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Tax Reform - Opportunities and Risks for Multinational Groups

PwC Israel

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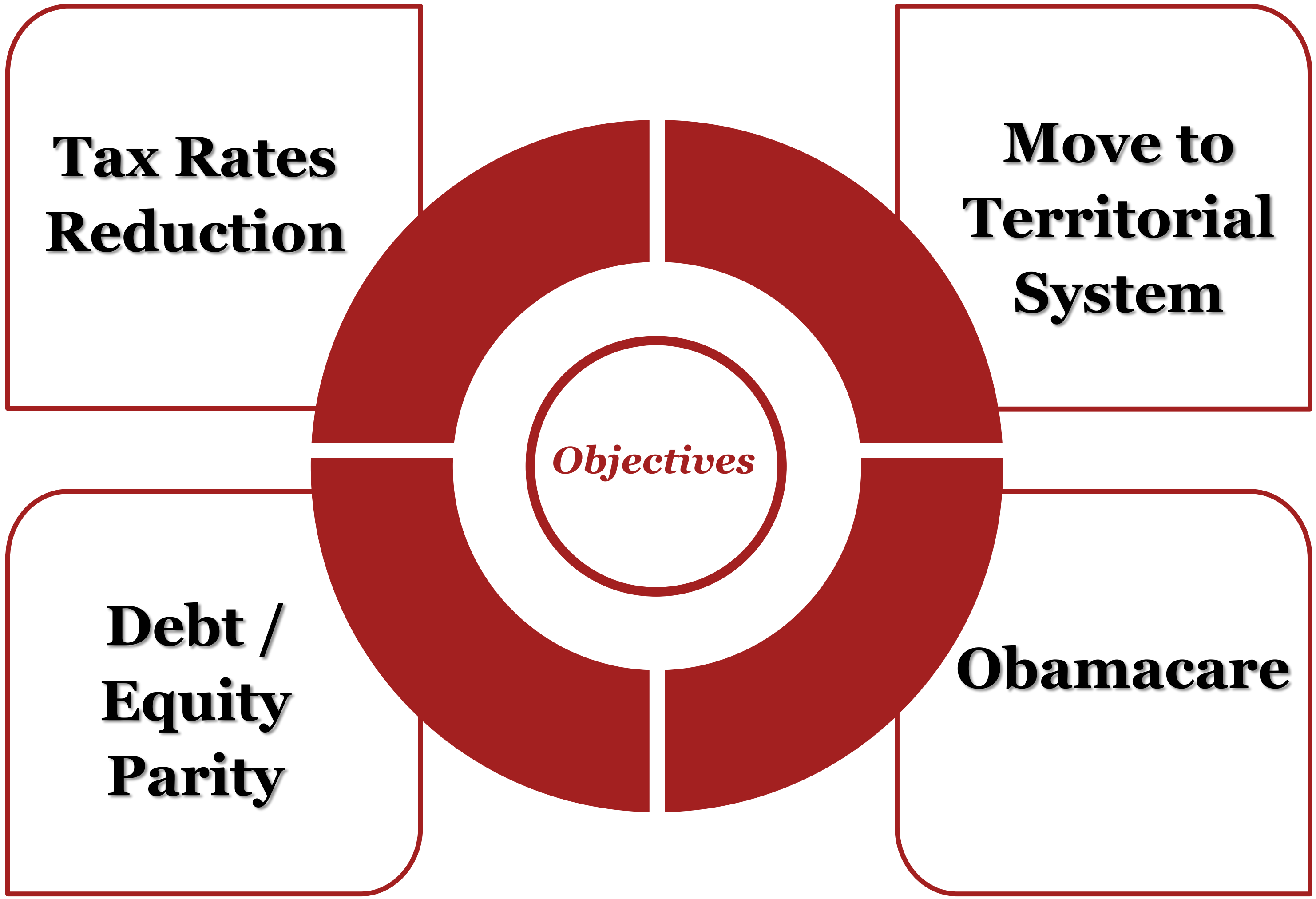
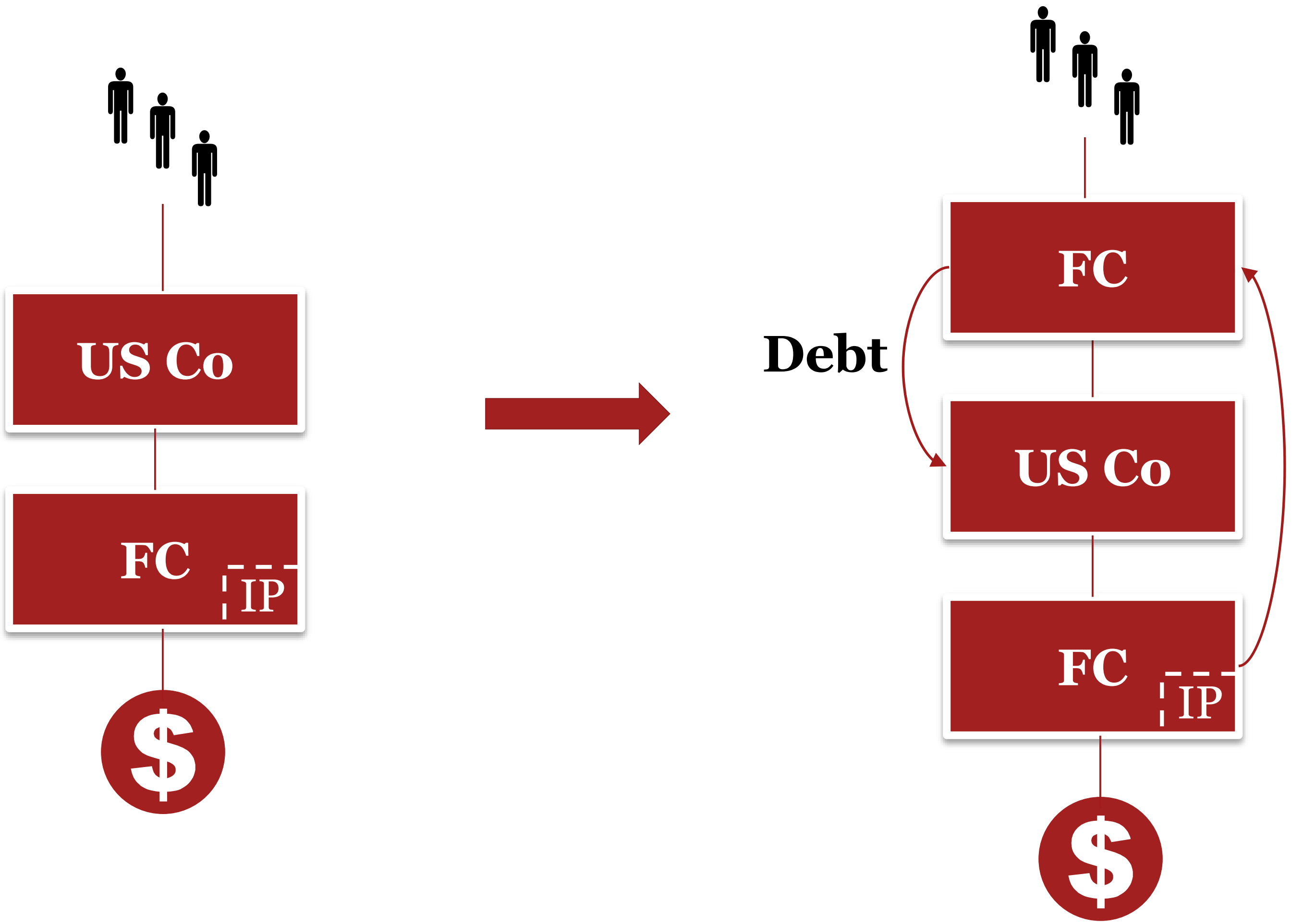
Tax Reform - Objectives



