LB&I Training
Tax Cuts & Jobs Act (TCJA)

Training
Participant Guide
October 2019

Official IRS Training Material

Welcome

LB&I Tax Cuts & Jobs Act Training

IRS Mission Statement

IRS

Mission Statement

Provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.

Document 6987 (Rev. 12-2013) Catalog Number 62293V Department of the Treasury **Internal Revenue Service** publish.no.irs.gov

14 General Principles of Ethical Conduct

Please see **Document 9300** for a complete list of the 14 General Principles of Ethical Conduct for Federal Employees.

Taxpayer Bill of Rights

Please see **Publication 1** to read the full text of Your Rights as a Taxpayer.

TCJA Course Overview

LB&I Tax Cuts & Jobs Act training sessions are a large part of LB&I's multi-pronged approach to tax reform training. This mandatory training course covers IRC § § 199A, 451, 163(j), 951A, 250, 59A, 965, 367 and 91.

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TCJA Course Agenda

Monday - October 21, 2019

- Executive Opening, Introductions and Admin
- IRC § 199A (Qualified Business Income Deduction)

Tuesday - October 22, 2019

- IRC § 451 (Income Recognition Guidance)
- IRC § 163(j) (Limitation on Business Interest Expense)

Wednesday - October 23, 2019

- IRC § 163(j) (Limitation on Business Interest Expense) (cont'd)
- IRC § 367 & 91 (Transfer Pricing/Outbound Transfers)

TCJA Course Agenda (cont’d)

Thursday - October 24, 2019

- IRC § 951A (Global Intangible Low-Taxed Income)
- IRC § 250 (Foreign Derived Intangible Income)

Tuesday - October 29, 2019

- IRC § 965 (Transition Tax)

Wednesday - October 30, 2019

- IRC § 59A (Base Erosion and Anti-abuse Tax)

Thursday – October 31, 2019

- Final Comments and Executive Closing

LB&I Training
Tax Cuts & Jobs Act (TCJA)

IRC § 250
Foreign-Derived Intangible Income (FDII)

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Instructor Introductions

Lesson Objectives

After this lesson, you should be able to:

- **Define** the relevant FDII terminology
- **Determine** the proper treatment for different types of income (does it qualify as FDII or not?)
- **Determine** applicable FDII rules and necessary steps in a variety of situations
- **Describe** FDII documentation requirements
- **Apply** the steps to compute FDII in various scenarios
- **Examine** Form 8993 to determine allowable deduction under IRC 250

Tax Reform

- The Tax Cuts & Jobs Act (TCJA)…
  - Significantly modified the U.S. system of international taxation for U.S. corporations
  - This included substantial changes to international deferral (some of what might have been considered timing previously, is now more urgent → now or never)
  - “Partial territoriality” going forward → 0% partly
  - Corporate domestic income rate change 35% → 21%
    - 13.125% effective rate on Foreign-Derived Intangible Income (FDII)
    - 10.5% effective rate on Global Intangible Low-Taxed Income (GILTI)
    - Lower effective rates for FDII & GILTI achieved through special deduction (IRC 250)

Tax Reform

- The Tax Cuts & Jobs Act (TCJA)…
  - From a policy perspective GILTI and FDII both:
    - Estimate returns deemed to be higher than normal,
      - Determined by reference to qualified business asset investment (**QBAI**)
      - Deemed to be earned because of "intangibles"
  - Where GILTI measures certain earnings of foreign corporations and FDII measures certain earnings of domestic corporations
  - Similar – different – complementary

FDII in a Nutshell

- The FDII computations are complex, but the questions underlying FDII are simple…
  - What amount of intangible income is the domestic corporation deemed to produce?
    -and-
  - What is the foreign-derived ratio of that deemed intangible income?

Note: foreign-derived ≠ foreign source

(*not the same concept as sourcing*)

GILTI and FDII Side-by-Side

GILTI and FDII are like two sides of the same coin

- IRC 250(a) deals with GILTI & FDII
- GILTI definition is from IRC 951A
- FDII definition is from IRC 250(b)

GILTI looks at deemed excess foreign returns (deemed attributable to intangibles)

Domestic corporations (excluding RICs, REITs, and S Corporations) are allowed a deduction generally equal to 50% (or 37.5% after 2025) of their GILTI inclusion under section 250 that results in GILTI being subject to an effective U.S. tax rate of 10.5% until 2025 (13.125% after 2025)

FDII looks at similar deemed excess domestic returns that are considered foreign-derived

Domestic corporations (excluding RICs, REITs, and S Corporations) are subject to a reduced rate of tax on their FDII through IRC 250 deduction of 37.5% of FDII

