

The background of the slide features a stylized graphic with a dark blue and black background. It includes a series of vertical bars of varying heights in shades of blue and green, overlaid with a red line graph. Below the bars, there are horizontal lines of binary code (0s and 1s) in a light blue color. The K&L GATES logo is positioned in the upper left corner, consisting of the text "K&L GATES" in white, sans-serif font, set against a solid red rectangular background.

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2018 CAIA CFA Presentation  
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# **U.S. Tax Reform: Impact on Investment Management Businesses**

Charles H. Purcell, Seattle

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## BACKGROUND ON U.S. TAX REFORM

- Bill known as the Tax Cuts and Jobs Act (“TCJA”) signed December 22, 2017 (HR 1 or The Trump Tax Act)
- Comprehensive tax reform affecting virtually all taxpayers
- 7 weeks from start to finish
- Fast pace/process led to drafting errors, lack of clarity, gaps, overlaps and unintended consequences



## THE AFTERMATH

- Congress will spend 2018 fixing these problems
  - Technical corrections
  - Legislative changes
- Treasury/IRS regulatory and guidance projects to interpret and implement



## MAJOR THEMES

- Most significant spread between corporate and individual rates since 1982
- Different tax treatment for taxpayers receiving the same or similar types of income
- Increased complexity in the Code for business taxpayers
- Significant variations in treatment of similar transactions from year to year built into the Act
- Major changes for foreign related transactions



# AGENDA

- Fund and Management Company Issues
  - Reduction of corporate rate
  - Three-year holding period for long-term capital gains treatment for carried interests
  - Elimination of miscellaneous itemized deductions
  - 20% pass-through income deduction (new Section 199A)
  - Limitation on deductibility of state and local taxes
  - Foreign Derived Intangible Income (“FDII”)
  - Treatment of gain on sale of partnership interest by a non-U.S. partner



## AGENDA (CONTINUED)

- Portfolio Company and Investment Related Issues
  - Changes to rules relating to corporate net operating losses (“NOLs”)
  - New limitations on interest deductibility
  - Full expensing for certain capital investments
  - One-time tax on accumulated foreign earnings
  - New participation exemption for dividends from foreign subsidiaries
  - Addition of “global intangible low-taxed income” (“GILTI”) to the U.S. anti-deferral regime





# Fund and Management Company Issues



## FEDERAL CORPORATE INCOME TAX RATE REDUCED TO 21%

- Biggest difference between corporate and individual rates since 1982
- Significant incentive to incorporate, especially when there is reinvestment in business operations





# EVERYTHING OLD IS NEW AGAIN

- Old rules will become more important
  - Personal Holding Company Tax
    - Penalty tax on corporations that are closely held and have significant investment income
  - Accumulated Earning Tax
    - Tax on earnings that are accumulated in excess of the needs of the business



## SECTION 1202 BECOMES MORE IMPORTANT

- Gain on sale of corporate stock of certain small companies (less than \$50 million in value) may be subject to a zero percent tax rate (subject to significant limitations)
- This benefit is now coupled with low corporate tax rates making investments in small C corporations much more advantageous



## ASSETS SALES ARE LESS VALUABLE TO BUYERS OF BUSINESSES

- One of the benefits of holding a business in a flow-through entity has been the ability to sell assets of the business to a buyer with little additional tax drag
- This gave buyers the ability to amortize or depreciate assets of the business based on the increased basis of the assets arising from the sale and creating a tax shield for the buyer, presumably increasing the price for the business
- Lower corporate tax rates decrease the value of being able to sell assets, which also makes C corporations more attractive



## NEW 3-YEAR HOLDING PERIOD FOR LONG-TERM CAPITAL GAINS TREATMENT FOR CARRIED INTERESTS

- The TCJA imposes a 3-year holding period requirement to treat capital gain derived from certain partnership profits interests as long-term capital gain
  - Short-term capital gain treatment if holding period is not met, taxable at ordinary income rates
  - No grandfathering of existing interests
  - Applies to private equity and hedge funds, though with potentially limited practical effect
- Prior to the change, the holding period requirement was one year



## CARRIED INTEREST (CONTINUED)

- Focused on investment businesses
  - Affected profits interests include those transferred or held in connection with the performance of substantial services in the trade or business of raising or returning capital and investing in, or disposing of, or developing, securities, commodities, debt instruments, options, derivatives, real estate held for investment, or any interest in a partnership to the extent of the partnership's interest in any of the foregoing assets
  - **Generally does not apply to profits interests in operating companies**