Tax Reform – Problem Presented



Agenda

1. Corporate Tax System
2. Interest Deduction Limitations
3. Anti-Hybrid Rules
4. Base Erosion and Anti Abuse Tax (BEAT)
5. Territorial System & Toll Charge
6. U.S. Resident Individual Holding an Israeli Corporation
7. Global Intangible Low-Taxed Income (GILTI) & Foreign Derived Intangible Income (FDII)
8. Attribution Rules
9. Other Key Items
10. Excessive Employee Remuneration
11. Qualified Equity Grants
12. Limitation on Business Expenses
13. State Tax
14. Financial Statements Considerations

Corporate Tax System

- **Corporate income tax rate was reduced to 21% (effective as of January 1, 2018)**
- **Corporate Alternative Minimum Tax (AMT) was repealed**
  - ✓ For TY 2018, 2019, and 2020, AMT credit carryforward can be utilized to offset regular tax with any remaining AMT carryforwards eligible for a refund of 50% of the outstanding balance. Any remaining AMT credit carryforwards will become fully refundable beginning in the TY 2021.
- **Net operating losses (NOLs) is limited to 80% of taxable income**
- **NOLs will be carried forward, but not carried back**

Interest Expense Deduction

- Limit the interest deduction to 30% of EBITDA from TY 2018 until TY 2021 and of EBIT from TY 2022 onwards