GILTI and FDII Side-by-Side (cont'd) 1

GILTI and FDII are like two sides of the same coin

Tested Income is a CFC's gross income less U.S.-source effectively connected income, gross income that is taken into account in determining subpart F income, gross income excluded under the high tax exception in section 954(b)(4), related party dividends, and foreign oil and gas extraction income, less deductions (including taxes) that are properly allocable to gross tested income

Deduction Eligible Income (DEI) is defined as the domestic corp's gross income less subpart F and section 956 income, GILTI inclusions, CFC dividends, domestic oil and gas extraction income, foreign branch income, and financial services income, less allocable deductions

GILTI = U.S. shareholder's net CFC Tested Income less Net Deemed Tangible Income Return (Net DTIR)

FDII = Foreign-Derived portion of Deduction Eligible Income (DEI) less Deemed Tangible Income Return (DTIR)

GILTI and FDII Side-by-Side (cont'd) 2

GILTI	FDII
Net DTIR = 10% of U.S. shareholder's pro rata share of QBAI – specified interest exp.	DTIR = 10% of a domestic corporation's QBAI
QBAI = Avg. of tested income CFC's aggregate adjusted bases (quarterly) in specified tangible property	QBAI = Avg. of U.S. corp's aggregate adjusted bases (quarterly) in specified tangible property
Specified Tangible Property = any depreciable tangible property used in the CFC's business in the production of tested income	Specified Tangible Property = any depreciable tangible property used in the production of deduction eligible income

GILTI and FDII Side-by-Side (cont'd) 3

GILTI	FDII
Determination of adjusted bases for QBAI purposes is done on a straight line basis (ratably for each relevant day of the year)	Same
Foreign Tax Credits @80% and limited by an inclusion percentage. GILTI FTC is in a separate basket with no carryovers or carrybacks of excess FTC.	Foreign Tax Credits @ 100%

FDII Terms and Definitions

- Deduction Eligible Income (DEI) is generally the eligible pool of income that potentially qualifies as FDII.
- Qualified Business Asset Investment (QBAI) represents the taxpayer's tangible business assets that produce DEI.
- Deemed Tangible Income Return (DTIR) is ten percent of QBAI and is used to estimate tangible profit.

FDII Terms and Definitions

- Deemed Intangible Income (DII) is profit in excess of DTIR, if any, and is considered earned from intangible assets.
- Foreign-Derived Deduction Eligible Income (FDDEI) is the portion of DEI from certain foreign sales and services.
- Foreign-Derived Ratio (FDR) is the quotient of FDDEI over DEI, which is ultimately multiplied by DII to determine FDII. The FDR cannot exceed one (1) as part of this calculation.

FDII Equation Components

DEI = (Gross Income – Exclusions – Allocable Deductions)

QBAI = Quarterly Average Adjusted Basis in Specified Tangible Property

DTIR = (10% x QBAI)

DII = (DEI – DTIR)

FDDEI = The Portion of DEI from Foreign-Derived Sales and Services

FDR = (FDDEI / DEI)

FDII = (DII x FDR)

250 Deduction with respect to FDII = (37.5% x FDII)
(results in 13.125% effective rate)

Questions

Exclusions in Computing FDII

- Income NOT eligible for the IRC 250 deduction determined by reference to FDII (exclusions):
  - Income from CFC dividends
  - Income under IRC 951(a)(1) (subpart F and section 956 income)
  - Income under IRC 951A (GILTI)
  - Foreign branch income (now a separate category of income for purposes of the IRC 904(a) FTC computation)
  - Financial services income
  - Domestic oil and gas extraction income

Foreign Branch Category

Foreign branch category income is excluded from DEI.

- A foreign branch is a section 989 qualified business unit (QBU) that conducts a trade or business outside the United States.
- Foreign branch category income is generally the gross income of the taxpayer (recognized for U.S. tax purposes) that is recorded on the books of a foreign branch.
  - Some income is excluded from the foreign branch category even if it is on the books of a foreign branch, e.g., income from stock (unless an exception applies).

Foreign Branch Category (cont'd)

- The gross income reflected on the books is then increased or decreased by reallocating gross income between the general category and the foreign branch category for certain disregarded transactions.
  - The reallocation does not affect the character of the income, only the category.
  - Certain payments are excluded, such as disregarded interest expense.
  - Income of a branch may be DEI if it is reallocated to general.
  - Income of the owner may be excluded if it is reallocated to the foreign branch.