## CARRIED INTEREST (CONTINUED)

- The 3-year holding period appears to apply with respect to both asset sales at the partnership level and to direct sales of affected partnership interests
- It appears that a holder of a profits interest who is subject to the new rule and has held the profits interest for less than three years may nevertheless achieve long-term capital gain treatment with respect to allocations of capital gain from a partnership if the partnership's holding period for the sold asset is more than three years



## CARRIED INTEREST (CONTINUED)

- Availability of long-term capital gains rates for qualified dividend income is apparently unaffected
- Under a special rule, a partnership interest that otherwise would be subject to the three-year holding period requirement is excepted if held by a person employed by another entity that is engaged in a trade or business (other than one of the trades or businesses mentioned above) — *e.g.*, an operating business — and provides services only to such other entity





## CARRIED INTEREST (CONTINUED)

- Thus, in the private equity setting it appears that portfolio company executives or other employees may be able to receive a carried interest in an upper-tier partnership without triggering the three-year holding period requirement, notwithstanding that the partnership itself is engaged in the trade or business of investing
- The precise scope of this rule is uncertain
- Exceptions:
  - Interests held, directly or indirectly, by a corporation (but not S corporations)
  - Capital interests that provide a right to share in partnership capital commensurate with the amount of capital contributed or with the amounts included in income as compensation under Section 83



## CARRIED INTEREST

- Dividend income is still eligible for long-term capital gain treatment
- May see managers receive stock on sale of company
- Other structures are being discussed to minimize the effect of limitations



## ELIMINATION OF MISCELLANEOUS ITEMIZED DEDUCTIONS

- Prior Law: individuals were permitted to deduct certain miscellaneous itemized deductions (*e.g.*, investment management fees) to the extent such deductions exceeded 2% of adjusted gross income
- TCJA: effective for tax years after December 31, 2017 and before January 1, 2026, miscellaneous itemized deductions, including investment management fees, will no longer be deductible for individuals, trusts, and estates
- Performance fees may be significantly affected



## 199A DEDUCTION: INTRODUCTION

- Potentially applies to income earned through partnerships (including LLCs taxed as partnerships), S corporations and sole proprietorships
  - The deduction is allowed to itemizers and non-itemizers alike
  - Sunsets at the end of 2025



## 199A DEDUCTION: INTRODUCTION (CONT'D)

- Extremely complex
- 20% deduction of the income for sole proprietorships, S corporations and partnerships from business activities
- Bad businesses – Law, medicine, investment management, consulting, and other trades or businesses where the principal asset of the business is the skill of one or more of its employees or owners
  - Limited to income below \$315,000
- Good businesses include everything else (including engineers and consulting services)
  - Structured so that the amount of the deduction is dependent upon (1) W-2 wages and (2) investment in depreciable tangible property



## SPECIAL RULES FOR REIT AND PUBLICLY TRADED PARTNERSHIP DISTRIBUTIONS

- Regular REIT dividends are subject to the 20% deduction without regard to the income limitations
- Publically traded partnership distributions are also subject to this rule



## 199A DEDUCTION: DETAILS (CONT'D)

- The potential Section 199A deduction with respect to any “qualified trade or business” of the taxpayer generally is equal to the lesser of:
  - (1) 20 percent of the taxpayer’s “qualified business income” with respect to such qualified trade or business; or
  - (2) The greater of:
    - 50 percent of the W-2 wages with respect to the qualified trade or business; or
    - The sum of 25 percent of the W-2 wages with respect to the qualified trade or business, plus 2.5 percent of the unadjusted basis immediately after acquisition of all qualified property
- Subject to an overall cap of 20 percent of (i) taxable income over (ii) net capital gain