- Disallowed interest may be carried forward indefinitely

Interest Expense Deduction (Cont.)

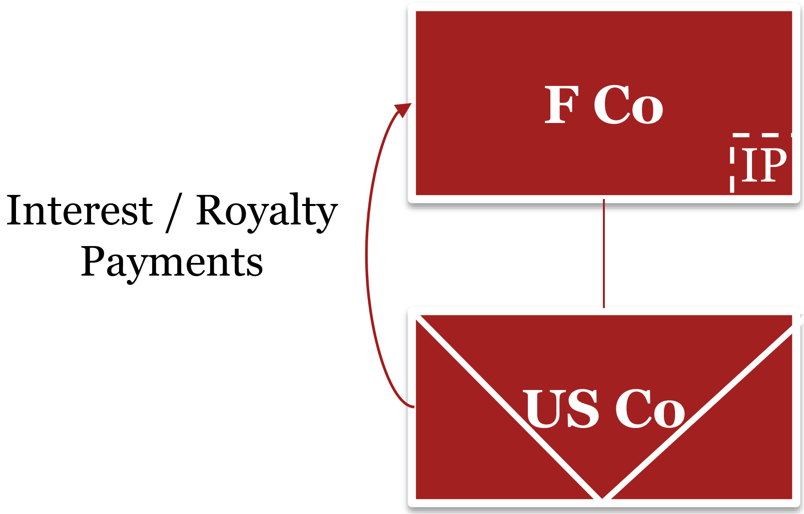
Taxable Income	$70
Total Interest Expense (paid to related and unrelated parties)	$50
Depreciation	$10

Adjusted Taxable Income (EBITDA)	$70+($50+$10) = $130
30% of Adjusted Taxable Income	$130*30% = $39
Disallowed Interest Expense	$50-$39 = **$11**

Interest Expense Deduction – Main Exceptions

- **Businesses with average annual gross receipts for the prior three years of less than $ 25 million**
- **An electing real property trade or business**

Anti-Hybrid Rules



- No deduction for interest or royalties, if the income is not taxed or is accorded a deduction in the recipient's jurisdiction

Base Erosion and Anti Abuse Tax (BEAT)

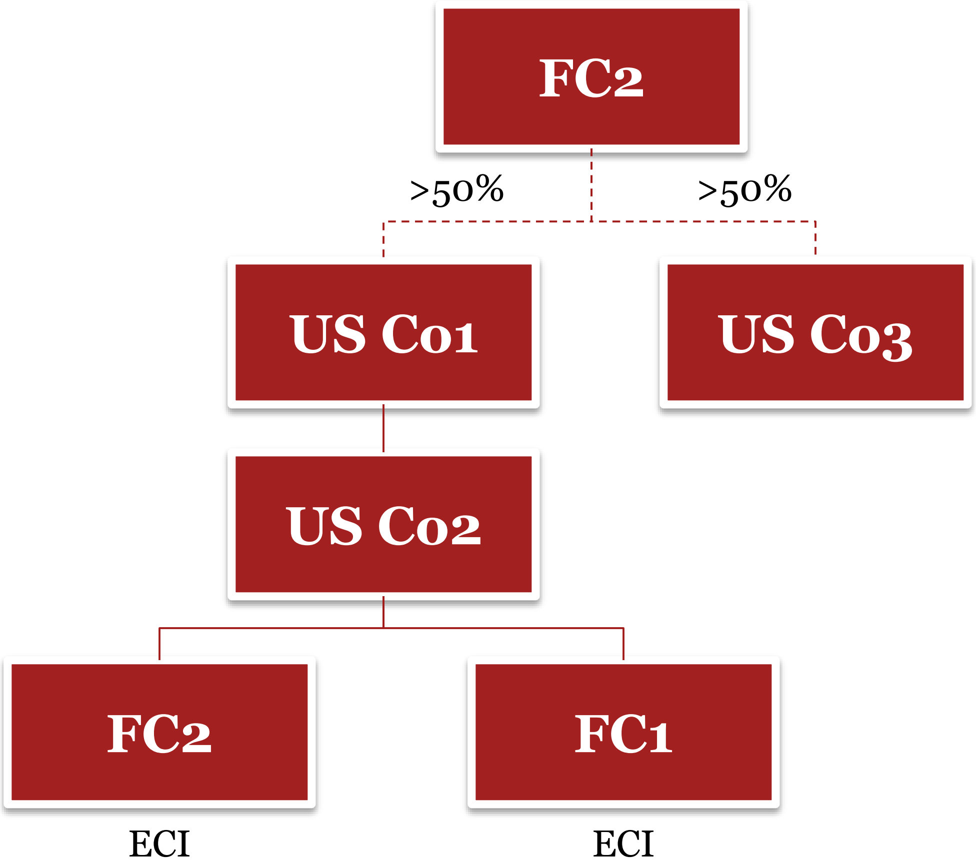
- Taxation of payments paid or accrued by a U.S. taxpayer to a related party foreign person
- Base Erosion Payments are payments with respect to which a deduction is allowable (*e.g.*, interest, royalties and management fee, *etc.*) and payments for depreciable / amortizable property
- Tax liability at a rate of 5% in TY 2018 and 10% in the following tax years on gross amounts

