Inbound: Are We There Yet? (Part 1)
Notices

The following information is not intended to be “written advice concerning one or more Federal tax matters” subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230.

The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.
Agenda

01 Compliance Landscape

02 Royalties
### Today’s presenters

<table>
<thead>
<tr>
<th>Name</th>
<th>Title</th>
<th>Firm/Company Name</th>
<th>Email</th>
</tr>
</thead>
<tbody>
<tr>
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</table>
Tax reform – new rules, new disclosures

— BEAT will put significant pressure on reporting of intercompany payments. Taxpayers have a lot more reporting to do on the same payments.

— Existing forms (5471, 1118, 5472) are also modified to cover a host of Tax Reform issues, and will need to report information consistently

— Some forms (1042-S, 1125-A, 8975) are untouched by Tax Reform, and must also reflect consistent positions

— FDII (8993) will also require a greater amount of supporting documentation in order to qualify for the anticipated tax benefits, with respect to transactions entered with foreign related and unrelated persons

— State and local compliance may (or may not) pick up federal level items or approaches

— Historically, the various portions of a taxpayer’s reporting package were prepared by different internal stakeholders / external advisors, who weren’t coordinated. How long can that last?
## Tax reform – new rules, new disclosures

<table>
<thead>
<tr>
<th>Form Number</th>
<th>Related Tax Reform Provision</th>
<th>Status</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Form and Schedules</td>
<td>Instructions</td>
</tr>
<tr>
<td>965</td>
<td>Mandatory Repatriation</td>
<td>Final</td>
<td>Final</td>
</tr>
<tr>
<td>5471</td>
<td>6038A, 951(b), GILTI, anti-hybrids</td>
<td>Final</td>
<td>Final</td>
</tr>
<tr>
<td>5472</td>
<td>BEAT, FDII</td>
<td>Final</td>
<td>Final</td>
</tr>
<tr>
<td>8858</td>
<td>Now includes branch reporting</td>
<td>Final</td>
<td>Final</td>
</tr>
<tr>
<td>1120</td>
<td></td>
<td>Final</td>
<td>Final</td>
</tr>
<tr>
<td>1120-F</td>
<td></td>
<td>Final</td>
<td>Final</td>
</tr>
<tr>
<td>8990</td>
<td>163(j)</td>
<td>Final</td>
<td>Final</td>
</tr>
<tr>
<td>8991</td>
<td>BEAT, anti-hybrids</td>
<td>Final</td>
<td>Final</td>
</tr>
<tr>
<td>8992</td>
<td>GILTI</td>
<td>Final</td>
<td>Final</td>
</tr>
<tr>
<td>8993</td>
<td>GILTI, FDII</td>
<td>Final</td>
<td>Final</td>
</tr>
</tbody>
</table>
State conformity to IRC – three methods

- **Rolling** (a.k.a. Moving)
  - Conforms with IRC in effect for current year, keeping state current with federal changes

- **Fixed-Date** (a.k.a. Static)
  - Adopts IRC as of a specific date. State periodically updates conformity date to incorporate federal changes

- **Selective**
  - State conforms to select IRC provisions and does not incorporate all of the provisions of the IRC as of a certain date

Caution: A state may adopt different methods for different taxpayer types
General state conformity to the internal revenue code

- No general corporate income tax
- Rolling conformity or conformity to current IRC (Alaska, D.C.)
- Fixed Date or static conformity (Hawaii)
- State conforms only to specific sections of the IRC (Arkansas, California, Hawaii, Mississippi)
Legislation conforming to the internal revenue code

- **No general corporate income tax**
- **Rolling conformity or conformity to current IRC (D.C.)**
- **Rolling conformity with legislation addressing certain provisions of federal tax reform**
- **Conformity legislation has not been enacted, or selective conformity**
- **Conformity legislation has been enacted (Hawaii)**
Royalties

**Base Case:** USS pays For IPCo a royalty for IP used in the course of its business.

**Material Issues to Be Considered**

- BEAT risk on outbound royalties
- FDI benefits for income from sales to foreign customers?
- US income and withholding tax compliance
- UK tax compliance, including country-by-country reporting
- Potential application of the UK CFC rules
- OECD compliant IP regime?
- State and local issues
Royalties

Reported as a royalty on US Sub’s 1042-S

For CbyC purposes, 3P revenue reported in the US, with the deduction reflected in PBIT. Country A shows only related revenue.