# 199A DEDUCTION: QUALIFIED TRADE OR BUSINESS

- Includes any trade or business, unless a specific exception applies
- Exceptions:
  - Specified Service Trade or Business. Generally excludes any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any other trade or business where the principal asset of the trade or business is the skill of one or more of its employees or owners (other than architecture and engineering) (a “specified service trade or business”)
  - Employees. Excludes the trade or business of performing services as an employee
  - Investment Management, Trading and Dealing. Excludes trades or businesses that involve the performance of services that consist of investing, investment management, trading, or dealing in securities, partnership interests or commodities
- Notwithstanding the general exception, a specified service trade or business may be a qualified trade or business with respect to a taxpayer if the taxpayer’s taxable income is less than \$415,000 (in the case of a joint filer) or \$207,500 (in the case of a single filer)
  - Phase-outs are applied, however, as the taxpayer’s taxable income rises above \$315,000 to \$415,000 (in the case of a joint filer) or \$157,500 to \$207,500 (in the case of a single filer)



# 199A DEDUCTION: QUALIFIED BUSINESS INCOME

- Generally determined as the net amount of items of income, gain, deduction, and loss that are “effectively connected” with the conduct of a qualified trade or business in the United States
  - Note: generally intended to incentivize businesses to conduct activities in the U.S.
  - Although beyond the scope of this presentation, care must be taken to structure tax efficient foreign operations and may involve a different choice of entity than for U.S. operations
  - Section 199A imports concepts of Code Section 864(c) (part of the “inbound” international tax rules) to determine whether income is effectively connected with a qualified trade or business
- Excludes most passive types of income
  - Capital gain or loss, dividends, interest (other than properly allocable to a trade or business (e.g., a lending business)), commodities gains, foreign currency gains, income from notional principal contracts, any amount received from an annuity (other than in connection with a trade or business), and any item of deduction or loss properly allocable to any of the foregoing
  - Notably, it does not exclude rental income
- Also excludes reasonable compensation and guaranteed payments



# 199A DEDUCTION: W-2 WAGES

- Generally includes wages that are properly reportable on Form W-2 to the extent such wages are properly allocable to qualified business income
- To qualify as W-2 wages for purposes of Section 199A, the wages must be reflected on a Form W-2 or Form W-2c within 60 days of the due date of Form W-2 with the Social Security Administration (*i.e.*, generally within 60 days of January 31<sup>st</sup> of the taxable year following the year in which the wages are paid)
- Issues may arise for pass-through businesses with profits interest holders that have historically reported compensation income to such holders as wages on Form W-2 rather than as guaranteed payments on Form K-1
  - Unlocking the Section 199A deduction may require restructuring of profits interest arrangements so that sufficient W-2 wages may be paid at the operating entity level
- Each partner in a partnership or shareholder in an S corporation takes into account such person's "allocable share" of the W-2 wages for purposes of computing such person's deduction under Section 199A



## 199A DEDUCTION: QUALIFIED PROPERTY

- Generally includes the depreciable tangible property held by and available for use in a qualified trade or business at the close of the taxable year and used in the production of qualified business income during such year
- The unadjusted tax basis of such property may be used to support a Section 199A deduction generally for the later of 10 years from the date the property was first placed in service or the last day of the last full year of the recovery period for such property under Code Section 168 (MACRS)
- The addition of the qualified property concept in Section 199A was added in Conference and apparently is designed to benefit the real estate industry, though the provision potentially benefits capital-intensive operating businesses as well

