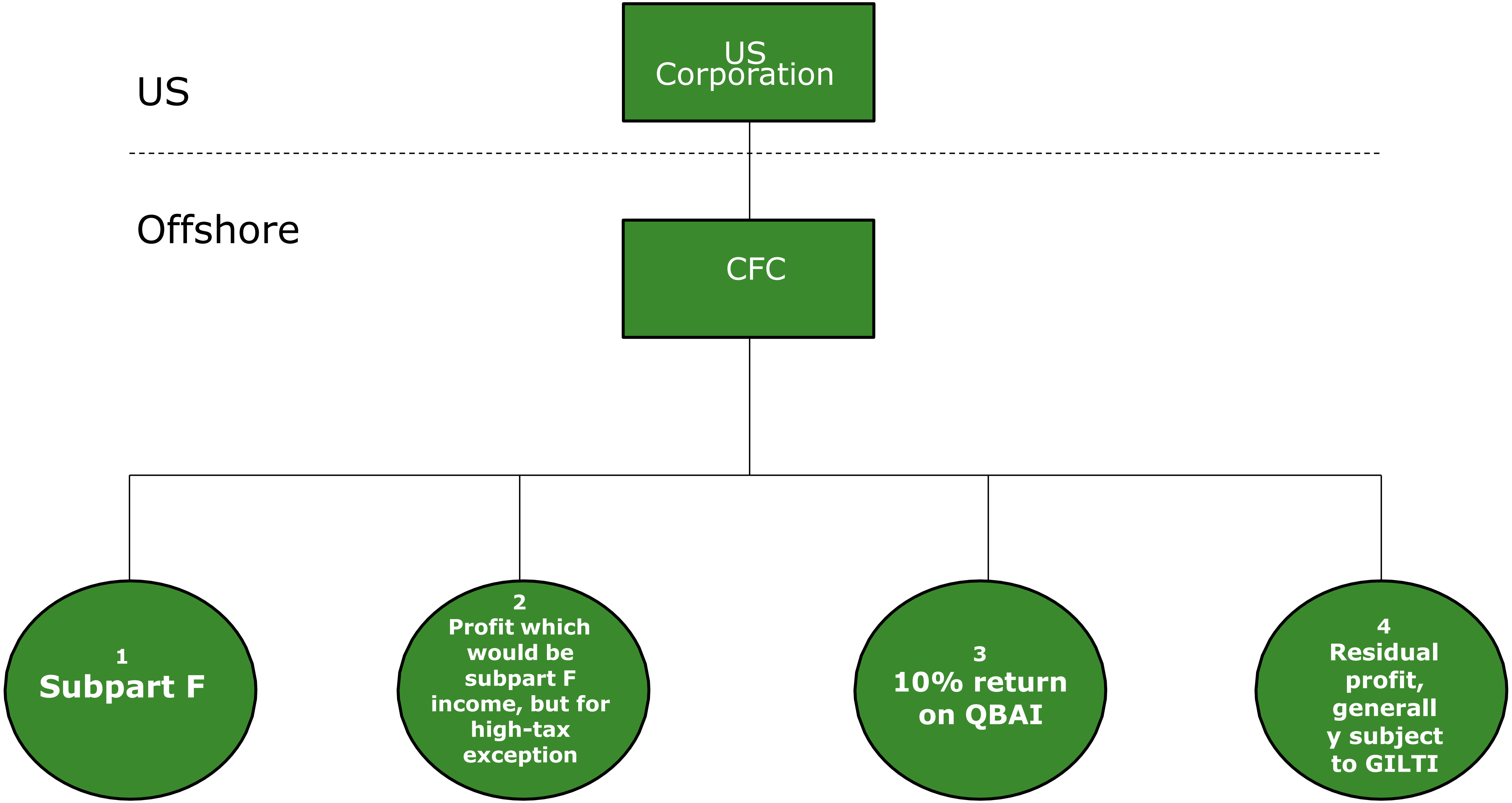
    13.125 percent starting in 2026, minus a reduced foreign tax credit

GILTI–Global Intangible Low-Taxed Income (Cont.)

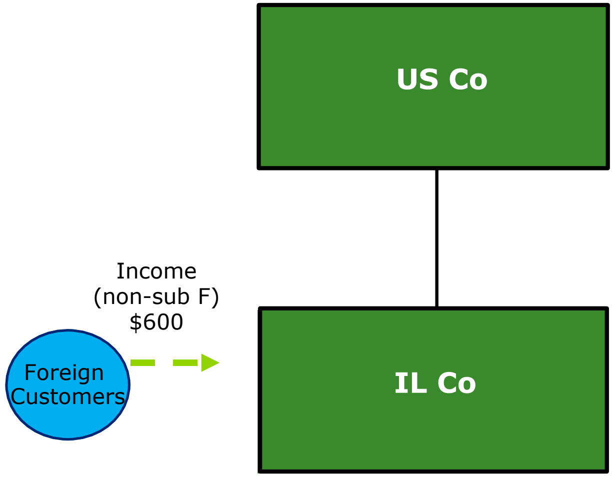
- Many new terms of art have been created for the GILTI calculation, and the calculation itself is complicated
- The core of the GILTI calculation is to start with the foreign corporation's gross income (excluding certain items) and then to reduce that gross income by the foreign corporation's deductions, including taxes
  - The remainder is then reduced further by a deemed 10 percent return on the tax basis of depreciable tangible property (minus any relevant interest expense). This final amount is the GILTI amount included in income by each US shareholder of the foreign corporation
  - The tax liability resulting from the GILTI inclusion is reduced by a 50 percent deduction before 2025 and a 37.5 percent deduction minus a reduced foreign tax credit

Deloitte.