Reported as a base erosion payment and base erosion tax benefit paid or accrued to the CFC. (Also reflected on Sch. M.)

5472 required? Not if all of US Sub’s reportable transactions with related parties are already reflected on a 5471 (which would not include the third party sales).

If UKP is required to file an 1120-F, note Additional Information, question DD requires information that would trigger an 8991 filing obligation.
Royalties

Reported as a royalty that is a base erosion payment and gives rise to a base erosion tax benefit

<table>
<thead>
<tr>
<th>Type of Base Erosion Payments</th>
<th>Aggregate Base Erosion Payment for Purposes of Base Erosion Percentage</th>
<th>Aggregate Base Erosion Tax Benefit for Purposes of Base Erosion Percentage</th>
<th>Base Erosion Payment for Purposes of Modified Taxable Income</th>
<th>Base Erosion Tax Benefit for Purposes of Modified Taxable Income</th>
<th>Any 25% Owner of the Taxpayer</th>
<th>Person Related Under Sections 6011 or 707(b)(1) to the Taxpayer</th>
<th>Any Person Related Within the Meaning of Section 4952 to the Taxpayer</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Reserved for future use</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>X</td>
</tr>
<tr>
<td>2 Reserved for future use</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>X</td>
</tr>
<tr>
<td>3 Purchase or creations of property rights for intangibles (patents, trademarks, etc.)</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>X</td>
</tr>
<tr>
<td>4 Rents, royalties, and license fees</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>X</td>
</tr>
<tr>
<td>5a Compensation/consideration paid for services NOT excepted by section 69A(c)(6)</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>X</td>
</tr>
<tr>
<td>5b Compensation/consideration paid for services excepted by section 69A(c)(6)</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>X</td>
</tr>
<tr>
<td>6 Interest expense</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>X</td>
</tr>
<tr>
<td>7 Payments for the purchase of tangible personal property</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>X</td>
</tr>
<tr>
<td>8 Premiums and/or other considerations paid or accrued for insurance and reinsurance as covered by section 69A(c)(3) and section 69A(c)(2)(A)(III)</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>X</td>
</tr>
</tbody>
</table>
Royalty income to IPCo is subpart F income, which is excluded from DEI in calculating the FDII benefit from US Sub’s sales to non-US customers.

What happens to the matching expense? Does US Sub get to allocate it against the excluded sub F income, or must the expense get allocated to DEI/FDDEI?

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| Royalties |

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**Part I**  Determining Deduction-Eligible Income (DEI) (see instructions)

<table>
<thead>
<tr>
<th>Line</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Gross Income</td>
</tr>
<tr>
<td>2</td>
<td>Exclusions</td>
</tr>
<tr>
<td>2a</td>
<td>Income included under section 951(a)(1)</td>
</tr>
<tr>
<td>2b</td>
<td>Income included under section 951A (form 8992, Part II line 3)</td>
</tr>
<tr>
<td>2c</td>
<td>Financial Services Income</td>
</tr>
<tr>
<td>2d</td>
<td>GFC Dividends</td>
</tr>
<tr>
<td>2e</td>
<td>Domestic Oil and Gas Extraction Income</td>
</tr>
<tr>
<td>2f</td>
<td>Foreign Branch Income</td>
</tr>
<tr>
<td>2g</td>
<td>Total Exclusions (add lines 2a through 2f)</td>
</tr>
<tr>
<td>3</td>
<td>Gross Income less Total Exclusions (subtract line 2 from line 1)</td>
</tr>
<tr>
<td>4</td>
<td>Deductions properly allocable to the amount on line 4</td>
</tr>
<tr>
<td>5</td>
<td>Deduction Eligible Income (DEI) (subtract line 5 from line 4)</td>
</tr>
</tbody>
</table>

**Part II**  Determining Deemed-Deemed Intangible Income (DEI) (see instructions)

<table>
<thead>
<tr>
<th>Line</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>DEI from Part I, line 6, above</td>
</tr>
<tr>
<td>2</td>
<td>Deemed Tangible Income Return (10% of OBAI)</td>
</tr>
<tr>
<td>3</td>
<td>Deemed Intangible Income (DEI) (subtract line 2 from line 1)</td>
</tr>
</tbody>
</table>