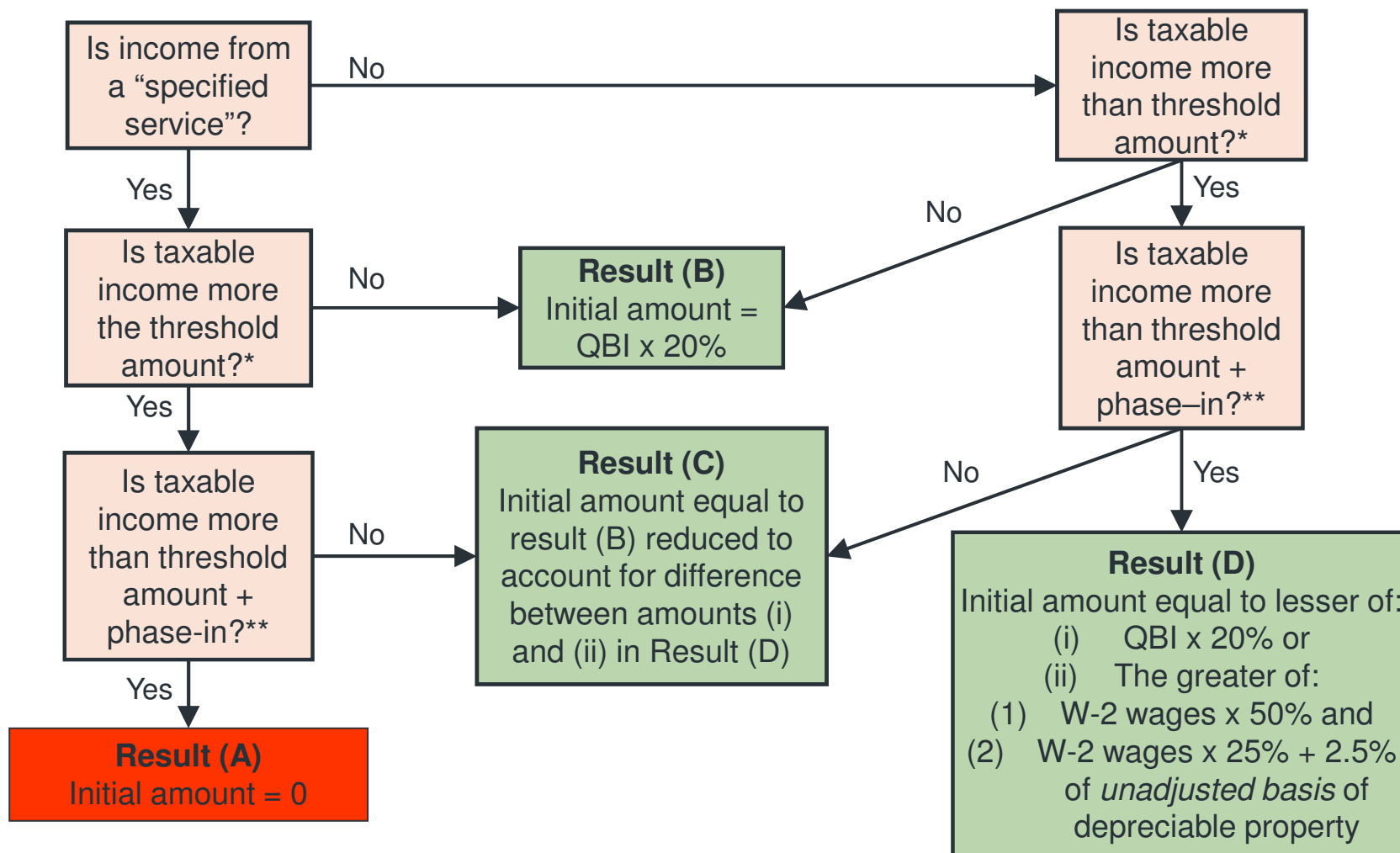


## 199A DEDUCTION: SIGNIFICANCE OF THRESHOLD AMOUNTS

- Generally, if taxable income is below the applicable threshold amounts:
  - The 199A deduction may be available with respect to a specified service trade or business; and
  - The W-2 and/or qualified property conditions do not apply
- Threshold amounts are adjusted for inflation and currently are \$315,000 for joint filers and \$157,500 for single filers
- Phase-in of limits applies as the taxpayer's taxable income rises above \$315,000 to \$415,000 (in the case of a joint filer) or \$157,500 to \$207,500 (in the case of a single filer)



## SECTION 199A DEDUCTION: BASIC DECISION TREE



\* Threshold Amount is \$315,000 of taxable income if filing jointly and \$157,00 in all other cases

\*\* Phase-In is \$100,000 of taxable income if filing jointly and \$50,000 in all other cases

Note: deduction subject to overall cap of 20 percent of (i) taxable income over (ii) net capital gain

## LIMITATION ON DEDUCTIBILITY OF STATE AND LOCAL TAXES

- TCJA significantly limits an individual's ability to deduct state and local taxes through 2025
- TCJA permits deductions of up to \$10,000 for income, property and sales taxes
  - \$10,000 cap does not apply to property and sales taxes that are attributable to the individual's trade or business or Section 212 investment activity
- Issue: Partnership investments in operating businesses in high tax states may be less attractive





## FOREIGN DERIVED INTANGIBLE INCOME

- With an emphasis on incentivizing U.S. companies to maintain onshore operations, the TCJA added the FDII regime
- Includes a 13.125% tax rate (increased to 16.41% in 2026) for a U.S. corporation's FDII
- FDII -- generally income related to services provided and goods sold by a U.S. corporation to foreign customers
- Benefits for sales and services to foreign customers
  - Foreign funds which are not “related”
  - Foreign investors