GILTI – Overview of Relevant Earnings



GILTI example



<u>IL Co</u>
Gross Income: $600
Taxes: $75
Tangible Asset Basis: $0

*** No expenses other than interest expense and taxes**

GILTI calculation

Global Intangible Low Taxed Income

- Net IL Co tested income: $525

IL Co tested income: $525

$600 Gross Income
\- <u>$75</u> Allocable deductions and taxes
$525

- GILTI: $525 – ($0 Tangible Asset Basis) = $525

FTC calculation

- Inclusion percentage: $525/$525 = 1
- Aggregate taxes: $75 + $0 = $75
- Deemed paid credit: 80% * 1 * $75 = $60
- §78 gross-up: 100% * 1 * $75 = $75

Total §951A Inclusion

- Grossed-up GILTI: $525 + $75 = $600
- Less deduction for foreign-derived intangible income: $600 * 50% = $300

<u>Scenario 1</u> US taxpayer WITH Foreign Tax Credit limitation	**<u>Scenario 2</u>** US taxpayer with NOLs
Residual US tax	**Residual US tax**
$600 – $300 = $300 $300 * 21% = $63	$600 * 21% = $126
Less FTC = $60	**Less FTC = $0**
Residual Tax = $3	Residual Tax = $126

Key takeaway

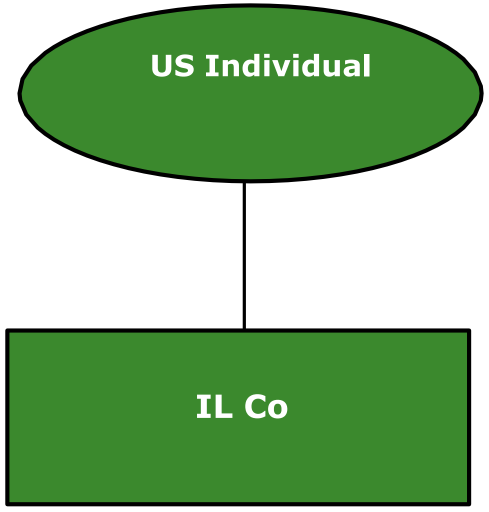
Taxpayer's foreign tax credit position can have a profound impact on the application of GILTI. Consider the following scenarios:

- US NOLs
- Individual taxpayers

Deloitte.

US taxation of GILTI

Individual and Section 962(b) election
(applicable to many individual dual US/Israeli citizen holders of shares in CFCs)



IL Co
Gross Income: $100 Foreign Rate: 13.125%
QBAI: $0

Residual US tax calculation WITHOUT Section 962(b) election

US individual

- Net IL Co tested income: $100 IL Co gross income - $13.125 foreign taxes = $86.675
- GILTI: $86.675
- § 960 deemed paid taxes and § 78 gross-up: N/A for individuals

- Residual US tax
  - No 50% GILTI deduction
  - US tax: 37%* x $86.675 GILTI = $32.07
  - Global ETR on GILTI = 45.2%

*Assumes highest marginal tax rate

Residual US tax calculation WITH Section 962(b) election

US individual

- Net IL Co tested income: $100 - $13.125 = $86.675
- GILTI: $86.675
- Deemed paid taxes: 80% x 100% x $13.125 = $10.50
- § 78 gross-up: 100% x 100% x $13.125 = $13.125
- Total inclusion: $100 ($86.675 GILTI + $13.125 § 78 gross-up

- Residual US tax (assumes no 50% GILTI deduction)
  - US tax before FTC: 21% x $100 = $21
  - FTC: $10.5**
  - Residual US tax: $10.5
  - Global ETR on GILTI (before repatriation): = 23.625% (i.e., more than the 13.125% global ETR for a domestic corporation eligible for the deduction)

**Assumes no expenses allocated and apportioned to the GILTI basket

Key takeaways

- US individuals are not eligible for § 960 deemed paid credit associated with GILTI or the 50% GILTI deduction under § 250.
- Consider making a section 962(b) election to mitigate the U.S. tax on a GILTI inclusion. In such case, a U.S. individual should be taxed at the corporate income tax rate on his or her GILTI, and may be eligible for the 80% deemed paid credit under § 960(d).
  - Query whether the § 962(b) election results in eligibility for individuals to apply the 50% deduction under § 250. If a U.S. individual is not eligible for the 50% GILTI deduction, the U.S. residual tax threshold on GILTI would be 26.25% (= 21% / 80%).

Deloitte.

Territorial system vs. full inclusion system (with foreign tax credits)

- Potential impact of the GILTI regime?
  - In many cases, calculation of GILTI as a residual will effectively mean that US has abandoned deferral.
  - Instead adopted a full inclusion system with foreign tax credits.
- Lee Sheppard, Tax Notes:
  - "Congress repealed deferral without telling you. Deferral applies only to a narrow little slice of foreign income that is attributable to depreciable tangible assets."

Deloitte.

GILTI: impact of Foreign Tax Credits

- Next 8 years: effective US tax rate on GILTI, before considering foreign tax credits, might be 10.5%
  - Due to the 100% inclusion of GILTI in gross income and a 50% deduction for that same amount
- 80% cap on foreign tax credits
  - E.g., if the CFC has paid 5% tax on GILTI, US corporation can claim a Foreign Tax Credit of only 4%, leaving it to pay US tax of 6.5%
- If foreign tax rate is higher than 13.125%, there will be excess credits, which will be wasted (no carry forward)

Deloitte.

GILTI – Overview of Relevant Earnings

- GILTI: impact of limited taxable income
  - Effective US tax rate on GILTI can be increased by an additional 10.5%, up to the full US tax rate of 21% (if US corporation derives insufficient taxable income)
    - Reduction in amount of GILTI deduction
    - 100% immediate expensing of qualified property placed in service after September 27, 2017 and before 2023

FDII–Foreign-Derived Intangible Income

Deloitte.

FDII–Foreign-Derived Intangible Income

- FDII is a new type of income category for US corporations
- Many new terms of art have been created for the calculation of FDII, and the calculation itself is complicated
- FDII is income derived from:
  - Sales or other dispositions of property to a foreign person for a foreign use;
  - A license of IP to a foreign person for a foreign use; and
  - Services provided to a person located outside of the United States.
- Special rules apply to related-party transactions, but many related-party transactions are likely to qualify if the property or services is for use by a third party outside the United States

Deloitte.

FDII–Foreign-Derived Intangible Income (Cont.)