**Part III**  Determining Foreign Derived Ratio (see instructions)

<table>
<thead>
<tr>
<th>Line</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1a</td>
<td>DEI derived from sales, leases, exchanges, or other dispositions (but not licenses) of property to a foreign person for a foreign use (see instructions)</td>
</tr>
<tr>
<td>1b</td>
<td>DEI derived from a license of property to a foreign person for a foreign use (see instructions)</td>
</tr>
<tr>
<td>1c</td>
<td>DEI derived from services provided to a person or with respect to properly located outside of the United States (see instructions)</td>
</tr>
<tr>
<td>2</td>
<td>Foreign Derived Deduction Eligible Income (FDDEI) (add lines 1a through 1c)</td>
</tr>
<tr>
<td>3</td>
<td>Deduction Eligible Income (DEI) (Part I, line 6, above)</td>
</tr>
<tr>
<td>4</td>
<td>Foreign Derived Ratio (FDDEI / DEI) (divide line 2 by line 3)</td>
</tr>
</tbody>
</table>

**Part IV**  Determining FDII and/or GILTI Deduction (see instructions)
For IPCo has US source, foreign personal holding company income, so no income is reflected on this page.

US Sub is not a related look-through entity so generally passive basket. However, if any tax is imposed (i.e., per subpart F), the income would end up kicking out to general basket.
As an example, in Massachusetts, this is a partial view as to the amount of disclosure requirements on a royalty payment to a foreign affiliate, if claiming an exception.
Royalties

Potential Solution 1: US Sub analyzes the royalty and classifies as COGS.

US Sub

For IPCo

UKP

$ US royalties

Products

$ US royalties

BEAT-able?

Royalty cost “migrates” to line 2 of the 1120 and appears on the 1125-A. As a result, gross income is much closer to taxable income.

1042-S reporting stays the same, as does the CbyC report for US and Country A (COGS, like deductions, shows up in PBIT, not revenue).
Royalties

Sch. A of the 8991 (reporting base erosion payments) is currently left blank – no COGS is reported unless paid within an inverted group. (But what will lines 1 and 2 bring?)

But as long as the filer had gross receipts of at least $500M in at least 1 of the 3 preceding years, Part I of the 8991 still needs to be completed. This is where filers show their math on the “applicable taxpayer” test.

\[\text{Gross receipts of the applicable taxpayer, See instructions} \]
\[\text{Gross receipts from partnerships} \]
\[\text{Gross receipts of all other persons treated as 1 person as the applicable taxpayer pursuant to section 59A(e)(3)} \]
\[\text{Gross receipts, Combining lines 1a through 1c} \]
\[\text{3 year average annual gross receipts (Divide line 1e by 3.0)} \]

\[\text{If line 1f}$500 million or more?} \]
\[\text{Yes, Continue to line 2.} \]
\[\text{No, STOP here and attach this form to your tax return.} \]
COGS needs to be attributed – using any reasonable method – to gross DEI and gross FDDEI. This can include COGS associated with activities undertaken in an earlier taxable year, including periods preceding the section 250 effective date.
Certain jurisdictions (e.g. Texas) utilize COGS as a computation in the overall state tax liability. Texas COGS can differ substantially from Federal COGS. Does the change qualify as COGS for Texas?
Potential Solution 2: Group pulls production, etc., functions offshore and US Sub becomes a stripped risk buy-sell entity.

UKP’s CbyC data is similar to previous reporting, but a year-to-year comparison shows a shift in profits and functions from the US to Country A. Unless future guidance allows UKP to consolidate data, the interco royalty income would also be reflected.
Royalties

Product purchases are non-FDAP (and now, income foreign-produced inventory sold in the US is foreign source).

However, need to value and declare a dividend to UKP, who must provide a valid W-8BEN-E to support treaty benefits, and report on the 1042-S.

The 1125A royalty-related COGS amount is unchanged from prior solution, but is now embedded in the transfer price of the products.

The 5472 is generally not required if a 5471 would otherwise disclose the relevant transactions. Here, interco transactions between US Sub’s two CFCs, are reported on Sch. M. But product sales would not be reflected on a 5471.