Base Erosion and Anti Abuse Tax (BEAT)

	Example A	**Example B**
NOL Carry-Forward	$200	$50
Gross Income	$200	$200
Base Eroding Deductions	($50)	($50)
Other Deductions	($50)	($50)
Taxable Income (before NOL)	$200-$50-$50 = $100	$100
Utilized NOL	($100)	($50)
Taxable Income	-	$50
“Regular” Tax Liability (21%)	**-**	**$10.5**
Addback to Calculate BEAT:		
Base Eroding Deductions	$50	$50
Base Eroding % of NOL	($50/$100)*$100= $50	($50/$100)*$50=$25
Adjusted Taxable Income	$100	$125
Tax (10%)	$10	$12.5
BEAT	$10-$0 = **$10**	$12.5-$10.5 = **$2**

BEAT - Exception

- The BEAT will apply with respect to payments made by U.S. companies with an average annual gross receipts in excess of $500 million



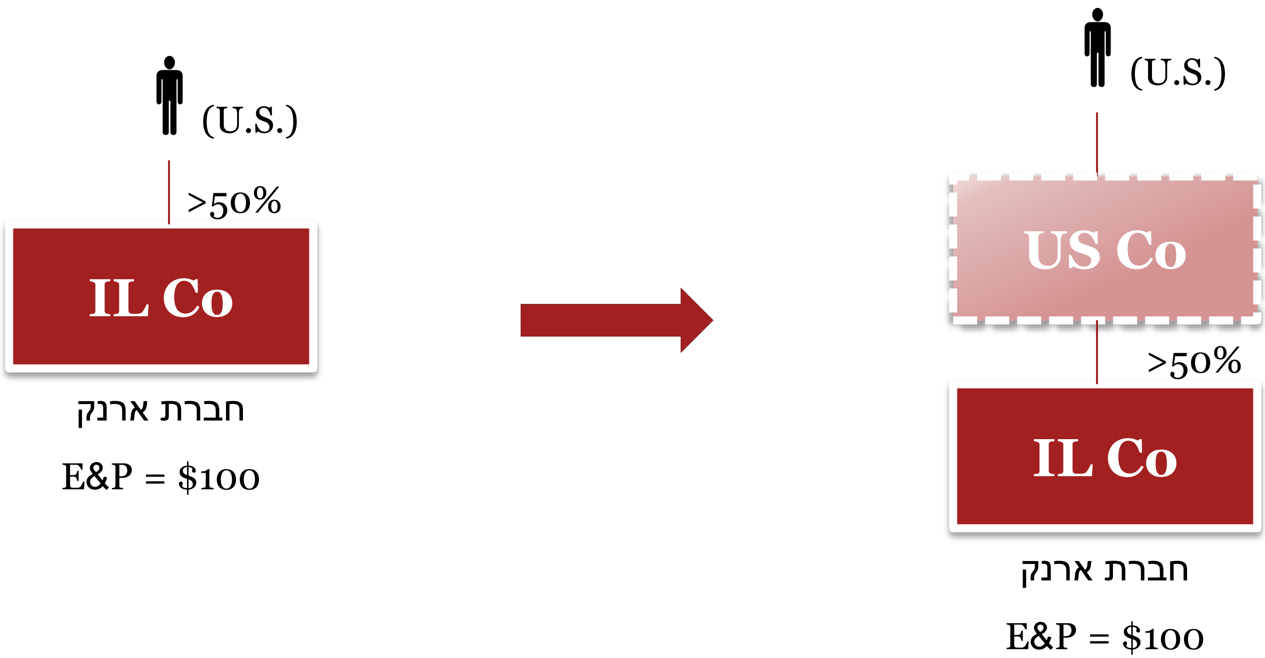
Territorial Tax System & Toll Charge

- Moving to a territorial system
- 100% foreign dividend exemption
- No repeal of CFC rules
- One-time repatriation “toll charge”

Repatriation "Toll Charge" - Example

Deemed Dividend Income	
Foreign E&P	100
Less: Previously Taxed Income ("PTI")	-
Deferred Foreign Income ("DFI")	100
DFI attributable to cash assets	20
DFI attributable to non-cash assets	100 – 20 = 80
Total DFI	100
Participation Exemption	
Cash Asset Deduction	20*(1-**15.5%**/35%)=11.14
Non-Cash Asset Deduction	80*(1-**8%**/35%)=61.7
Taxable Income:	
DFI	100
Less: cash asset deduction	(11.14)
Less: non-cash asset deduction	(61.7)
Total taxable DFI	27.16
Taxable Income	**27.16**
Tax Liability (35%)	**9.5**

U.S. Resident Individual Holding an Israeli Corporation

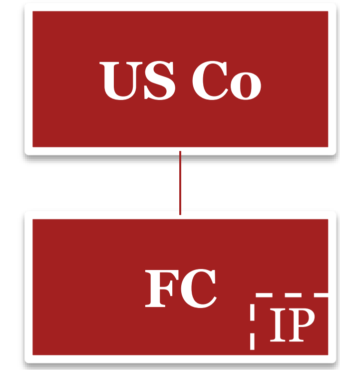


- **Toll charge**
- **No dividend received deduction in future years**

- **IRC 962 election**

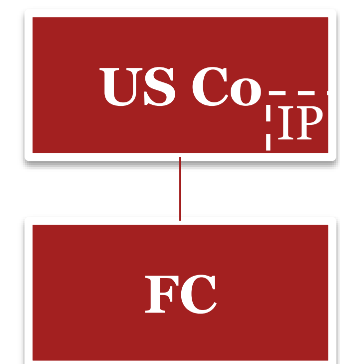
Global Intangible Low-Taxed Income (GILTI) & Foreign Derived Intangible Income (FDII)

- **GILTI = CFC income in excess of 10% return on tangible assets**



  - ✓ The GILTI will be subject to an effective tax rate of 10.5%
  - ✓ 80% of foreign tax credit will be allowed (*i.e.*, if the tax rate with respect to the income of the CFC in the foreign country is higher than 13.125%, the GILTI should not be taxed)