- US corporations are required to include FDII in gross income but then will be allowed a deduction on the FDII
  - From 2018 through 2025, the deduction is 37.5 percent, and starting in 2026 it is 21.875 percent.
  - When combined with the 21 percent corporate income tax rate, the effective US tax rate on FDII is 13.125 percent for 2018 through 2025 and 16.406 percent starting in 2026.
- The deduction is available for US corporations owned by non-US MNCs.

Consider:

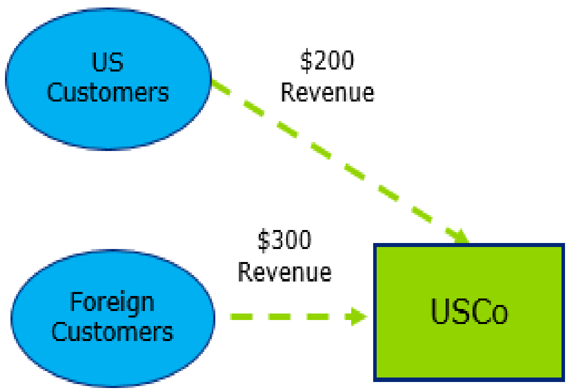
- Is FDII compliant with BEPS action 5 on harmful tax practices?
- Does FDII breach the WTO rules in regard to export subsidies?

Deloitte.

FDII example

Basic facts

	USCo P&L
Sales of Products for use in the US	200.0
Sales of Products for use outside the US	300.0
Total Deductible Eligible Revenue	500.0
Cost of Goods Sold	100.0
Gross Profit	400.0
Allocable Deductions including Interest	100.0
Potential FDII Eligible Income	300.0
Other Income / (Deduction) for non-FDII Eligible Activities	0.0
Taxable Income	300.0
Identify QBAI and reduce by routine return of 10% (here 0)	(0)
Allocate Cost of Goods Sold to FDII eligible income	60
Allocate deductions to FDII eligible income	60
FDII	180
FDII Deduction Factor/FDII Deduction	37.5%/67.5
Adjusted Taxable Income	232.5
Tax Rate	21%
Tax	48.82
USCO ETR	16.27%



Macro – Micro Considerations

Potential Macro Implications

- Tax incentive for an Israeli corporation?
- The available preferential rates in Israel are 12% and 7.5%
- Assume:
  - The Israeli company does not derive subpart F income and is not a manufacturer (therefore relatively low QBAI)
  - All of the subsidiary’s profits constitute GILTI
  - What would be the aggregate effective tax rate on the Israeli company’s profits?
- For example:
  - If tax incentive rate = 0%, then the US ETR would be 10.5%, and the aggregate ETR would be 10.5%
  - If the incentive rate = 5%, US would give a foreign tax credit of 4% (after applying the 80% cap). The US ETR would be 6.5% (10.5-4), whereas the aggregate ETR would be 11.5% (5 + 6.5).

Deloitte.

GILTI – Local Incentive Rates

Local Rate	US Effective Tax Rate	Aggregate Effective Tax Rate
23% (Israel standard rate)	0%	23%
12% (first Israel incentive option)	.9% (10.5-9.6 after applying 80% FTC cap)	12.9%
7.5% (second Israel incentive option)	4.5% (10.5-6, after applying 80% FTC cap)	12%

Deloitte.

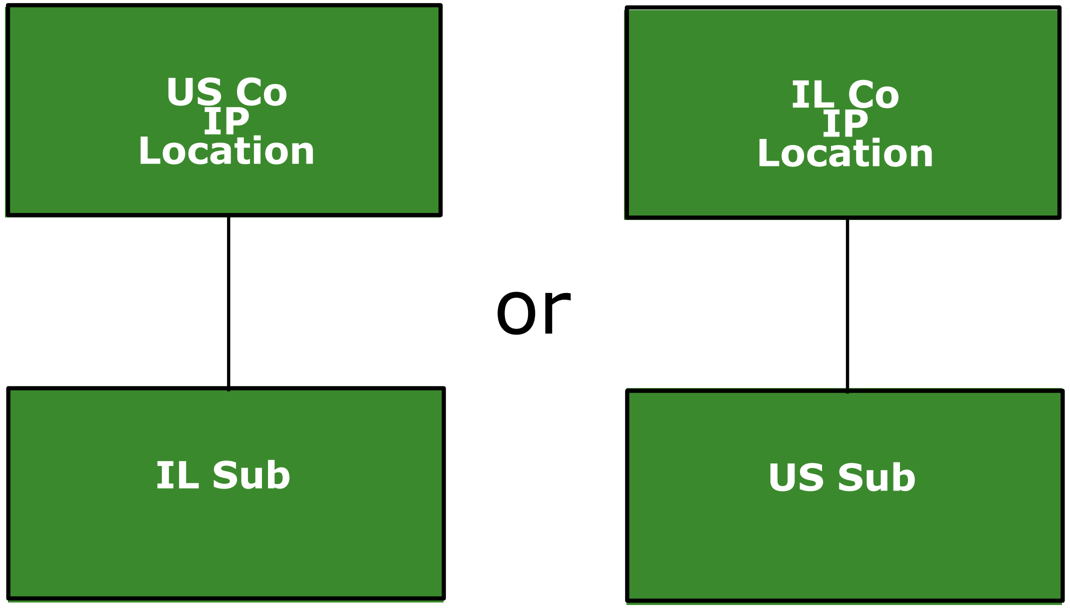
Now what - How do foreign countries react?

- Rethink incentives
  - Grants?
  - Other incentives?
  - Outside of the box thinking is necessary – time for new ideas

Deloitte.

Corporate Structuring Considerations

- IP Location?
  - For startups
  - For mature companies
  - Consider exit implications on sale to US buyer
- Do we now have new answers?



Base Erosion Anti-Abuse Tax (“BEAT”)

Deloitte.