If a 5472 is required, it must include a 1059A disclosure.

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Distribution of appreciated assets gives rise to gain recognition under section 311(b). Potentially eligible for FDII benefits.
Potential Solution 3: Cost sharing, trading off outbound royalties for amortization.

Buy-in is **potentially** BEAT-able, as US Sub amortizes intangibles (net of For IPCo buy-ins, if any).

If so, reflect gross and net payments as base erosion payments and base erosion tax benefits, respectively. Amount of tax benefits is the amount of amortization taken for the year.

Cost sharing payments received by US Sub are netted pro rata against all deductions (BEAT-able and not BEAT-able) associated with its development costs.
**Royalties**

US Sub now has section 174 expenses, which it must apportion. R&D expenses are apportioned to gross FDDEI and gross non-FDDEI under Reg. 1.861-17.

Note, the exclusive apportionment rules are turned off for FDII purposes.
# Additional timing opportunities for R&D costs

<table>
<thead>
<tr>
<th>Section 59(e)</th>
<th>Section 174(b)</th>
<th>Rev. Proc. 2000-50</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Population of costs</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>All §174 expenditures</td>
<td>All §174 expenditures</td>
<td>All software development costs, inclusive of §174 expenditures</td>
</tr>
<tr>
<td><strong>Scope of election</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Applied to all or a specified portion of §174 expenditures</td>
<td>Applied to one or more specified projects</td>
<td>All §174 expenditures incurred during the year</td>
</tr>
<tr>
<td><strong>Amortization period</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deducted ratably over a 10-year period, beginning in the year of the expenditure</td>
<td>Period of not less than 60 months (per project), beginning in the month that the taxpayer is treated as first realizing the benefits</td>
<td>Period of not less than 60 months, as chosen at the time of election, beginning in the month that the taxpayer is treated as first realizing the benefits</td>
</tr>
<tr>
<td><strong>Method of election / de-election</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Elected on a return statement; revoked only with the Commissioner’s consent</td>
<td>3115 (applied on a cut-off basis, with no §481 adjustment), with an annual return statement identifying the deferred expenditures; a change in accounting method can be made to return to current deduction (applied on a cut-off basis)</td>
<td>3115 (with a §481 adjustment) specifying the amortization period; after 5 years, an automatic method change can be made to return to current deduction (with a §481(a) adjustment).</td>
</tr>
</tbody>
</table>
What if US Sub retains limited foreign rights, and licenses to some affiliates?

Does German Sub get the full benefit of deductions for the royalties?

Again, no outbound royalties so no BEAT risk. No FDII on product sales, as that line of business is being run out of Germany. No subpart F income from local German sales.

US customers

$\$$

Products

US Sub

$\$

Licenses

$ royalties

FDII eligible?

German customers

$\$

Products

German Sub

$ royalties

Need to be able to document inputs / entitlement to claim foreign use of the IP.
General considerations – BEAT planning, state impacts

As it relates to BEAT and BEAT planning, there are various state impacts that should be analyzed:

— If there is a change to COGS, that may result in additional benefit or detriment in states that rely on their own COGS computation (e.g. Texas)
— If there are changes to transfer pricing methodology, there could be an impact to the expense disallowance provisions on intercompany transactions in a given jurisdiction
— A further refinement to the transfer pricing methodology may be required and result in additional state benefit
— State jurisdictions will analyze intercompany payments for “embedded royalty” charges and potentially subject a portion to intercompany expense disallowance provisions
— Structure changes should be analyzed for potential state benefit or detriment
P.S. – When do deductions arise?

With downward attribution, For IPCo is a CFC...

- Section 267(a) applies to non-interest, deductible payments to related persons (e.g., service fees or royalties)
- Section 267(a)(3)(B) contains a special rule for payments to a related CFC
- Note, no direct or indirect US Shareholder on the scene
- Potential consequences of deferral
  - Applicable rate
  - Pre-BEAT vs. BEAT deductions
  - What to do?!?