Eligible Income in Computing FDII

- Income eligible for the 250 deduction with respect to FDII:
  - Income earned by a U.S. corporation relating to property:
    - Sold,
    - Leased,
    - Licensed,
    - Exchanged, or
    - Otherwise disposed of by the taxpayer to foreign persons for use outside the U.S. (i.e., for foreign use).
  - Income earned by a U.S. corporation for the performance of services by the taxpayer for a person, or with respect to property, located outside the U.S.

Questions

Foreign Use of Property

- Foreign use for general property (***Prop. Reg §1.250(b)-4(d)(2)***):
  - The property is not subject to domestic use within 3 years of the date of delivery; or
  - The property is subject to manufacture, assembly, or other processing outside the U.S. before the property is subject to a domestic use.
  - Special rules for transportation property
- Foreign use for intangible property (***Prop. Reg §1.250(b)-4(e)(2)***):
  - A sale of intangible property is for a foreign use only to the extent of the revenue generated from exploitation outside the U.S.
  - If a sale of rights providing for both within and outside the U.S., foreign use is in proportion to revenue from outside the U.S. over the total revenue

FDDEI Services

- FDDEI Services includes the following:

  - General service to a consumer or a business
  - Proximate service to a recipient
  - Property service with respect to tangible property
  - Transportation service to a recipient

  located outside the U.S.

- If a service is provided partly within the U.S. and partly outside the U.S., only the portion outside the U.S. is a FDDEI service (except for transportation services).
  - However, for proximate and property service, substantially all of a service is performed at a location if more than 80% of the time is spent at or near such location.

(Prop. Reg §1.250(b)-5)

Special Rules for FDII

- Special rules (including documentation guidelines) and general guidance are included in the proposed section 250 regulations.

- Statutorily, there are a small number of special rules:
  - Regarding Foreign Use in Domestic Intermediary Transactions
  - Regarding Foreign Use in Related Party Transactions
  - Related Party Definition

- Congress was concerned with preventing “round-tripping” and other transactions that seek to circumvent the intent of the 250 deduction.

Special Rules on Foreign Use for Intermediary Transactions

- Property sold to an unrelated foreign person for further manufacture or modification within the U.S.:
  - NOT considered a foreign use
  - this is true even if the unrelated person subsequently uses such property for a foreign use ***(IRC §250(b)(5)(B)(i))***

- Service provided to an unrelated person located in the U.S.:
  - NOT considered foreign-derived
  - this is true even if the unrelated person uses the services in providing services to any person, or with respect to property, located outside of the U.S. ***(IRC §250(b)(5)(B)(ii))***

Special Rules on Foreign Use for Related Party Transactions

- Property sold to a foreign related party is for a foreign use, if taxpayer establishes the property is ultimately sold or used by related party:
  - in connection with a sale or service to an unrelated foreign person for a foreign use

  Prop. Reg §1.250(b)-6(c)

- Services provided to a foreign related person is for a foreign use, if taxpayer establishes the services:
  - are NOT substantially similar to the services provided by such related party to U.S. persons

  Prop. Reg §1.250(b)-6(d)

- Related party = affiliated group member within the meaning of section 1504(a), substituting 50% for 80% and without regard to paragraphs (2) and (3) of section 1504(b)

Impact on transfer pricing models:

- Pre-TCJA:
  - Focus on supply chain models that did not correlate with actual flow of product
  - Allocation and apportionment of income and intangible assets to low- or no-tax jurisdictions
- Post-TCJA:
  - Intangible income from low- or no-tax jurisdictions now subject to GILTI
  - Income derived from certain transfers of property and provision of services now eligible for FDII deduction
- Result: Taxpayer modeling and revisions in transfer pricing methodologies to minimize their global effective tax rate

FTC Consideration

- Foreign tax credits are not part of the FDII computation
- FDII eligible sales and services gross income will typically be reported on the 1118 Sch. A with the GEN reporting code (which represents the general limitation category of income).
- Allocation and apportionment of expenses per Treas. Reg. 1.861-8 through 1.861-14T and 1.861-17 are relevant to gross DEI and gross FDDEI calculations.
- The FDII deduction is found on the 1118 Sch. A, col. 14(b), but may not tie to the 8993 because some of the FDII eligible services income may be U.S. source for FTC purposes.
- Foreign taxes (if any) relating to FDII sales or services are reported on the 1118, Sch. B, Part I.

Foreign Tax Credits

- It is possible to obtain both an FDII deduction and claim a foreign tax credit with respect to the same item of FDDEI as long as the relevant requirements of sections 250 and 901 and 904 are met.
- Practically, foreign taxes allocable to DEI will generally be withholding taxes.
  - Because foreign branch category income is excluded from DEI, it will be uncommon (but possible) for DEI to be subject to net basis tax in a foreign country.
  - DEI excludes Subpart F, GILTI, corporate dividends, and also does not include PTI distributions; thus, a taxpayer generally cannot have a deemed paid foreign tax (under section 960) that relates to DEI.
  - However, a general category foreign tax deemed paid under sections 960(a) or (b) may be creditable against general category foreign source DEI subject to the limitations of section 904.