Base Erosion Anti-Abuse Tax (BEAT)

Overview

Element	BEAT
US tax	**Applicable taxpayer** pays **Base Erosion Minimum Tax Amount** (BEMTA) if: ▪ **10%** of its **modified taxable income (5% for taxable years beginning in 2018)** exceeds ▪ its regular tax liability (reduced by credits other than (1) §41(a) research credits and (2) a portion of "applicable section 38 credits" equal to 80% of "applicable section 38 credits" or the BEMTA determined without such credits).
Applicable taxpayer	Corporations (excluding RICs, REITs, and S corps)
Taxable base	**Modified taxable income**: **Taxable income** determined without regard to— ▪ **Base erosion tax benefits** with respect to **base erosion payments** – Amounts paid or accrued to a foreign related party (generally, 25% "relatedness"), including in connection with the acquisition of depreciable/amortizable property – Amounts constituting a reduction in gross receipts paid or accrued to a related **surrogate foreign corporation** or a foreign member of the surrogate foreign corporation's expanded affiliated group (applies to 60-80% inversions post-11/9/17) – **Excludes:** ◦ Base erosion payments taxed at 30% under §§871 or 881 ◦ No-markup services, if certain requirements in §482 met ◦ Certain qualified derivatives ▪ Base erosion percentage of any NOL

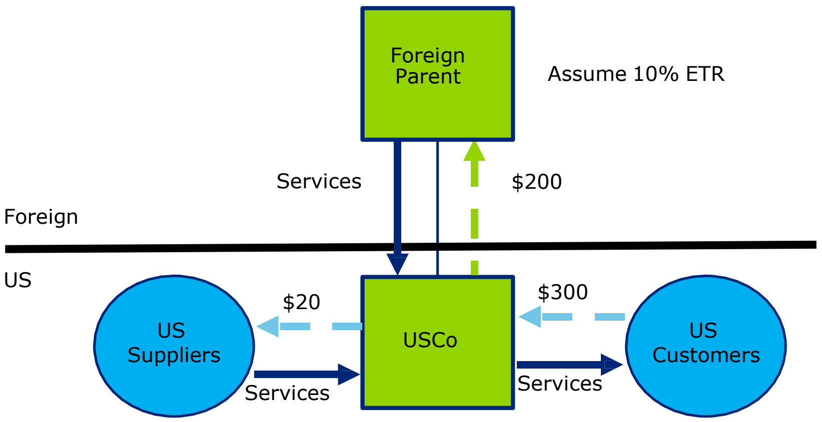
Deloitte.

Base Erosion Anti-Abuse Tax (BEAT)
Overview (cont)

Element	BEAT
Safe harbor	• 3-year average annual gross receipts (including those of related domestic corps and ECI of foreign corps) of $500 million or less • Base erosion percentage (ratio of base erosion tax benefits to all deductions excluding deductions allowable under §§172, 245A, and 250, and deductions with respect to certain at-cost service payments and qualified derivative payments excepted from BEAT) of **less than 3% (2% for banks)** for the taxable year
Foreign tax credit	N/A
Observations	▪ **Interaction** with GILTI and ECI under § 882 could give rise to double ***US*-taxed payments** ▪ **Financial transactions** *could* qualify as base erosion payments to the extent such transactions fail to qualify for the qualified derivatives exception ▪ If taxpayer's regular tax liability is reduced more than **50% by credits** or if taxpayer's taxable income is reduced more than **50% by base erosion payments**, BEAT may impose additional tax ▪ COGS not included in base erosion payments ▪ Application to taxpayers with large NOLs

Deloitte.

BEAT example



Legal Title Passage

Related Party Payment

Third-Party Payment

* For purposes of the BEAT computation, assume that:

(1)USCo qualifies as an Applicable Taxpayer; and

(2)The $200 payment for services by USCo is a payment for which a deduction is allowed in the taxable year.

BEAT

- Base Erosion Tax Benefit: $200
- 3% Safe harbor: Does not qualify
  - USCo base erosion percentage: 90.9%

    $200 / $220 = .909 or 90.9%

- BEMTA =

  Modified taxable income * 10% – (Regular tax liability (“RTL”) – Non-R&E credits)

  - MTI: $280

    $300 Gross income

    \- $20 Deductions (without regard to any base erosion tax benefit)

    $280

  - RTL: $16

    $300 Gross Income

    \- $220 Deductions

    $80

    x 21% Corporate Rate

    $16.8

Residual US tax

- $280 * 10% = $28
- Less RTL = $16.8
- BEMTA = $11.2

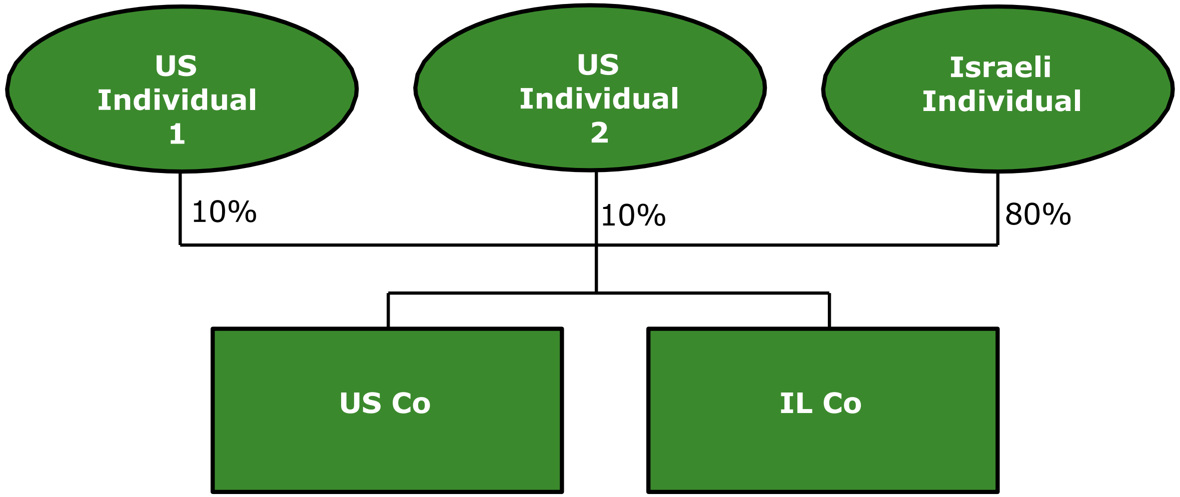
Key takeaways

- Total US tax of $28
- Additional U.S. taxable income would be taxed at 10% on the margin
- Deferral of expenses to increase U.S. taxable income would give rise to a DTA at 21%