- **FDII – an incentive to own IP in the U.S.**



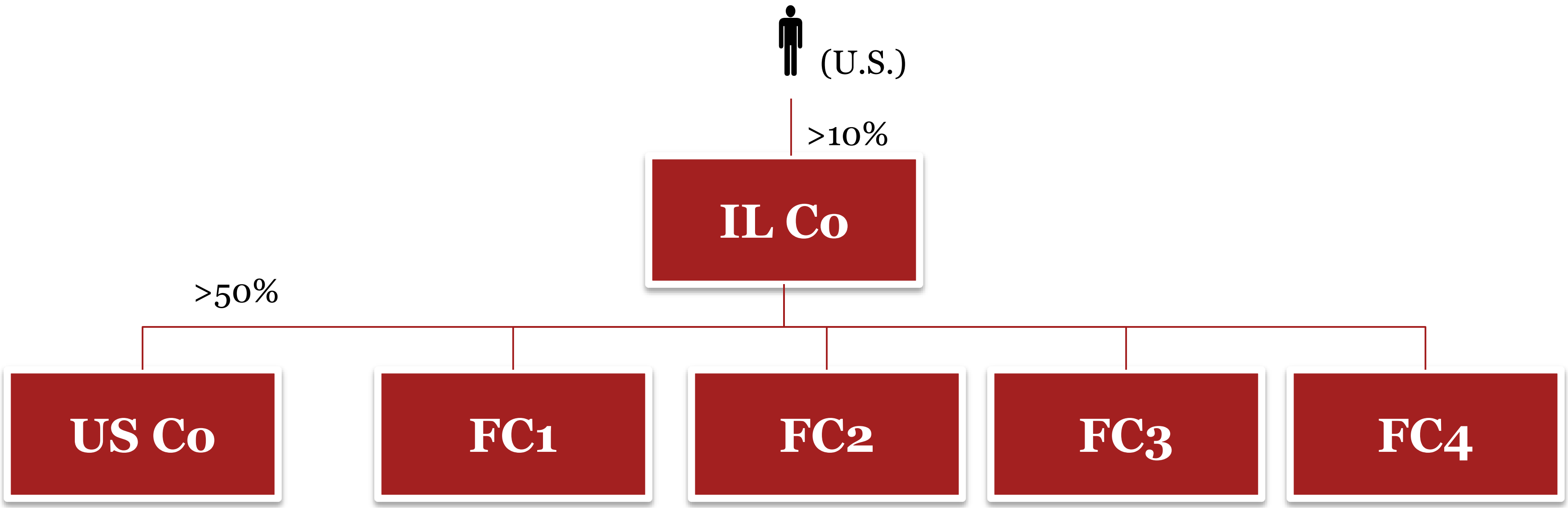
GILTI - Example

	Example A	Example B
Tested Income (Gross Income of CFC)	77,000	90,000
Adjusted Basis of Tangible Assets used in Trade or Business	200,000	200,000
Foreign Taxes Paid on Tested Income	23,000	10,000
GILTI	77,000-10%*200,000= 57,000	90,000-10%*200,000= 70,000
Deduction (50%)	(28,500)	(35,000)
Taxable GILTI	28,500	35,000
GILTI Tax (21%)	**5,985**	**7,350**
Available FTC	80%*23,000*(57,000/77,000)= 13,621	80%*10,000*(70,000/90,000)= 6,222
Section 78 Gross Up	17,026	7,778
Total GILTI	74,026	77,778
50% Deduction	(37,013)	(38,889)
GILTI Inclusion	37,013	37,013
GILTI Tax (21%)	7,773	8,167
Utilized FTC	(7,773)	(6,222)
Total U.S. GILTI Tax	**-**	**1,994**

FDII - Example

Deduction Eligible Income	100,000
Adjusted Basis of Tangible Assets used in Trade or Business	200,000
Deduction Eligible Income related to Products or Services outside the U.S.	60,000
Qualified Business Asset Investment	10%*200,000=20,000
FDII	(100,000-20,000)*(60,000/100,000) = 48,000
Deduction (37.5%)	(18,000)
FDII taxable income	30,000
Total Tax on FDII (21%)	6,300
FDII Benefit	48,000*21% - 6,300= **3,780**

Attribution Rules



- FC1, FC2, FC3 and FC4 will be considered as CFCs of US Co
- Toll charge
- Filing of Form 5471 for each of FC1, FC2, FC3 and FC4 if they are held directly or indirectly by a U.S shareholder (Notice 2018-13)
- Effective as of January 1, 2017

Other Key Items

Topic	New Law
Cost Recovery (expensing) & Section 199	▪ Full expensing for investments in new and used property made after September 27, 2017 and before January 1, 2023. Five-year phase down of full expensing beginning in 2023 (additional year for certain qualified property with longer production period) ▪ Repeal of the deduction allowed for domestic production activities under Section 199
Individual Income Tax Rates	Seven tax brackets — 10%, 12%, 22%, 24%, 32%, 35%, and 37% (in TY 2018 through TY 2025)
Pass-Through Entities	Owners of pass-through entities (*e.g.*, S corporations, partnerships, LLC, *etc.*) will be eligible for a 20% deduction on their business income (in TY 2018 through TY 2025)
Estate Tax	The exemption will be doubled to estates worth $ 11 million for individuals and $ 22 million for married couples (in TY 2018 through TY 2025. Following TY 2025 the exemption will revert to the previous amounts)

Excessive Employee Remuneration – IRC 162(m)