# TREATMENT OF GAIN ON SALE OF PARTNERSHIP INTEREST BY A NON-U.S. PARTNER

- Historical IRS position: Non-U.S. partners subject to tax on gain from sale of partnership interest as “effectively connected income” (“ECI”) to the extent of gain inherent in partnership assets used in a U.S. trade or business
- Historical IRS position recently overturned in *Grecian Magnesite Mining, Industrial & Shipping Co., SA v. Commissioner*, 149 T.C. 3 (2017)
- TCJA legislatively overturns *Grecian Magnesite*
- Under TCJA, gain on the disposition of partnership interests is subject to U.S. tax to the extent attributable to the partnership’s assets used in a U.S. trade or business (consistent with historical IRS position)
- TCJA includes new withholding feature
  - Transferee required to withhold 10% of amount realized if any portion of gain is attributable to a U.S. trade or business unless transferor certifies that it is U.S. person
  - If transferee fails to withhold, the partnership must withhold from distributions to the transferee



## RECENT IRS NOTICE

- No tax if seller certifies that:
  - It is a U.S. person
  - There is no gain on the sale or
  - Less than 25% of the income from the partnership for each of the prior three years was ECI
  
- In addition, there is no tax if the partnership certifies that less than 25% of gain is ECI





# Portfolio Company and Investment Related Issues

# CHANGES TO RULES RELATING TO CORPORATE NOLs

- Prior Law:
  - NOLs could be carried back 2 years and carried forward 20 years
  - Generally, NOLs could be used as a deduction against 100% of a corporation's regular taxable income
- TCJA:
  - NOLs may be used to shelter only 80% of taxable income for taxable years after 2017
  - NOLs may not be carried back beginning in 2018
  - NOLs may be carried forward indefinitely
  - Changes are effective for NOLs arising in taxable years after December 31, 2017, *i.e.*, older NOLs are not subject to these rules
- Note: elimination of the NOL carryback may impact the ability to monetize transaction tax deductions in M&A setting



# NEW LIMITATIONS ON INTEREST DEDUCTIBILITY

- Old section 163(j) (the so-called “earnings stripping rules”) repealed
  - Under prior law, U.S. corporations owned by foreign entities, the interest expense of which exceeded 50% of EBITDA, could deduct interest paid to related foreign persons only if their debt to equity ratio was less than 1.5 to 1
- New 163(j) introduces substantial limitations on the deductibility of business interest that apply in domestic and international situations alike (and apply both to pass-throughs and corporations)
- Potentially far broader application of new limitations on interest deductibility as compared with old rules
- No grandfathering of existing debt



## NEW LIMITATIONS ON INTEREST DEDUCTIBILITY

- Under the TCJA, the deduction for business interest for any given tax year is generally limited to the sum of (1) business interest income for such year, plus (2) 30% of adjusted taxable income (“ATI”) for such year
- ATI generally is taxable income, computed without regard to:
  - (1) any item of income, gain, deduction, or loss that is not properly allocable to a trade or business;
  - (2) any business interest or business interest income;
  - (3) the amount of any net operating loss (“NOL”) deduction under Section 172; (4) the amount of any deduction under Section 199A; and
  - (5) in the case of taxable years beginning before January 1, 2022, any deduction allowable for depreciation, amortization, or depletion
- Prior to 2022, ATI approximates EBITDA; after 2022, ATI approximates EBIT



## APPLICATION OF NEW LIMITATIONS ON INTEREST DEDUCTIBILITY TO PASS-THROUGHS

- 30% cap applies at the entity level
- Excess ATI allocated to the partners for purposes of computing partner-level ATI
- Increase in basis upon disposition for excess business interest previously incurred but suspended



## CARRYOVER OF UNUSED INTEREST DEDUCTIONS

- Disallowed interest may be carried over indefinitely
- Treated as incurred in the next year
- Not part of NOL deduction (and therefore not subject to 80% limitation, discussed below)
- Subject to limitation after sale of the business under Section 382
- Excess business interest allocated from a partnership may be used only to offset future excess taxable income above the 30% cap allocated from that partnership in future years