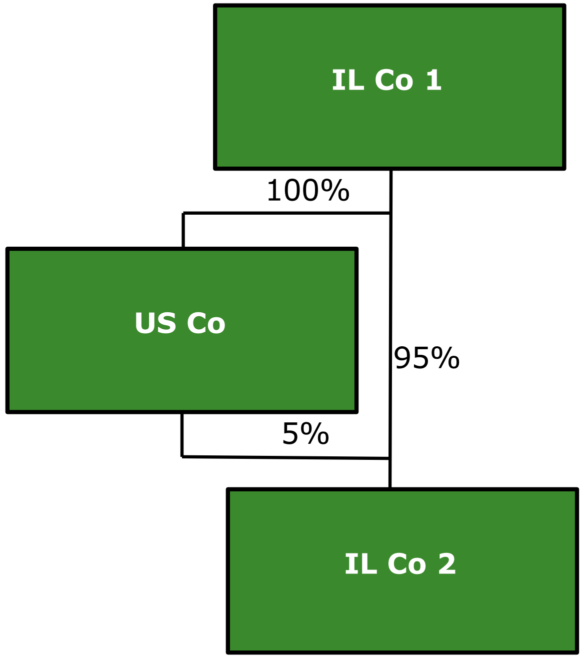
Trap for the unwary
Downward attribution of CFC status

Deloitte.

Downward Attribution



IL Co is considered a CFC, due to the attribution rules of Sec. 318, combined with the CFC provisions of Sec. 957. Moreover, US Individuals 1 and 2 are exposed to Subpart F, GILTI and Deemed Repatriation Tax (for 2017 E&P).



IL Co 2 is considered a CFC, due to the attribution rules of Sec. 318, combined with the CFC provisions of Sec. 957. Moreover, US Co is exposed to Subpart F, GILTI and Deemed Repatriation Tax (for 2017 E&P).

- New constructively owned CFCs
- Change is effective for last tax year beginning before January 1, 2018. Thus calendar year taxpayers impacted could be subject to transition tax for earnings of entities that were not CFCs previously.

Interest expense limitation (§163(j))

Interest expense limitation (§163(j))
Overview

- For every business (regardless of form) deduction for **business interest** limited to:
  - **Business interest income + 30% of adjusted taxable income (ATI)**
- **Business interest:** interest paid or accrued on indebtedness allocable to a trade or business
- **Adjusted taxable income (ATI):** taxable income computed without regard to—
  - Items (income, gain, deduction, or loss) not allocable to a trade or business
  - Business interest or business interest income
  - The bill's deduction for certain pass-through income
  - NOL deductions
  - Depreciation, amortization, or depletion **for taxable years beginning before January 1, 2022**
- Disallowed interest to be carried forward indefinitely
- **Limitation does not apply if the taxpayer's three-year annual average gross receipts does not exceed $25 million (aggregation rules apply).**
- **At taxpayer's election, limit does not apply to interest of a real property trade or business ("RPTOB"). If election is made, it is irrevocable and ADS depreciable life must be used for real property and qualified improvement property.**
    - RPTOB includes any real property development, redevelopment, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business (including lodging and senior living).

Deloitte.

Interest expense limitation (§163(j))

Application to pass-through entities

- No carryforward of excess limit
- Appears that existing disallowed interest expense will carry forward to new §163(j) regime
- Applies to partnerships at entity level
- Interest limitation **applies at the entity level** to limit partnership interest expense deductions (interest expense allowed is part of non-separately stated partnership income or loss)
- Partner adjusted taxable income (ATI) does not include distributive share of partnership income, except for the partner's share of "**excess taxable income**"
  - Avoids double counting ATI but allows partner to deduct more business interest if the partnership could have deducted more business interest
- It appears, but it is not entirely clear, that the interest expense that is allowed at the partnership level and allocated to partners is not retested at the partner level
- Partnership allocates "**excess business interest expense**" to partners in the year of disallowance (reducing outside basis):
  - Treats the excess as paid or accrued by the partner in succeeding years in which (and to the extent) the partner is allocated excess taxable income (unlimited carryforward)
  - Partner allowed to deduct excess business interest expense in succeeding year when allocated excess taxable income from the partnership
  - **Outside basis is increased for unused excess business interest expense upon disposal** or transfer and unused excess business interest expense does not carryforward further

Deloitte.

Interest deduction limitation
Comments

Calculation/planning considerations:

- Increased business interest income can “free up” otherwise disallowed interest;
- Increased ATI generally not a one-for-one offset against disallowed interest, only 30% (but consider shift of ATI not fully subject to U.S. tax, *e.g.*, due to lack of TI or foreign tax credits); Inbounds could benefit from combined group rules;
- The Conference Bill does not take into account depreciation, amortization, and depletion (temporary) in determining ATI for tax years beginning before 2022; as such, there is no incremental detriment by benefiting from immediate expensing under the TCJA until 2022 year;
- Compare NOL deduction (unlimited carryforward, limited to 80% of taxable income) with the disallowed interest carryforward (unlimited carryforward, no limit on TI utilization), and consider that utilized interest expense may be converted – in effect – to an NOL deduction (*e.g.*, in certain situations where ATI > TI due to NOL deduction or depreciation, amortization, and depletion);
- Application of consolidated return rules; and
- Special pass-through rules apply for corporate partners.

Deloitte.

Business interest expense limitation—section 163(j) (Corporate taxpayer, all items properly allocable to trade or business)

Section 163(j)		
Taxable income (loss)	$ 100.0	$ 100.0
Exclude interest income	(15.0)	(15.0)
Add back interest deduction	70.0	70.0
Add-back amortization and depreciation	55.0	
Adjusted taxable income (ATI)	**$ 210.0**	**$ 155.0**
	30%	30%
30% of ATI	**$ 63.0**	**$ 46.5**
Allowable interest deduction (30% of ATI + int. income)	**$ 78.0**	**$ 61.5**
Disallowed interest expense – section 163(j)	**0.0**	**$ 8.5**

Business interest expense limitation	Public Law No: 115-97 (tax years beginning before 1/1/22)	Public Law No: 115-97 (for tax years beginning on or after 12/31/21)
Net interest expense	55.0	55.0
Disallowed interest deduction	0.0	8.5
Carryover period	Indefinite	Indefinite

Deloitte.