- US Taxpayer accrues a deduction of $100 for services provided by Foreign Sister Co in 2017
- $100 was paid in 2018
Session evaluations

To evaluate this session, go on your app and select this session and scroll down to Surveys/Live polling:

You will be asked three evaluation questions. Please respond as we value your feedback.
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</tr>
</tbody>
</table>
Agenda

01 Services

02 Financing
Global services contracts

**Base Case:** US Sub enters a global services contract and pays For Sub a subcontracting fee, as well as for certain intercompany services.

Only reported on the 1042-S to the extent U.S. source (which is likely to be zero); For Sub provides a W-8BEN-E. The 1120 reflects the cost as a deduction, as COGS is not available for services income.

For CbyC purposes, 3P revenue reported in the US, with the deduction reflected in PBIT. Country A shows only related revenue.

Also reported on 5471, Sch. M, filed by USSH.
Global services contracts

Reported as a services fee that is a base erosion payment and gives rise to a base erosion tax benefit.
Global services contracts

FDII benefit available with respect to the services provided to foreign customers?

Whether US Sub is performing a sale or a service is based on the predominant character of the transaction. Any potential gap if US Sub cannot more generally claim COGS and wants to test transactions under the FDII services, as opposed to sales, rules?
Certain jurisdictions will require an analysis of intercompany service payments and require an addback if certain exceptions aren’t met. Guidance and reporting can be limited for state income tax purposes.
Global services contracts

Potential Solution 1: US Sub analyzes the intercompany services as SCM-eligible, for Reg. 1.482-7 and BEAT purposes.

Eligible for the SCM exception?

<table>
<thead>
<tr>
<th></th>
<th>£ $ services fees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subcontracted</td>
<td>$</td>
</tr>
<tr>
<td>services</td>
<td></td>
</tr>
<tr>
<td>$</td>
<td></td>
</tr>
<tr>
<td>$ services fees</td>
<td></td>
</tr>
<tr>
<td>US Sub</td>
<td></td>
</tr>
<tr>
<td>Services</td>
<td></td>
</tr>
<tr>
<td>$</td>
<td></td>
</tr>
<tr>
<td>$ services fees</td>
<td></td>
</tr>
<tr>
<td>For OpCo</td>
<td></td>
</tr>
<tr>
<td>$ services fees</td>
<td></td>
</tr>
<tr>
<td>$</td>
<td></td>
</tr>
</tbody>
</table>

Both cost and mark-up components of the SCM-eligible payment must be reflected on the 8991.

Same 1042-S, CbyC reporting, 5471, 5472, and (with respect to the intercompany services piece) 1120 treatment.

Note, however, the significant tracking exercise that is necessary to document For Sub costs charged through to US Sub. Also be careful to document the benefit to US Sub.
Global services contracts

Potential Solution 2: US Sub changes the timing of expenses (amortization, capitalization, etc.), reducing the amount of current base erosion tax benefits.

The 1120 shows lower current deductions / more income / reduced or eliminated NOL for the year, but (depending on the type of change made) may also show a section 481 adjustment.

With fewer base erosion tax benefits, and despite fewer total deductions, US Sub hopefully has decreased its base erosion percentage, as shown on the 8991.

Same 1042-S, CbyC reporting, 5472 and 5471 treatment.
Global services contracts

Some corporate function costs may implicate one or possibly two BEAT exceptions

1. Certain low-value, back office services may qualify for SCM exception
   a. “White list” services, provided automatic eligibility under IRS Rev. Proc. 2007-13
   b. “Black list” services, automatically excluded under Reg. §1.482-9(b)(4)
   c. “Grey list” services, which are other low-margin services included in neither of the above lists, the median comparable mark-up for which is less than or equal to 7%

2. In addition, certain corporate functions may be eligible for capitalization as mixed services costs, under section 263A:
   a. For taxpayers with inventory, these costs may be capitalized and recovered as COGS, permanently recasting these expenses as non BEATable expenses.
   b. For taxpayers with self-constructed assets, these costs are capitalized in basis and recovered through depreciation (generally over 39 years).
   c. Taxpayers having both inventory and self-constructed assets would allocate costs between the two
# Global services contracts