## EXCEPTIONS TO INTEREST DEDUCTION LIMITS

- Electing real estate businesses
- Small businesses (those with average annual gross receipts of \$25 million or less in the prior 3 years)
- Electing farm businesses
- Motor vehicle, boat and farm equipment dealers (for floor plan financing interest)



# RATIONALES AND IMPLICATIONS

- Raises revenue to pay for the reduction in corporate rates
- Belief that equity financing is more stable
- Reduces ability of financial buyers to acquire companies (*i.e.*, may negatively impact LBOs)
- Will provide an advantage to business entities with substantial capital
- Could cause highly-leveraged businesses to experience an increase in effective tax rates relative to prior law, despite the lowering of rates
- U.S. corporations, regardless of whether they are foreign-controlled, are now subject to the limitations on interest deductibility under Section 163(j)
- Although real estate companies are not subject to the 30% limitation, such companies remain subject to the arm's-length requirement and general debt-equity principles
- May be possible to structure around interest limitations through use of economically equivalent alternatives to the extent not treated as debt for U.S. tax purposes (*e.g.*, sale-leasebacks)
- Debt financing may continue to be desirable notwithstanding new limitations (*e.g.* for withholding tax reasons)
- Together with the BEAT (discussed below), may incentivize multinationals to move debt to foreign affiliates



# FULL EXPENSING FOR CERTAIN CAPITAL INVESTMENTS

- Section 179 has been permanently amended to allow small businesses to expense up to \$1 million per year of certain depreciable tangible property purchased for use in the active conduct of a trade or business (\$500,000 under prior law)
- More broadly (but subject to sunset as described below), Section 168(k), which provides for bonus depreciation on tangible personal property where 179 does not apply, has also been amended to allow for increased depreciation deductions. This benefit varies by the year in which the property is placed in service
  - Through 2022, 100% of the cost of tangible personal property (whether new or used) may be deducted as bonus depreciation in the year such property is placed in service
  - This percentage is reduced by 20% every 2 years until 2027, when the benefit terminates
  - Any cost not recovered by bonus depreciation is written off under the regular MACRS system



## FULL EXPENSING FOR CERTAIN CAPITAL INVESTMENTS (CONT'D)

- Application of this provision to used property may result in a greater desire for asset acquisitions by buyers (particularly for capital-intensive businesses), though in many cases a significant portion of the purchase price will be allocated to goodwill and other intangible assets, the cost of which is not eligible for immediate expensing
- Taxpayers may elect out of bonus depreciation on a class of property basis for each year in which such property is placed in service
- Consider the interaction of the NOL rules, the interest deduction limits, and the new expensing rules (*e.g.*, taxpayers with NOLs that will not initially benefit from such immediate deductions may choose to make such elections)



# ONE-TIME TAX ON ACCUMULATED FOREIGN EARNINGS

- TCJA imposes a one-time transition tax on certain post-1986 deferred foreign earnings through a deemed repatriation of such earnings
- Any 10 percent U.S. shareholder (by vote) of a foreign corporation as of December 31, 2017, must include in income for the taxable year 2017 its proportionate share of the foreign corporation's undistributed earnings if such foreign corporation is a CFC or is a foreign corporation with at least one 10 percent U.S. corporate shareholder
- Tax Rates:
  - For corporate shareholders, 15.5 percent for earnings invested in cash or cash equivalents and 8 percent for earnings invested in non-cash assets
  - For individuals, 17.5 percent for earnings invested in cash or cash equivalents and 9.05 percent for earnings invested in non-cash assets





## ONE-TIME TAX ON ACCUMULATED FOREIGN EARNINGS (CONT'D)

- Mainly aimed at ending deferral of taxation of the offshore earnings of multinational corporations
- However, may result in phantom income (*i.e.*, income without a related cash distribution)
  - For example: U.S. investors in a U.S. fund where the fund held shares of a foreign corporation amounting to a 10 percent voting interest as of December 31, 2017, even if such investors' indirect interests in the foreign corporation were below 10 percent as of such time





## NEW PARTICIPATION EXEMPTION FOR DIVIDENDS FROM FOREIGN SUBSIDIARIES

- TCJA provides U.S. corporate shareholders of a “specified 10 percent owned foreign corporation” with a 100 percent dividends received deduction for the foreign-source portion of the dividends received from such corporation
- The effect is to exempt such dividends from the U.S. federal income tax base – *i.e.*, the exemption moves the U.S. tax system closer to a “territorial” system
- A one-year holding period generally is required (expressed as 365 days over a two-year period)
- Foreign tax credits are not allowed for the exempt portion of any dividend