Attributes: NOLs and Disallowed Interest Expense

Disallowed interest expense under section 163(j) is a tax attribute similar to an NOL.

	NOLs	New Section 163(j) Disallowed Interest
C/F and C/B Periods	Under the Act, generally indefinite carryforward and no carryback (exception for P&C insurance companies).	Indefinite carryforward and no carryback. A carryforward of disallowed interest treated as paid or accrued in succeeding tax year.
Utilization	Under the Act, can offset 80% of taxable income (exception for P&C insurance companies).	Can offset 100% of taxable income.
Treatment as attribute	NOLs treated as attribute under section 381(c) subject to applicable limitations.	Disallowed interest treated as section 381(c) attribute (new section 381(c)(20)).
Section 382	Section 382 applies (and on consolidated / subgroup basis under consolidated return regulations).	Section 163(j) disallowed interest treated as a pre-change loss under section 382(d) (new section 382(d)(3)).

NOTE: Under prior section 163(j), it was neither explicit nor clear if and how section 382 applied to disallowed interest (proposed regulations simply referred to the section 382 rules on built-in deductions). If prior disallowed interest is carried into the new regime, it appears to be treated as paid or accrued in the tax year subject to new section 163(j). Query whether such an attribute is now subject to section 382 and the effect of prior ownership changes.

Deloitte.

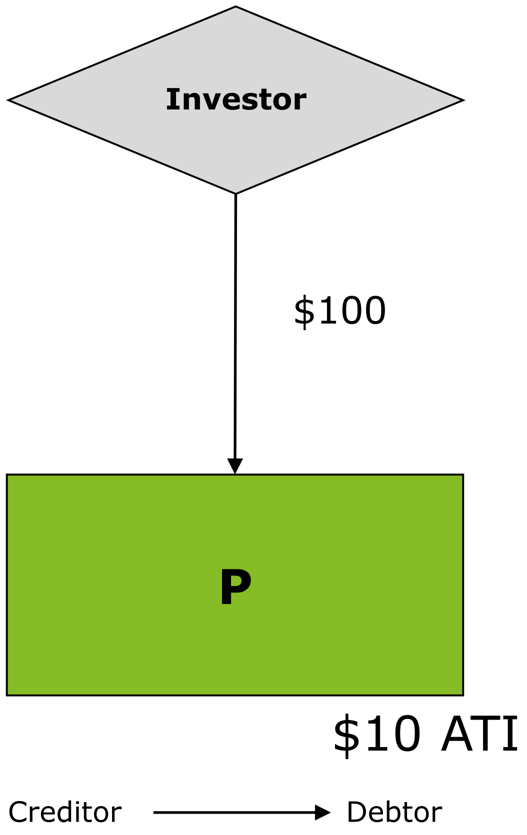
NOL and Section 163(j) Disallowed Interest Carryforwards

Facts:

- Investor lends $100 to P at 5% rate.
- In Year 4, P earns $10 (no business interest income). P has $10 of TI (without interest deduction). ATI is also $10.
- P carries into Year 4: a $10 NOL and a $10 section 163(j) interest expense carryforward.

Analysis:

- P's interest limitation is $3, equal to 30% of ATI ($10).
- It appears that:
  - P has $15 of interest accrued or paid in Year 4 ($5 in Year 2 and $10 of disallowed section 163(j) interest carried forward);
  - P can deduct $3 of that interest (without regard to NOL carryforwards);
  - P can carryforward $12 of interest;
  - P has TI of $7 after the $3 interest deduction; and
  - Can use NOLs to offset that TI (80% for post-Act NOLs).



Deloitte.

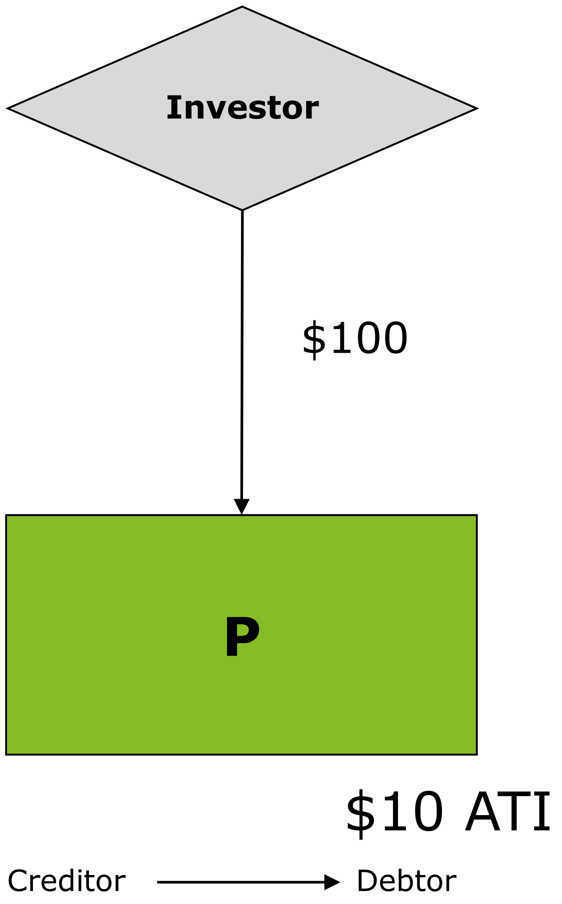
Section 163(j) Deductible Interest without Taxable Income

Facts:

- Investor lends $100 to P at 5% rate.
- In Year 1, P acquires a business for $100, and depreciates $40.
- In Year 1, P earns $10 (no business interest income). P’s ATI is $10 (TI without $40 depreciation and interest deduction).