Allocation and Apportionment of Expenses

- Expenses are generally allocated and apportioned to DEI and gross FDDEI under sections 1.861-8 through 1.861-14T and 1.861-17. But there are some special rules.
  - While certain GILTI and FDII assets and income are treated as exempt for purposes of the foreign tax credit limitation, this rule does not apply for purposes of computing FDII.
  - Exclusive geographic apportionment of research and experimentation expense is inapplicable for apportioning those expenses to FDII.
- The expense allocation rules are complex but:
  - Many expenses are directly allocated to the gross income to which they factually relate under section 1.861-8.
  - Some expenses cannot be factually related, such as interest and research and experimentation expenses. These expenses are apportioned under special rules under -9T through 14T and -17.

Questions

Special Rules for Documenting Qualifying Transactions

- Treasury's proposed section 250 regulations outline the documentation requirements as follows:
  - 1.250(b)-3(d)(1) thru (3) on documentation reliability requirements
  - 1.250(b)-4(c)(1) & (2) on documenting foreign person status
  - 1.250(b)-4(d)(1) and (3) on documenting general property foreign use
  - 1.250(b)-4(e)(1) and (3) on documenting IP foreign use
  - 1.250(b)-5(d)(1) and (3) on documenting services provided to consumers abroad
  - 1.250(b)-5(e)(1) and (3) on documenting services provided to business customers abroad
- The proposed regulations offer exceptions to some of the formal documentation requirements in certain circumstances, such as when a business or transaction falls under certain monetary thresholds or when a taxpayer might otherwise prefer not to classify a loss transaction as FDDEI.

Special Rules for Documenting Qualifying Transactions

- Exceptions to the documentation requirements include:
  - Small business exception for general property and general services: Taxpayers with gross receipts less than $10 million in a prior year can simply rely on a recipient's address in deciding if a transaction qualifies (foreign person, foreign use, etc.).
  - Small transaction exception for general property and general services: Taxpayers with gross receipts less than $5,000 in a taxable year from a single recipient can simply rely on the recipient's address to determine if a transaction qualifies.
  - Anti-abuse provision: If a taxpayer knows, or has reason to know, that a transaction would otherwise generate FDDEI, but the taxpayer fails to satisfy the documentation requirements, such transaction will nonetheless be treated as FDDEI if doing so reduces FDDEI.
- Transition rule – the formal documentation requirements are proposed to be effective for taxable years beginning after March 4, 2019 - prior to this any reasonable documentation maintained in the ordinary course of a taxpayer's business may be used to establish that a transaction produces FDDEI.

Questions

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Steps in Computing FDII and the 250 deduction

In the following steps, taxpayers will determine:

STEP 1 – Deduction Eligible Income (DEI)

STEP 2 – Deemed Tangible Income Return (DTIR)

STEP 3 – Deemed Intangible Income (DII)

STEP 4 – Foreign-Derived Intangible Income (FDII) and the 250 deduction with respect to FDII

Computing FDII and the 250 deduction STEP 1

STEP 1 – Determine Deduction Eligible Income (DEI)

- A domestic corporation's deduction eligible income for a taxable year is equal to the corporation's gross DEI reduced (but not below zero) by deductions allocated and apportioned to both gross FDDEI, and gross DEI that is not gross FDDEI.
- A domestic corporation's gross DEI does not include the following items of gross income:
  - any amount included in gross income under IRC 951(a)(1) (including tax gross-up),
  - any gross income inclusion under IRC 951A (GILTI including tax gross-up),
  - any financial services income,
  - any dividend received from a corporation which is a controlled foreign corporation of the domestic corporation,
  - any domestic oil and gas extraction income, and
  - any foreign branch category income, not including any income treated as foreign branch category income under the look-through rules.

Computing FDII and the 250 deduction STEP 2

STEP 2 – Determine Deemed Tangible Income Return (DTIR)

- A domestic corporation's deemed tangible income return is equal to ten (10) percent of its qualified business asset investment.
- Qualified business asset investment is determined on a quarterly average basis and is defined by reference to the GILTI definition of qualified business asset investment, with some modifications.
  - The term "tested income CFC" and "controlled foreign corporation" is substituted with the term "domestic corporation",
  - The term "CFC inclusion year" is substituted with the term "domestic corporation's taxable year", and
  - The term "gross tested income" is substituted with the term "deduction eligible income".
- Qualified business asset investment used to compute the ten (10) percent deemed tangible income return is determined on the basis of those assets employed in the production of DEI.