## High Level SCM Activities Vs. 263A Mixed Services Activities

<table>
<thead>
<tr>
<th>SCM “White List” Services</th>
<th>Both</th>
<th>Capitalizable 263A cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>— Environmental management policy</td>
<td>— General administrative</td>
<td>— Manufacturing</td>
</tr>
<tr>
<td>— Tax Services</td>
<td>— Data processing</td>
<td>— Production</td>
</tr>
<tr>
<td>— Financial accounting and financial planning (e.g. general budgeting)</td>
<td>— Meeting coordination and travel planning</td>
<td>— Extraction, exploration, or processing of natural resources</td>
</tr>
<tr>
<td>— Regulatory affairs</td>
<td>— Accounts payable function</td>
<td>— Construction</td>
</tr>
<tr>
<td>— Treasury function</td>
<td>— Cost accounting function</td>
<td>— Resale, storage &amp; handling activities</td>
</tr>
<tr>
<td>— Statistical assistance</td>
<td>— Security services</td>
<td>— Quality control function</td>
</tr>
<tr>
<td>— Personnel policy (e.g. establishing and managing personnel policy, developing employee training programs)</td>
<td>— Personnel operations (e.g., staffing, recruiting, payroll, benefits, unemployment, disability, and workers comp admin)</td>
<td>— Engineering, repairs, maintenance, and design (i.e., non-Section 174)</td>
</tr>
<tr>
<td>— Accounts receivable function</td>
<td>— IT services</td>
<td></td>
</tr>
<tr>
<td>— Audit function</td>
<td>— Legal services</td>
<td></td>
</tr>
<tr>
<td>— Corporate and public communications</td>
<td>— Business and property insurance function</td>
<td></td>
</tr>
<tr>
<td></td>
<td>— Purchasing function</td>
<td></td>
</tr>
</tbody>
</table>

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Global services contracts

“Black list” services

The following costs are not SCM-eligible services (i.e., they are included in the “black list”), nor are they capitalizable under Section 263A:

— Marketing, selling or advertising costs
— Financial transactions, including guarantees
— Providing insurance or reinsurance services
— Research, development, experimentation or scientific costs (discussed above)
## Global services contracts

<table>
<thead>
<tr>
<th>Feature</th>
<th>SCM Exception</th>
<th>263A Capitalization</th>
</tr>
</thead>
<tbody>
<tr>
<td>Type of in-scope costs affected</td>
<td>Cross-border only (potentially BEATable)</td>
<td>Domestic (non BEATable) and cross-border</td>
</tr>
<tr>
<td>Amount of fees covered</td>
<td>Cost only</td>
<td>Cost plus markup (if any)</td>
</tr>
<tr>
<td>Is there a transition cost to this approach?</td>
<td>No</td>
<td>Yes, this is a change in method with a section 481(a) adjustment (data intensive exercise)</td>
</tr>
</tbody>
</table>
| Years covered                     | Whatever taxable years beginning on or after 1/1/18, for which the costs are properly documented per the BEAT rules | - *Inventory* – may include costs incurred back to 2017  
- *Self-constructed assets* – may include costs incurred back to 1987 |
| Non-BEAT tax consequences         | No change in timing or amount of deduction for non-BEAT tax purposes | - *Inventory* – costs recovered as COGS  
- *Self-constructed assets* - costs recovered through depreciation  
-May significantly increase taxable income |
Global services contracts

Potential Solution 3: Is it possible to claim that US Sub is acting solely as an agent for For Sub? Depends on the contracts...

Pass-through of customer revenue?

If the argument is successful, the payment to For Sub is not reflected on the 8991.

The CbyC must reflect 3P revenue for both US Sub and For Sub, as well as For Sub’s related revenue for any intercompany services. Intercompany amounts must also be reduced on the 5471.
Global services contracts

**Potential Solution 4:** Customer contracts are “localized” (i.e., US Sub and For Sub each contract with customers)

- For CbyC purposes, only 3P revenue reported in both the US and Country A. Master and Local Files (assuming still required) must be amended.

- No deduction on the 1120, no 1042-S, and no 5472 or 5471 Sch. M disclosure needed – no intercompany flows at all.

- This structure removes the BEAT exposure entirely and no BEAT (Sch. A) reporting applies.

- Also removes export services transactions from US Sub, so no potential FDII benefits.
Global services contracts

For Sub now has income from foreign services, some of which may be local, others non-local.

Non-local services give rise to subpart F income, while local services give rise to GILTI. Shift non-local to UKP to avoid sub F?