The limitation will cover remunerations to CEOs

Repeal of exclusion for qualified performance-based compensation

Repeal of exclusion for commissions

Elimination of the "last day of the year" rule

Expansion of the definition "publicly held corporation" to include domestic publicly traded corporations, including corporations that are subject to filing requirements due to publicly held debt

Effective for tax years beginning after December 31, 2017

Qualified Equity Grants

- ✓ Illiquid company may offer a broad based stock option or restricted stock unit (RSU) plan to certain employees
- ✓ The options or RSUs should be offered to at least 80% of an employer's U.S. employees
- ✓ Participants could elect to defer gains from an option exercise or RSU vesting for up to 5 years
- ✓ Employer reporting and other requirements would apply, including with respect to coordination with existing Incentive Stock Option (ISO) and Employee Stock Purchase Plan (ESPP)

Effective for tax years beginning after December 31, 2017. Transition rule for compensation paid pursuant to a plan where the right to participate in the plan is part of a written binding contract with the employee in effect on November 2, 2017

Limitation on Business Expenses

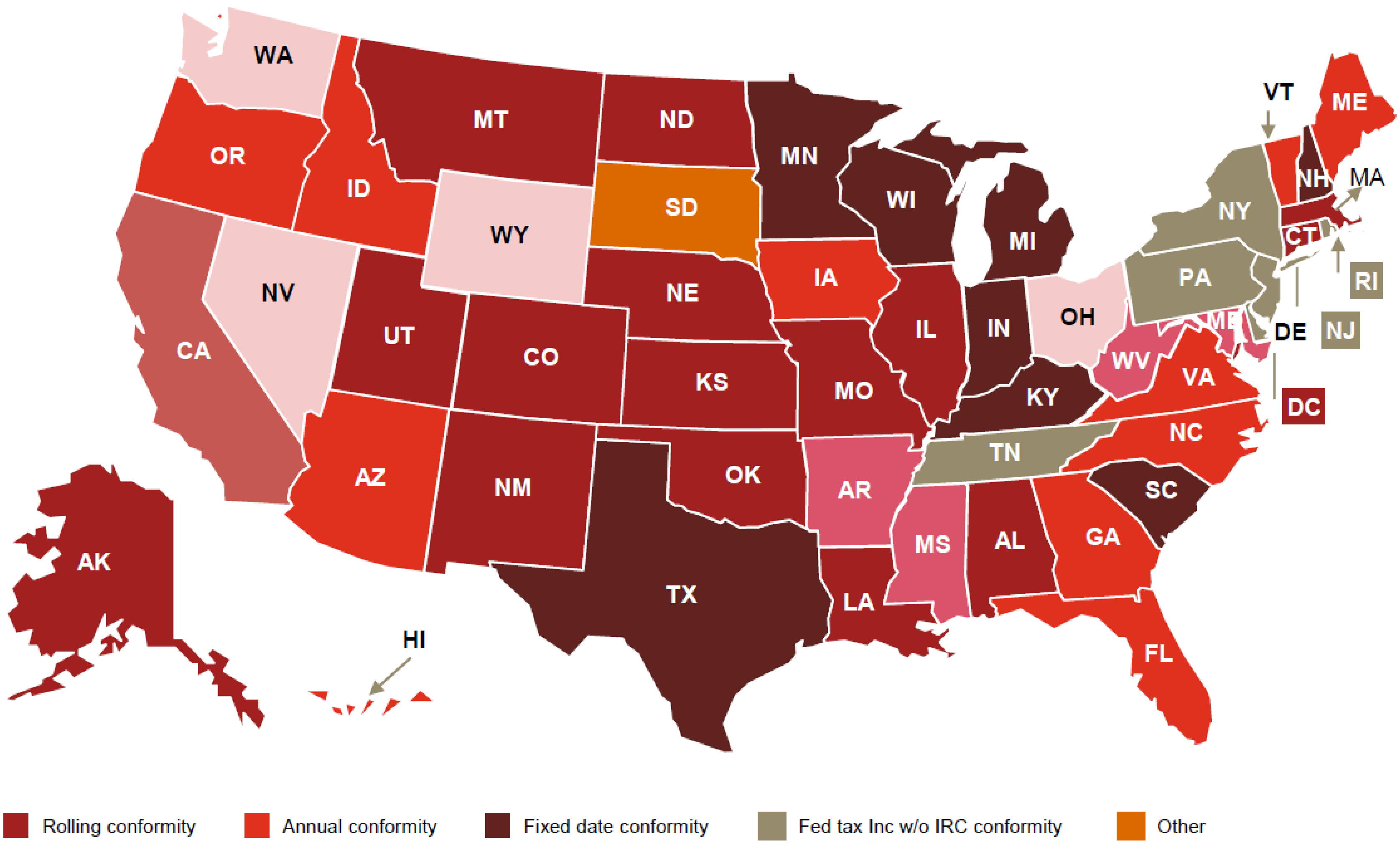
- **Disallowance of entertainment expenses**
- **50% limitation on deduction with respect to business meals**
- **50% limitation on deduction with respect to meals provided for convenience of employer (100% disallowance following TY 2025)**
- **Disallowance of transportation expenses**