Computing FDII and the 250 deduction STEP 3

STEP 3 – Determine Deemed Intangible Income (DII)

- A domestic corporation's deemed intangible income for a taxable year is the excess of the corporation's deduction eligible income over the corporation's deemed tangible income return for the taxable year.
  - Deemed intangible income, as defined for these purposes, is a purely a statutory creation and will not predictably correlate with intangible assets owned by a domestic corporation.
  - Instead, like the rest of the FDII computation, calculating DII is strictly formula-driven and is not based on tracing of income attributable to intangible property.

Computing FDII and the 250 deduction STEP 4

STEP 4 – Determine FDII and 250 deduction with respect to FDII

- Once all of the other components have been determined under Steps 1 thru 3, a domestic corporation's FDII can be computed as the portion of deemed intangible income that is foreign-derived. This is accomplished by multiplying DII by the foreign-derived ratio (that is, the ratio of foreign-derived deduction eligible income to the deduction eligible income).
- A domestic corporation's foreign-derived ratio for a taxable year is the ratio (not to exceed one) of the corporation's FDDEI to DEI.

Computing FDII and the 250 deduction STEP 4 (cont'd)

STEP 4 – Determine FDII and 250 deduction with respect to FDII (cont'd).

- A domestic corporation's gross FDDEI for a taxable year is the portion of gross DEI which is derived from a:
  - Sale, lease, license, exchange, or other disposition of property to any person who is not a U.S. person if the property is for a foreign use or
  - Provision of services that are provided to any person not located in the U.S. or with respect to property not located in the U.S.
- As detailed in the examples that follow, the 250 deduction with respect to FDII rate is currently 37.5 percent of FDII (21.875 percent for taxable years beginning after 2025).

Computing FDII and the 250 deduction (Full Equation)

$$\overbrace{\overbrace{\left(\overbrace{\text{Gross 1120 Income Minus Exclusions Minus Allocable Deductions}}^{\text{DEI}} - \overbrace{10\% \times \overbrace{\text{Quarterly Avg. of Adjusted Basis in Depreciable DEI-Producing Tangible Property}}^{\text{QBAI}}}^{\text{DTIR}}\right)}^{\text{DII}} \times \overbrace{\left(\frac{\text{FDDEI}}{\text{DEI}}\right)}^{\text{FDR}}}^{\text{FDII}}$$

FDII x 37.5% = **250 deduction w/r/t FDII**

FDII - Example 1 - Facts

- US Parent (USP) is a domestic corporation that manufactures and sells property to unrelated foreign and domestic customers.
- USP generates only deduction eligible income in its business (no exclusion items).
- USP has a quarterly average adjusted basis of $1,200 in specified tangible property.
- USP sells $100 to U.S. customers (to which there are $20 of allocable deductions).
- USP sells $300 to foreign customers (to which there are $60 of allocable deductions).

FDII - Example 1 - Step 1

The first step is to determine USP's deduction eligible income:

DEI = (Gross Income – Exclusions – Allocable Deductions)

- Step 1 – Determine Deduction Eligible Income (DEI)

Gross Income	$ 400
Less subpart F Inclusions	0
Less GILTI	0
Less Financial Services Income	0
Less CFC Dividends	0
Less Domestic Oil and Gas Extraction Income	0
Less Foreign Branch Income	0
Gross Income Less Exclusions	400
Less deductions (including taxes) properly allocable to DEI	(80)
Deduction Eligible Income (DEI) (and Taxable Income)	$ 320

FDII - Example 1 - Step 2

The second step is to determine USP's deemed tangible income return:

QBAI = Quarterly Average Adjusted Basis in Specified Tangible Property

DTIR = (10% x QBAI)

- Step 2 – Determine Deemed Tangible Income Return (DTIR)

Avg. Qualified Business Asset Investment (QBAI)	$ 1,200
Multiplied by 10 percent	x 10%
Deemed Tangible Income Return (DTIR)	$ 120

FDII - Example 1 - Step 3

The third step is to determine USP's deemed intangible income:

$$DII = (DEI - DTIR)$$

- Step 3 – Determine Deemed Intangible Income (DII)

Deduction Eligible Income (DEI)	$	320
Less Deemed Tangible Income Return (DTIR)		(120)
Deemed Intangible Income (DII)	$	200

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FDII - Example 1 - Step 4

The fourth step is to determine USP's foreign-derived intangible income and the deduction for foreign-derived intangible income:

FDDEI = The Portion of DEI from Foreign-Derived Sales and Services
FDR = (FDDEI / DEI)
FDII = (DII x FDR)
250 deduction with respect to FDII = (37.5% x FDII)

- Step 4 – Determine FDII and 250 deduction with respect to FDII

Qualifying sales to foreign customers	$ 300
Less allocable deductions	(60)
Foreign-Derived Deduction Eligible Income (FDDEI)	$ 240
Foreign-Derived Ratio (FDR) = FDDEI / DEI ($240 / $320)	0.75
Deemed Intangible Income (DII)	$ 200
Multiplied by Foreign-Derived Ratio (FDR)	x 0.75
Foreign-Derived Intangible Income (FDII)	$ 150
250 deduction w/r/t FDII (37.5% * 150.00)	$56.25
Effective tax rate (FDII) = $\frac{(150.00-56.25)\text{x }0.21}{150.00}$	**13.125%**

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FDII - Example 2 - Facts

- **Facts in Example 2 are different from Example 1**
  - USP is a domestic corporation that employs dual use property to produce two types of income (a building).
  - The building generates both deduction eligible income and domestic oil and gas extraction income (DOGEI), which is not DEI.
  - USP earns $300 of income that qualifies as DEI and $200 of DOGEI ($500 total income).
  - USP is a calendar year taxpayer and sells the building on April 30 to an unrelated taxpayer.

Question: how should USP calculate QBAI?

FDII - Example 2 – Analysis

How is a depreciable dual use property that generates $500 of total income ($300 of which is DEI) taken into account in determining QBAI?

- Apportionment - 60 percent of the property is treated as specified tangible property.
  - equal to the percentage of DEI produced by the property ($300) compared with total income produced by the property ($500)
- So, in this case 60 percent of the property's quarterly bases are taken into account in determining QBAI.

FDII - Example 2 – Analysis

When this asset is then sold sometime within the taxable year, a proration must occur in computing QBAI.

- For partial years, all full quarter QBAI figures are summed together and divided by four (4) and this result is added to the final partial quarter QBAI figure prorated based on the days the asset is owned in the final partial quarter divided by 365 (days in a year).

Time for an illustration…

FDII - Example 2 - Illustration

- **Illustration (Partial Year and Dual Use Property)**
  - Since the building was sold on April 30, and USP is a calendar year taxpayer, one full quarter ending March 31 is counted, along with the number days in the partial quarter ending April 30.
  - On March 31 and April 30 the property's adjusted bases were $165 and $205, and 60 percent of these amounts are equal to $99 and $123, respectively.
  - When averaged the January 1 through March 31 amount of $99 is $24.75 ($99 divided by 4).
  - The average of the April 1 through April 30 amount of $123 is calculated as $10.11 ($123 * 30 / 365).
  - These figures are added together. Thus, QBAI equals $34.86 (USP's average QBAI is computed as $24.75 + $10.11 in this instance).

FDII - Example 3 - Facts

- Assume the same facts as Example 2, except now we know that DOGEI income of $200 incurs directly allocable expenses of $250 in total, for a loss of $50.
- We also now know that DEI of $300 is split evenly between foreign-derived deduction eligible income (FDDEI) and income that does not qualify as FDDEI.
- FDDEI incurs $120 of allocable deductions (net $30).
- DEI that does not qualify as FDDEI incurs $115 of allocable deductions (net $35).

Based on this, let’s finish the FDII computations!

FDII - Example 3 - Step 1

The first step is to determine USP's deduction eligible income:

DEI = (Gross Income – Exclusions – Allocable Deductions)

- Step 1 – Determine Deduction Eligible Income (DEI)

Gross Income		$ 500
Less Subpart F Inclusions		0
Less GILTI		0
Less Financial Services Income		0
Less CFC Dividends		0
Less Domestic Oil and Gas Extraction Income		(200)
Less Foreign Branch Income		0
Gross Income Less Exclusions		300
Less deductions (including taxes) properly allocable to DEI	($120 + $115)	(235)
Deduction Eligible Income (DEI)		$ 65

FDII - Example 3 - Step 2

The second step is to determine USP's deemed tangible income return:

QBAI = Quarterly Average Adjusted Basis in Specified Tangible Property

DTIR = (10% x QBAI)

- Step 2 – Determine Deemed Tangible Income Return (DTIR)

Avg. Qualified Business Asset Investment (QBAI) (from Ex. 2)	$	34.86
Multiplied by 10 percent	x	10%
Deemed Tangible Income Return (DTIR) (rounded)	$	3.49