US Sub has traded off a potential BEAT liability and the possibility of FDII benefits, for a 10.5% or 21% current income inclusion.
Global services contracts

Potential Solution 5: Customer enters the global services contract with UKP who subcontracts US services to US Sub

No deduction on the 1120; no 1042-S needed.
This structure removes all BEAT exposure and no BEAT (Sch. A) reporting applies.

US Sub loses significant FDII benefits, as UKP is the party being engaged to provide services to foreign customers. No FDII benefits for services provided to UKP, as UKP is also contracting with US customers.

For CbyC purposes, US Sub has inbound revenue instead of an outbound payment. For Sub reflects the deduction in Country A.

Reported as an inbound services fee from For Sub on 5471, Sch. M.
Global services contracts – state considerations

— There is a need to consider whether service payments amongst affiliates are deductible for state tax purposes
— Should also consider whether the receipt of service income creates nexus in state and local jurisdictions for the foreign entity
— Also consider the state tax impact of the removal or reduction of the intercompany service payment (e.g. contracting locally)
— *FDII benefit at the state level is in flux and conformity with selective decoupling can create compliance complexities*
New York conformity – GILTI and §250 deduction

State taxable income computation begins with Line 28 from federal Form 1120, which includes GILTI but not § 250 deductions.

GILTI deduction under IRC section 250 (a)(1)(B)(i) reported on CT-225 with code S-5112
No deduction is allowed for FDII
New York conformity – GILTI apportionment

GILTI is not included in the New York column

GILTI less related
IRC § 250
deduction included
on line 53,
Everywhere column.
Taxpayers must attach a statement indicating the amount of GILTI included in the Everywhere column.
GILTI and FDII – additional state impacts

— Does the state conform to new section 951A?
— Is any GILTI included in the state tax base?
— If included in the state tax base, does GILTI receive receipts factor representation?
— How is GILTI sourced if included in the receipts factor? See a few approaches…..
— Is there any other means of excluding GILTI?
— Is there a foreign commerce clause argument that the income should be excluded or that factor relief is needed?
— How does the GILTI deduction work for state purposes?
— If there is an exclusion for GILTI, will the taxpayer still get the section 250 deduction?
— The same issue will present itself with the deduction being allowed under Code section 250 to reduce the tax rate on Foreign Derived Intangible Income (FDII)
— And then there is the state of New Jersey.........
New Jersey – GILTI

—New Jersey recently issued guidance on GILTI and the IRC section 250 deduction

- Under P.L. 2018 c. 131, New Jersey enacted a provision allowing taxpayers to take the IRC section 250(a) deduction

—The section 250(a) is limited to taxpayers:
  - That include GILTI and FDII income on both its federal and New Jersey CBT returns **AND**
  - Took the section 250(a) deduction for federal purposes

—Thus, if a taxpayer is not allowed a 250(a) deduction for federal purposes, it may not take the deduction for New Jersey CBT purposes
Based on New Jersey’s computation and approach, using GDP for entities in few states can create substantial state tax impacts, not the state’s 3.1% approach if an entity was economically taxed in every state.

Note the impact of increases to GILTI that might otherwise be offset by Foreign Tax Credits. States don’t have a Foreign Tax Credit concept and increases in GILTI can create substantial increases in GILTI state tax.
Financing
Example – financing, base case (plain vanilla debt)

Base Case 1 (Plain Vanilla Debt): US Sub borrows from For Sub deducts the interest expense.

Interest reported on the 1042-S; For Sub provides a W-8BEN-E. The 1120 reflects the interest deduction.

For CbyC purposes, US reflects the deduction in PBIT. Country A shows related revenue for the interest income.

Reported as an inbound loan and outbound interest payment on the 5472.
Financing

Reported on Form 8990, as part of business interest expense.

Reported as interest on 8991 but BEAT applies only after section 163(j) (i.e., to the extent 163(j) does not apply first)
Financing (common hybrid cases)

- **IBL / IFL structure**
  - UKP
  - US Sub
  - FinCo
  - Ire Sub
  - $ interest from US Sub to FinCo

- **IBL with zero-tax lender**
  - UKP
  - US Sub
  - FinCo
  - $ interest from US Sub to FinCo
  - CayCo

- **IBL with Hungarian FinCo**
  - UKP
  - US Sub
  - Hungary FinCo

Need to consider:
- US tax analysis (anti-hybrid, 163(j), BEAT)
- UK CFC rules
- EU State Aid
- EU mandatory disclosure rules
Financing

Interest reported on the 1042-S; FinCo provides a W-8BEN-E. If 1.881-3 anti-conduit rules apply, treaty withholding tax benefits may not be available.