## NEW PARTICIPATION EXEMPTION FOR DIVIDENDS FROM FOREIGN SUBSIDIARIES (CONT'D)

- “Specified 10 percent owned foreign corporation” generally is any non-U.S. corporation that has at least one U.S. corporate shareholder that owns at least 10 percent of the stock of the non-U.S. corporation (excluding a passive foreign investment company that is not also a CFC)
- The participation exemption applies to distributions from a CFC to the extent earnings attributable to such distributions do not otherwise constitute Subpart F income or GILTI (or were includible previously under Section 956)
- The basis of stock of a specified 10 percent owned foreign corporation must be reduced by the exempt portion of the dividend for purposes of determining loss with respect to the later sale or disposition of such stock



# NEW PARTICIPATION EXEMPTION FOR DIVIDENDS FROM FOREIGN SUBSIDIARIES (CONT'D)

## ■ Limitations

- Not available for “hybrid dividends” – *i.e.*, an amount received from a CFC, which receives a deduction (or other tax benefit) against any non-U.S. income tax on account of the dividend
- Not available for GILTI
- Not available for gains realized on the sale of stock of a non-U.S. corporate subsidiary except in the case of a CFC to the extent that gain is treated as a dividend under Section 1248
  - May encourage Section 338 elections for sales of non-U.S. subsidiary stock, but impact of GILTI rules must be considered.



# GLOBAL INTANGIBLE LOW-TAXED INCOME

- TCJA adds new Section 951A, which effectively expands the CFC anti-deferral regime to include a new class of income known as GILTI, which significantly reduces deferral for foreign corporations
- GILTI is a new type of income that may be taxed to U.S. shareholders of a CFC in a manner similar to the taxation of Subpart F income
- Generally, GILTI includes all net operating income (taking into account allocable interest deductions) of a foreign corporation not otherwise taxed to U.S. shareholders in excess of a 10 percent return on the adjusted cost basis of the tangible assets of the company used in the production of such operating income



## GLOBAL INTANGIBLE LOW-TAXED INCOME (CONT'D)

- Corporations (excluding S corporations): effective tax rate of 10.5% (rising to 13.25% in 2026)
- Individuals (including income earned by individuals through pass-throughs): regular rates apply (currently a maximum rate of 40.8%, taking into account 3.8% Medicare tax)
  - Individuals subject to GILTI should consider whether election under Section 962 may be available and beneficial with respect to GILTI
- Tax-exempt organizations do not appear to be subject to tax on GILTI unless such income also is UBTI
- U.S. corporate shareholder is eligible for indirect foreign tax credit of 80% of the foreign taxes paid with respect to GILTI
- As noted above, the participation exemption does not apply to GILTI