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FDII - Example 3 - Step 3

The third step is to determine USP's deemed intangible income:

$$DII = (DEI - DTIR)$$

- Step 3 – Determine Deemed Intangible Income (DII)

Deduction Eligible Income (DEI)	\$ 65.00
Less Deemed Tangible Income Return (DTIR)	(3.49)
Deemed Intangible Income (DII)	\$ 61.51

FDII - Example 3 - Step 4

The fourth step is to determine USP's foreign-derived intangible income and the deduction for foreign-derived intangible income:

FDDEI = The Portion of DEI from Foreign-Derived Sales and Services
FDR = (FDDEI / DEI)
FDII = (DII x FDR)
250 deduction with respect to FDII = (37.5% x FDII)

- Step 4 – Determine FDII and 250 deduction with respect to FDII

Qualifying sales to foreign customers		$ 150
Less allocable deductions		(120)
Foreign-Derived Deduction Eligible Income (FDDEI)		$ 30
Foreign-Derived Ratio (FDR) = FDDEI / DEI	($30 / $65)	0.4615
Deemed Intangible Income (DII)		$ 61.51
Multiplied by Foreign-Derived Ratio (FDR)		x 0.4615
Foreign-Derived Intangible Income (FDII)		**$ 28.39**
250 deduction w/r/t FDII		**Is it limited by Taxable Income**

FDII - Example 3 - Step 4 (cont'd)

The fourth step gave us FDII of $28.39. But before we compute the Sec. 250 deduction with respect to FDII (37.5 percent of FDII), we need to find out if the 250 deduction overall is going to be limited by taxable income.

Sec. 250 deduction is reduced if… ((FDII + GILTI) > Taxable Income)

- Step 4 – Determine FDII and 250 deduction with respect to FDII (cont'd)

Net Domestic Oil and Gas Extraction Income	($ 50)
Total Deduction Eligible Income	65
Taxable Income (assume the gain on building sale = $0)	$ 15
Foreign-Derived Intangible Income (FDII)	$ 28.39
Since FDII exceeds Taxable Income the Sec. 250 deduction is limited to 37.5 percent of Taxable Income ($15 x 37.5%)	$ 5.63

Note: Example assumes that all income is FDII, therefore, allocating limitation between FDII and GILTI is not needed.

FDII - Example 4 - Retailer Hypothetical

Determining if property sold to a retailer is for a foreign use, and whether the sale potentially qualifies for the 250 deduction with respect to FDII, can depend on a variety of factors.

Assume a U.S. corporation sells property to a foreign person that operates retail stores. Consider how the answer on foreign use will change if the retailer operates:

- only physical stores abroad,
- physical stores in the U.S. and abroad,
- physical stores abroad, and also sells products online to customers in the U.S. and abroad.

FDII - Example 5 - Distributor Hypothetical

Determining if property sold to a distributor is for a foreign use, and whether the sale potentially qualifies for the 250 deduction with respect to FDII, can depend on a variety of factors.

Assume a U.S. corporation sells property to a foreign person that acts as a distributor. Consider how the foreign use answer will change if the distributor sells:

- only to retail stores abroad,
- to retail stores in the U.S. and abroad,
- to retail stores abroad, but also sells some property to a retail affiliate abroad, which then sells the property to a U.S. affiliate that operates in the U.S.,
- only to retail stores abroad that also sell products online to customers in the U.S. and abroad.

FDII - Example 6 - Manufacturer Hypothetical

Determining if property sold to a manufacturer is for a foreign use, and whether the sale potentially qualifies for the 250 deduction with respect to FDII, can depend on a variety of factors.

- Assume a U.S. corporation sells property to a foreign person that is a manufacturer. Consider how the answer on foreign use will change if the manufacturer performs minor assembly, packaging, or labeling activities abroad with the property and then sells the property to customers in the U.S.

- Key Point: Manufacturing is considered to be the creation of or material physical change to tangible property, but does not include minor assembly, packaging, or labeling.

FDII - Example 7 - Consumer Hypothetical

Determining if property sold to a consumer is for a foreign use, and whether the sale potentially qualifies for the 250 deduction with respect to FDII, can depend on a variety of factors.

Assume a U.S. corporation sells property to a foreign person that is a consumer. Consider how the answer on foreign use will change if the consumer(s) is/are:

- delivered the property abroad, and the consumer uses the property to operate a business abroad,
- delivered the property abroad, and the consumer uses the property to operate a business both abroad and in the U.S.,
- individuals or business customers who are delivered the property both abroad and in the U.S.

What if the sale consists of intangible property delivered online (for example, to a device)?

FDII - Example 8 - Services to Companies

Determining if services performed for a company located outside the U.S. potentially qualify for the 250 deduction with respect to FDII, can depend on a variety of factors.

