

Final regs on deduction for foreign-derived intangible income and GILTI

The IRS recently issued final regs that cover determining the amount of the tax deduction for foreign-derived intangible income (FDII) and global intangible low-taxed income (GILTI). The regs also coordinate the FDII and GILTI deduction with other tax provisions. They retain the basic approach and structure of the proposed regs, with certain revisions. Here are some highlights.

Documentation requirement

For purposes of the FDII deduction, the proposed regs provided that a taxpayer must obtain specific types of documentation to establish that:

- A recipient is a foreign person,
- Property is for a foreign use, or
- A recipient of a general service is located outside the United States.

The final regs eliminate the documentation requirement. Instead, the final regs have more general substantiation requirements that aren't limited to a narrow set of documents.

The proposed regs also provided a transition rule whereby, for taxable years beginning on or before March 4, 2019, taxpayers could use any reasonable documentation maintained in the ordinary course of business to establish that a recipient is a foreign person, property is for a foreign use or a recipient of a general service is located outside the United States, as applicable, in lieu of the specific documentation described in the proposed regs. Taxpayers are now permitted to rely on this transition rule for taxable years beginning before January 1, 2021.

Anti-avoidance rule

The final regs adopt the proposed regs' anti-avoidance rule. This rule says that, for purposes of calculating a domestic corporation's qualified business asset investment, a transfer of specified tangible property by a domestic corporation to a related party is disregarded if, within a two-year period beginning one year before the transfer, the domestic corporation leases the same or substantially similar property from a related party. Such a transfer and lease must also occur pursuant to a principal purpose of reducing the domestic corporation's deemed tangible income return. However, the final regs add that the anti-avoidance rule doesn't apply to a transfer of property that occurs before March 4, 2019.

Foreign person

The final regs adopt the proposed regs' rules that require documentation to prove that a sale is made to a foreign person. However, the final regs also provide that the sale of property is presumed made to a foreign person if the sale is as described in one of four categories:

1. Foreign retail sales,
2. Sales of general property that are delivered to an address outside the United States,
3. In the case of general property that isn't sold in a foreign retail sale or delivered overseas, the billing address of the recipient is outside the United States, or
4. In the case of sales of intangible property, the billing address of the recipient is outside the United States.

The presumption doesn't apply if the seller knows or has reason to know that the sale is to a recipient other than a foreign person.

The final regs also specify that a seller has reason to know that a sale is to a recipient other than a foreign person if the information received as part of the sales process indicates that the recipient isn't

a foreign person, and the seller fails to obtain evidence establishing that the recipient is, in fact, a foreign person.

Information that indicates that a recipient isn't a foreign person includes, but isn't limited to, a U.S. phone number, billing address, shipping address or place of residence. With respect to an entity, evidence may include information showing that the entity is incorporated, formed or managed in the United States.

Reason to know

The final regs adopt the proposed regs' rule that a sale of property qualifies as a foreign-derived deduction eligible income sale only if the seller doesn't know or have reason to know that the recipient isn't a foreign person. However, the proposed regs also required that the seller or renderer didn't know or have reason to know that the property won't be for a foreign use.

The final regs eliminate the "have reason to know" language. Instead, the final regs provide that the sale is for a foreign use if the seller determines that such sale is to a person described in the applicable regulations.

Determining foreign use of intangible property

Consistent with the proposed regs, the final regs provide that foreign use of intangible property is determined based on revenue earned from "end users" located outside the United States. An end user is defined under regulations as the person who ultimately uses or consumes property, or a person who acquires property in a foreign retail sale.

However, the final regs provide more detailed guidance for determining where revenue is earned from end users of the intangible property, including rules for intangible property:

- Embedded in general property or used in connection with the sale of general property,
- Used to provide services, and
- Used in research and development.

Generally, the final regs place the location of use of the intangible property with the location of the end user. This is usually the person who ultimately uses the general property in which the intangible property is embedded or associated with, or, if the intangible property is used to provide a service, the service recipient. These rules provide the same determination of location of end user for sales or licenses of intangible property used in research and development.

Location of a business recipient of general services

The final regs retain the same general approach as the proposed regs for determining the location of the business recipient. They do so by stating that a service is provided to a business recipient located outside the United States to the extent that the service confers a benefit on operations of the business recipient that are located outside the United States.

The location of a business recipient's operations is determined based on whether its activities are regular and continuous in a particular geographical location. This generally wouldn't include activities in outer space or international space, but may include international waters (for example, in the case of a drilling rig).

The final regs clarify that an office or other fixed place of business is a "fixed facility" through which the "business recipient" engages in a trade or business. A fixed facility is a place, site, structure or other similar facility through which the business recipient engages in a trade or business. In addition, the final regs provide that, for purposes of determining the location of the business recipient, the service provider may make reasonable assumptions based on the information available to it.

In addition, the final regs provide that, if the business recipient doesn't have an identifiable office or fixed place of business, the recipient is deemed to be located at its primary billing address. And the final regs expand the definition of "business recipient" provided in the proposed regs to include all related parties of the recipient.

With respect to advertising services, under the final regs, the operations of the business recipient that benefit from the advertising service are deemed to be located where the advertisements are viewed by individuals. The final regulations further provide that, if advertising services are displayed on the Internet, the advertising services are viewed at the location of the device on which the advertisements are viewed. For this purpose, the IP address may be used to establish the location of that device.

With respect to other (non-advertising) electronically supplied services provided to a business recipient, the recipient that benefits from the general service is deemed to be located where the general service is accessed. If the location where the business recipient accesses the electronically supplied service is unavailable then, generally, the business recipient that benefits from the general service provided by the service provider is deemed to be located at the business recipient's billing address.

Applicability dates

The applicability dates of the final regs vary depending on the specific regulation in question. We've covered just a few notable provisions here; consult your CPA for more information and any questions you might have about the final regs. •