If caught within the anti-hybrid rules, reported as a hybrid instrument payment on draft 5472.

Reported as an inbound loan and outbound interest payment on the 5472.

For CbyC purposes, FinCo reports interest income as related revenue and US Sub generally reflects the expense in PBIT regardless of whether and to what extent the interest is deductible for tax purposes.

The OECD Country-by-Country Report – Page 1

Revenue

<table>
<thead>
<tr>
<th>Tax Jurisdiction</th>
<th>Related Party</th>
<th>Unrelated Party</th>
<th>Total</th>
<th>Profit (Loss) before Income Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>$$$</td>
<td>$$$</td>
<td>$$$</td>
<td></td>
</tr>
<tr>
<td>Country A</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td></td>
</tr>
</tbody>
</table>

Income tax

The 1120-F now includes a question on hybrid instruments.

Form 5472 (Rev. 3-19)

Part VII

If caught within the anti-hybrid rules, reported as a hybrid instrument payment on draft 5472.

EE During the tax year, did the corporation pay or accrue any interest or royalty for which a deduction is not allowed under section 267A (see instructions)?

- If "Yes," enter the total amount of the disallowed deductions . . . . → $
Financing / 163(j) – state considerations

— Need to consider if the state conforms to revised section 163(j)
— Certain states who decoupled from the revisions to 163(j) as part of tax reform will follow prior law. This can create the requirement for multiple computations
— The draft regulations conform that the limitation is computed on a consolidated group basis. Consideration needs to be given to how the limitation is computed for state purposes when the state and federal filing methodologies differ
— It is important to understand whether the state will allow an indefinite carryforward
— Consideration must be given to how the interest expense limitation will interact with state related party interest expense disallowance statutes
Combined reporting vs. Separate reporting states

1 Combined reporting for a tax based on gross receipts

2 Combined reporting required for certain “big box” retailers, for tax years beginning after 31 December 2013

3 Combined reporting required for privilege periods ending on or after 7/31/19
Consolidated rules vs. Separate - example

<table>
<thead>
<tr>
<th></th>
<th>Interest Income</th>
<th>ATI</th>
<th>Interest Expense</th>
<th>Allowable Deduction: Consolidated</th>
<th>Allowable Deduction: Separate Co</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corp A</td>
<td>$300</td>
<td>$100</td>
<td>$400</td>
<td>$320</td>
<td>$330</td>
</tr>
<tr>
<td>Corp B</td>
<td>$200</td>
<td>$500</td>
<td>$-</td>
<td>$-</td>
<td>$-</td>
</tr>
<tr>
<td>Corp C</td>
<td>$-</td>
<td>$400</td>
<td>$600</td>
<td>$480</td>
<td>$120</td>
</tr>
<tr>
<td>Total</td>
<td>$500</td>
<td>$1,000</td>
<td>$1,000</td>
<td>$800</td>
<td>$450</td>
</tr>
</tbody>
</table>

**Limitation calculation**

—Interest Income + (Adjusted Taxable Income (ATI) x 30%) = Limit

**Consolidated limitation**

—$500 + (30% x $1000) = $800

—In this example, Corporation C’s share of the limitation is $480 ($800/$1,000 x $600)

**Separate company limitation**

—Corporation C’s separate limitation is $120 ($0 + (30% x $400))
State conformity to post-reform IRC §163(j)

As of April 11, 2019

- **Conform - rolling or fixed to a post-reform date**
- **Decouple – specifically decoupled from post-reform 163(j)**
- **Has not updated conformity or has selective conformity and does not adopt**
- **Updated fixed conformity but not for 2018 aspects of tax reform**
- **No general corporate income tax**

**Alaska**
- Conformity starting in TY2019
  - Decouples starting in TY2020
- VA - conforms to 163(j) but allows a 20% subtraction for disallowed interest
Questions
Thank you
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