The limitations apply with respect to expenses incurred or paid after December 31, 2017

State Tax

- State income tax is expected to be a larger portion of the domestic tax liability
- Conformity issues
- Main new provisions that may create differences between the federal and state tax treatment:
  - ✓ Cost recovery
  - ✓ NOLs
  - ✓ Toll charge
  - ✓ Dividend received deduction

State Tax - Conformity

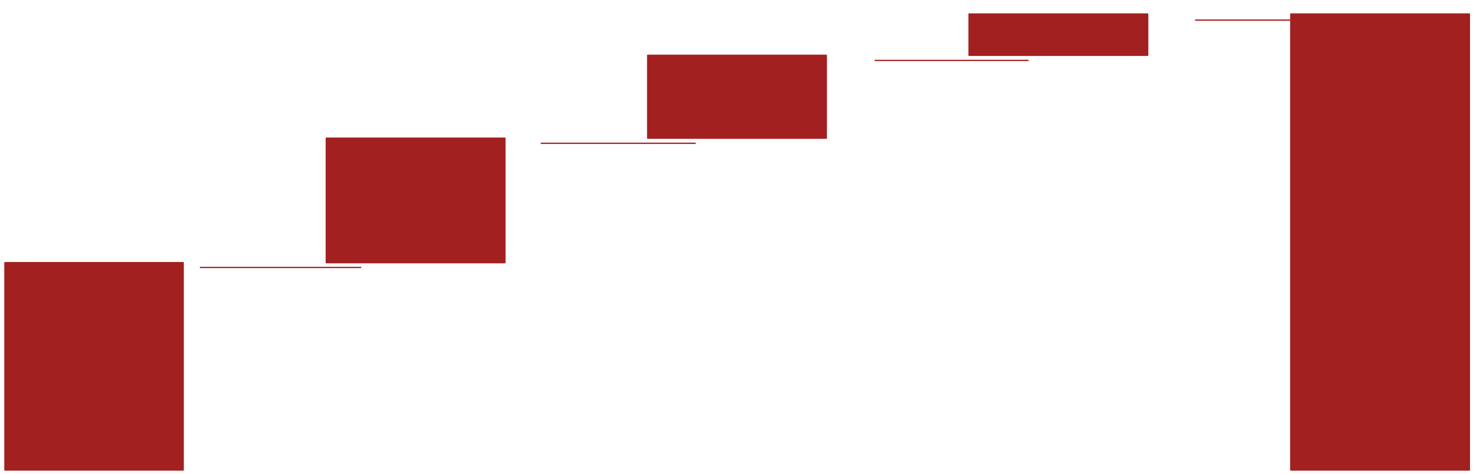


Impact on Financial Statements

- ✓ Deferred tax assets and liabilities to be measured at the enacted tax rate
- ✓ Record tax liability for repatriation “toll charge”
- ✓ Evaluate changes to indefinite reinvestment assertion, and record and disclose the impact as appropriate
- ✓ Evaluate the impact of the BEAT, GILTI and FDII
- ✓ Evaluate the impact of the interest deduction limitation rules

Impact on Financial Statements (Cont.)

- ✓ Record income taxes receivable for AMT credit
- ✓ Evaluate state tax impact
- ✓ Consider the impact on valuation allowance assessments
- ✓ Assess uncertain tax positions
- ✓ Consider changes in processes, controls, data needs, and systems



SEC Guidance – SAB 118

- *Certain disclosures should be provided in situations where a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the Tax Reform*
- *Applies to SEC registrants, as well as private companies using US GAAP*

Thank You!

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