Analysis:

- P’s interest limitation is $3, equal to 30% of ATI ($10). Thus, $3 of interest is deductible, with $2 disallowed interest carried forward.
- P has no TI (depreciation and allowed interest expense exceed taxable income). P has a net loss of $33 ($10 TI, less $40 depreciation and $3 of allowed interest deduction), which may be carried forward as an NOL deduction.
- Thus, it appears that, in effect, for the $5 of interest paid in Year 1: (i) $3 contributed to an NOL (subject to 80% utilization under the Act) and (ii) $2 became a disallowed section 163(j) carryforward to Year 2 (not subject to the limitation on NOLs).



Anti-hybrid provisions

Anti-hybrid provisions

Anti-hybrid statute does not appear to cover all types of hybrid transactions

Section 267A

The provision denies a deduction for any disqualified related party amount 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 paid or accrued to a related party to the extent that: (1) there is no corresponding inclusion to the related party under the tax law of the country of which such related party is a resident for tax purposes or is subject to tax, or (2) such related party is allowed a deduction with respect to such amount under the tax law of such country. A disqualified related party amount does not include any payment to the extent such payment is included in the gross income of a U.S. shareholder under section 951(a).

Deloitte.

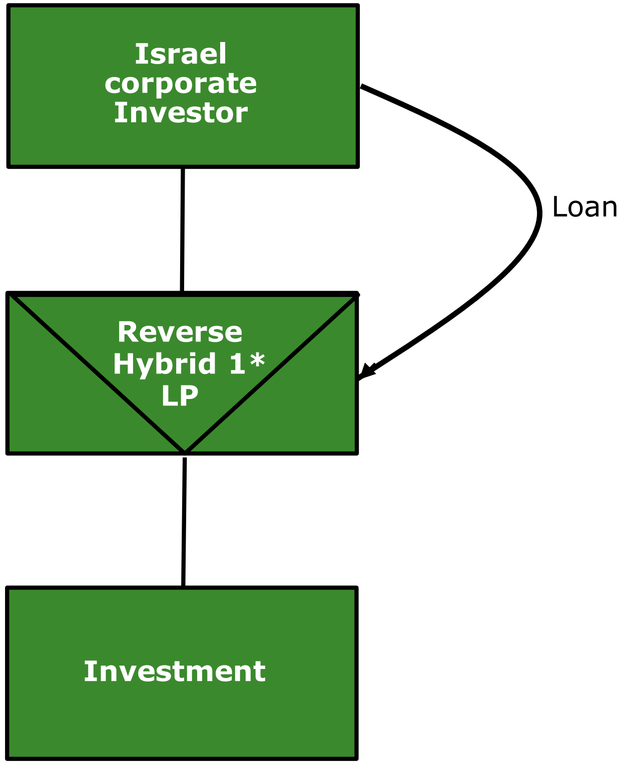
Anti-hybrid provisions

Authority to issue regulations is broad:

- Denying deductions for **conduit arrangements** that involve a hybrid transaction or a hybrid entity,
- The application of this provision to **branches and domestic entities**
- Applying this provision to certain **structured transactions**
- Denying all or a portion of a deduction claimed for an interest or a royalty payment that, as a result of the hybrid transaction or entity, is included in the recipient’s income under a **preferential tax regime** of the country of residence of the recipient and has the effect of reducing the country’s generally applicable statutory tax rate by at least 25 percent
- Denying all of a deduction claimed for an interest or a royalty payment if such amount is subject to a **participation exemption system** or other system which provides for the exclusion or deduction of a substantial portion of such amount,
- Rules for determining the tax residence of a foreign entity if the foreign entity is otherwise considered a **resident of more than one country or of no country**
- **Exceptions to the general rule set forth in the provision**, and
- Requirements for **record keeping, and information** in addition to any requirements imposed by section 6038A.

Deloitte.

Anti-hybrid provisions - Classic Structure



- Here, it may be possible for the IRS to challenge the deduction of any interest paid, claiming that there is no corresponding inclusion of the interest income in Israel.
- However, forthcoming regulations will likely consider the applicability of these provisions to certain Israeli structures in which there is a corresponding inclusion of the interest income for tax purposes, which is then statutorily offset by another deduction, resulting in little or no effective net tax liability.

* Treated a corporation for US Federal Income Tax Purposes, Passthrough entity for Israeli Income Tax Purposes

Multistate Considerations

Deloitte.

State tax conformity to IRC—as of January 1, 2018

Rolling conformity to IRC currently in effect

Conforms to IRC as of a specific date (as noted for each affected state)

Selectively conforms (as noted for each affected state to 'IRC currently in effect', or to 'IRC as of a specific date.')