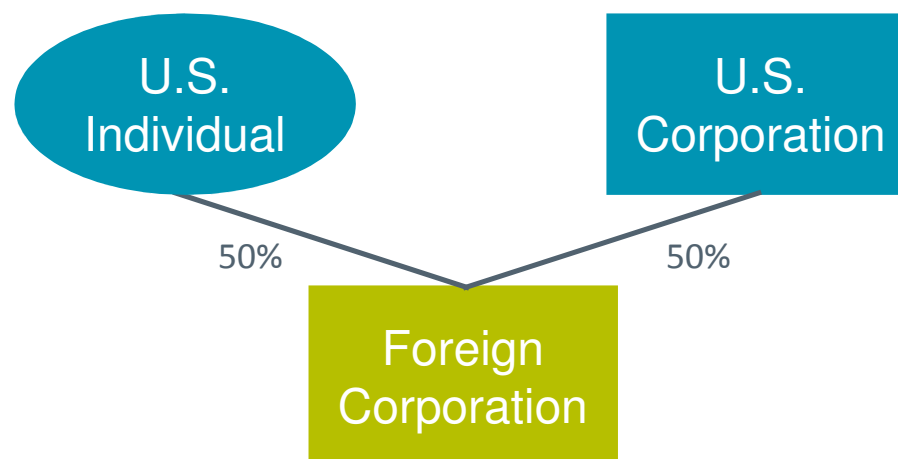


# GLOBAL INTANGIBLE LOW-TAXED INCOME (CONT'D)

- GILTI provisions could apply to a domestic fund (*e.g.*, a private equity fund) that holds more than 50% of the stock of a non-U.S. corporation, and also could apply to a domestic fund holding 10% or more (by vote or value) of the stock of a non-U.S. corporation if after accounting for other U.S. shareholder groups such non-U.S. corporation were a CFC
  - Fund would be required to include on the K-1s of the investors and general partners of the fund their allocable share of the non-U.S. corporation's GILTI on an annual basis
- Non-U.S. vehicle (*e.g.*, a Cayman Islands limited partnership) may still result in CFC (and GILTI inclusion), but likelihood would be lower
- Fund managers should consider (1) whether any of their fund investments are in CFCs; (2) if a fund does have investments in CFCs, whether tax distribution provisions will be triggered if the fund has any GILTI that is allocated to its investors or managers; and (3) whether restructuring may be desirable to avoid the GILTI rules



# GILTI EXAMPLE



		U.S. Corporations		U.S. Individuals*	
		Prior Tax	Current Tax	Prior Tax	Current Tax
<b>Per U.S. Shareholder through CFC</b>					
Passive Income (capital gains, dividends)	\$ 40.00	\$ 14.00	\$ 8.40	\$ 15.84	\$ 14.80
Gross Income from Sales to Unrelated Buyer	\$ 50.00		\$ 5.25		\$ 18.50
Active Royalties (IP owned by CFC)	\$ 50.00		\$ 5.25		\$ 18.50
Services Income (non-Subpart F)	\$ 50.00		\$ 5.25		\$ 18.50
<b>Total</b>	<b>\$ 190.00</b>	<b>\$ 14.00</b>	<b>\$ 24.15</b>	<b>\$ 15.84</b>	<b>\$ 70.30</b>

\* Individual subject to tax at 37% rate, no 3.8% Medicare tax



# FDII EXAMPLE



		U.S. Corporation			U.S. Individual*	
		Prior Tax	Current Tax		Prior Tax	Current Tax
<b>FDII (U.S. taxpayer earning directly)</b>						
Passive Income (capital gains, dividends)	\$ 40.00	\$ 14.00	\$ 8.40		\$ 8.00	\$ 8.00
Gross Income from Sales to Non-U.S. Buyer	\$ 50.00	\$ 17.50	\$ 6.56		\$ 19.80	\$ 18.50
Active Royalties (IP used abroad)	\$ 50.00	\$ 17.50	\$ 6.56		\$ 19.80	\$ 18.50
Services Income (non-U.S. recipient)	\$ 50.00	\$ 17.50	\$ 6.56		\$ 19.80	\$ 18.50
<b>Total</b>	\$ 190.00	<b>\$ 66.50</b>	<b>\$ 28.09</b>		<b>\$ 67.40</b>	<b>\$ 63.50</b>

\* Individual subject to tax at 37% rate, no 3.8% Medicare tax



# COMPARISON OF GILTI AND FDII OUTCOMES

		U.S. Corporations			U.S. Individuals*	
GILTI + Sub F (per U.S. Shareholder through CFC)		Prior Tax	Current Tax		Prior Tax	Current Tax
Passive Income (capital gains, dividends)	\$ 40.00	\$ 14.00	\$ 8.40		\$ 15.84	\$ 14.80
Gross Income from Sales to Unrelated Buyer	\$ 50.00		\$ 5.25			\$ 18.50
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FDII (U.S. taxpayer earning directly)		Prior Tax	Current Tax		Prior Tax	Current Tax
Passive Income (capital gains, dividends)	\$ 40.00	\$ 14.00	\$ 8.40		\$ 8.00	\$ 8.00
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Services Income (non-U.S. recipient)	\$ 50.00	\$ 17.50	\$ 6.56		\$ 19.80	\$ 18.50
<b>Total</b>	<b>\$ 190.00</b>	<b>\$ 66.50</b>	<b>\$ 28.09</b>		<b>\$ 67.40</b>	<b>\$ 63.50</b>

\* Individual subject to tax at 37% rate, no 3.8% Medicare tax

**THANK YOU!**

Charles Purcell  
charles.purcell@klgates.com  
(206) 370-8369



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