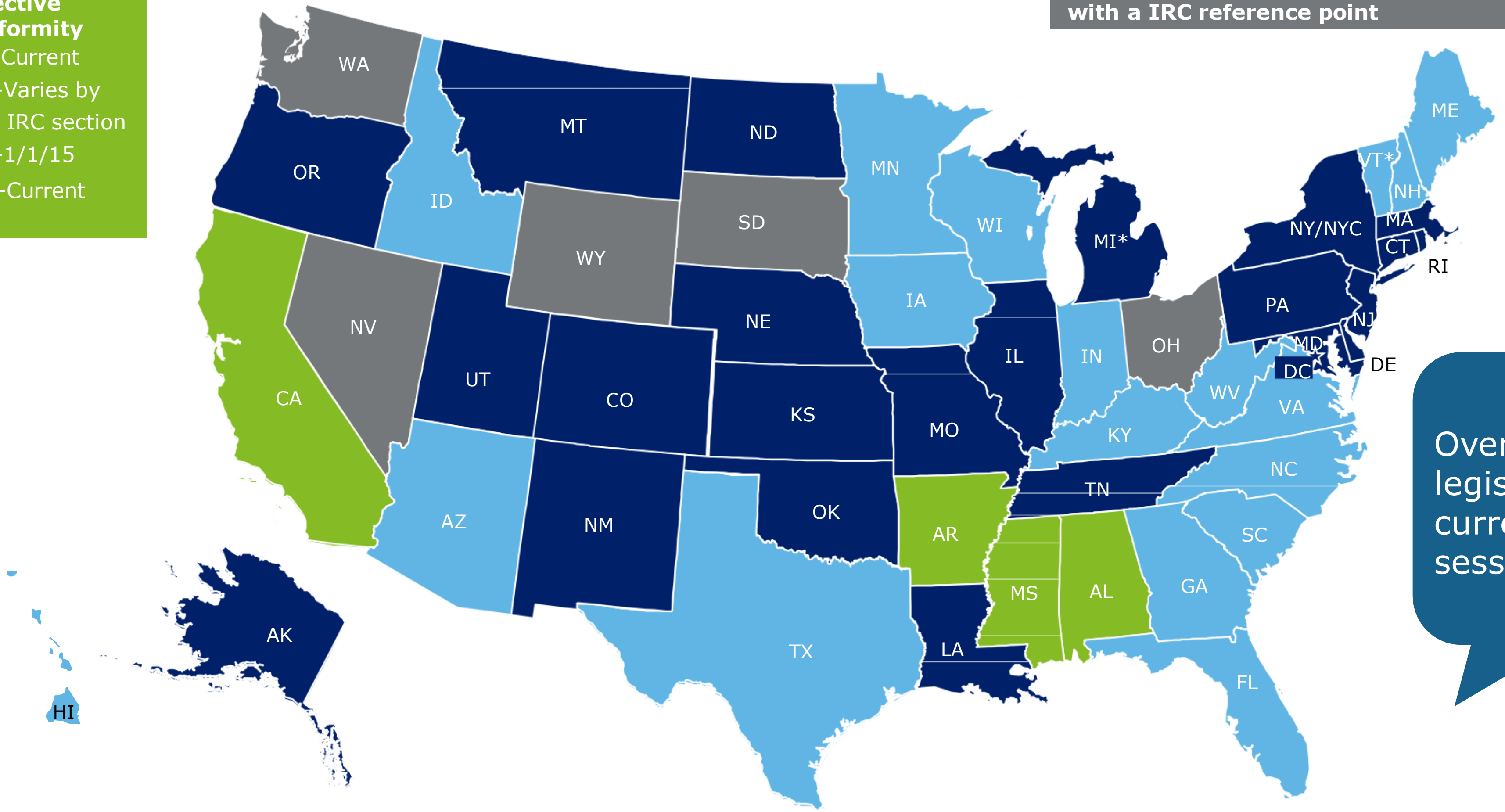
Not applicable b/c state does not levy an entity level tax with a IRC reference point

Specific Date Conformity

AZ—1/1/17
FL—1/1/17
GA—1/1/17
HI—12/31/16
ID—1/1/17
IN—1/1/16
IA—1/1/15
KY—12/31/15
ME—12/31/16
MI*—Current or 1/1/12
MN—12/16/16
NH—12/31/16
NC—1/1/17
SC—12/31/16
TX—1/1/07
VT*—IRC in effect for 2016 TY
VA—12/31/16
WV—12/31/16
WI—12/31/16

Selective Conformity

AL—Current
AR—Varies by IRC section
CA—1/1/15
MS—Current



Over 35 state legislatures currently in session

Slide to be used for illustrative purposes only. Not to be used as a substitute for research into application of rules.

Practical Impact for Israeli Investors to Consider

Israel Marketplace – General Observations

Rate Change

- Nearly all companies will be impacted by the reduction in the U.S. corporate tax rate from 35% to 21%. This change has been made with an aim towards making the U.S. more competitive relative to other countries around the world, including Israel. The narrowing of the disparity between the Israel and US rates may give some Israeli companies food for thought as they decide where to expand, and where they should house their Intellectual Property.
    - Israeli officials have already stated publicly that the local rate may need to be adjusted in order to remain competitive.

Interest

- Many Israeli companies are already leveraged to the extent allowable. The new provisions will constrain the allowable leverage in nearly all industries, with the exception of real estate, which is excluded from the new limitations (see below).
- In highly capital intensive businesses such as manufacturing, more leeway due to depreciation add-back for limitation purposes through 2021.

Capital Expensing

- Companies contemplating the formation or expansion of manufacturing activities in the U.S. should strongly consider the phase out of the 100% expensing provisions starting after 2022.
- Availability of capital expensing provisions to used property may be relevant to companies that have hesitated to purchase such assets in the past.

Deloitte.

Israel Marketplace – General Observations (cont.)

Real Estate Companies

- Consider increasing leverage on any “blockers” used for non-U.S. investors.
    - New proposed 30% limitation on interest expense replaces the current section 163(j) rules and does not apply to real property trade or businesses.
    - As signed, it appears that there would be no limitation on interest paid by a C corporation “blocker” owning real estate, other than debt/equity concerns. If elected not to be subject to 30% interest limitation, real residential and commercial property must be depreciated over 30/40 years respectively.
- However, companies must consider whether related party interest and royalty payments implicate the base erosion anti-hybrid provisions, which require a corresponding inclusion in a related company.
- Passthrough real estate companies may qualify for a reduced tax rate on ongoing income, resulting in approximately a 29.6% rate on the annual operating income (in practicality, very little, if any, taxable income flowing up from the U.S. entities).
- REITs may warrant additional consideration as an investment vehicle going forward.
- Consider reviewing current structures in light of the new corporate tax rate.

Practical considerations:

- Stay tuned:
    - Reactions of countries in adapting to this new reality
    - Reaction of the OECD and WTO. Will there be more formal challenges to some of the tax reform?
    - Expect additional guidance and regulations to be released regularly in the near term
- In general, the question remains as to where companies should locate their IP, but this reform adds complexity to these decisions

Deloitte.

Q & A

Deloitte.

Presenter Contact Information

Alan Cohen

U.S. & International Tax Director – Deloitte Israel Leader, US Tax Desk

Tel.: +972 73 399 4397

Email: alacohen@deloitte.co.il

Moshe Bina

U.S. & International Tax

Director – Deloitte Israel Tel.: +972 3 608 5519

Email: mbina@deloitte.co.il

About this presentation

This presentation contains general information only and Deloitte is not, by means of this presentation, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This presentation is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte shall not be responsible for any loss sustained by any person who relies on this presentation.

Deloitte.