Assume a U.S. corporation provides services to a company. Consider how the answer on foreign use will change if the company:

- has contracted for call center services to be provided to its customers, and the customers are located in and outside of the U.S.,
- pays for professional services that are provided to a branch of the company that is located abroad,
- pays for professional services that are provided to a branch of the company located in the U.S.,
- pays for professional services that are provided to a subsidiary of the company located abroad, but the services provided benefit both U.S. operations and operations located outside of the U.S.

FDII - Example 9 - Property Services

Determining if services performed with respect to property located outside the U.S. potentially qualify for the 250 deduction with respect to FDII, can depend on a variety of factors.

Assume a U.S. corporation provides services with respect to property. Consider how the answer on foreign use will change if the services are required to be performed abroad (in proximity to the property) for a client that needs a specific item of property serviced, maintained, or repaired.

Questions

Form 8993

Form **8993**
(December 2018)
Department of the Treasury
Internal Revenue Service

Section 250 Deduction for Foreign-Derived Intangible Income (FDII) and Global Intangible Low-Taxed Income (GILTI)

► Go to www.irs.gov/Form8993 for instructions and the latest information.

OMB No. 1545-0123
Attachment Sequence No. 933

Name of person filing this return | Identifying number

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

1	Gross Income			1	
2	Exclusions				
a	Income included under section 951(a)(1)	2a			
b	Income included under section 951A (from Form 8992, Part II, line 3)	2b			
c	Financial Services Income	2c			
d	CFC Dividends	2d			
e	Domestic Oil and Gas Extraction Income	2e			
f	Foreign Branch Income	2f			
3	Total Exclusions (add lines 2a through 2f)			3	
4	Gross Income less Total Exclusions (subtract line 3 from line 1)			4	
5	Deductions properly allocable to the amount on line 4			5	
6	Deduction Eligible Income (DEI) (subtract line 5 from line 4)			6	

Part II Determining Deemed Intangible Income (DII) (see instructions)

1	DEI (from Part I, line 6, above)	1	
2	Deemed Tangible Income Return (10% of QBAI)	2	
3	Deemed Intangible Income (DII) (subtract line 2 from line 1)	3	

Part III Determining Foreign Derived Ratio (see instructions)

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

Part IV Determining FDII and/or GILTI Deduction (see instructions)

1	Deemed Intangible Income (DII) (from Part II, line 3)	1	
2	Foreign Derived Ratio (from Part III, line 4)	2	
3a	FDII (multiply line 1 by line 2)	3a	
b	Global Intangible Low-Taxed Income (GILTI) Inclusion (see instructions for line 3b)	3b	
c	Total FDII and GILTI (add lines 3a and 3b)	3c	
4	Taxable Income (see instructions for line 4)	4	
5	Excess FDII and GILTI over Taxable Income (subtract line 4 from line 3c). If zero or less, enter -0- here and on lines 6 and 7	5	
6	FDII Reduction (divide line 3a by line 3c; multiply by line 5)	6	
7	GILTI Reduction (subtract line 6 from line 5)	7	
8	FDII Deduction (see instructions for line 8). (Enter here and on Form 1120, Schedule C; see instructions for information on other tax forms)	8	
9	GILTI Deduction (see instructions for line 9). (Enter here and on Form 1120, Schedule C; see instructions for information on other tax forms)	9	

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 37817J Form **8993** (12-2018)

https://www.irs.gov/pub/irs-pdf/f8993.pdf

Form 8993 Suggested Audit Steps

- Review Form 8993 for reasonableness and computational accuracy
- Obtain detailed workpapers (in native format) used to prepare form
  - Investigate disproportionate costs of goods sold attributed to DEI and not FDDEI
  - Likewise, review allocation and apportionment of deductions under 861, etc.
- Inquire about internal controls and methodology for FDII computation
- Obtain necessary supporting documentation used by taxpayer to determine DEI, FDDEI, non-FDDEI, QBAI, etc.

Form 8993 Suggested Audit Steps (cont'd)

- Review how the taxpayer determines:
  - If a sale of property is to a foreign person and for a foreign use
  - Whether a sale of intangible property is for a foreign use, if applicable
  - If an individual consumer of a general service is located outside the U.S.
  - Whether a business recipient of a general service is located outside the U.S.
- As necessary, confirm the taxpayer's documentation is reliable
- Expand audit of this area if warranted

Lesson Summary

At this point, you should be able to:

- **Define** the relevant FDII terminology
- **Determine** the proper treatment for different types of income (does it qualify as FDII or not?)
- **Determine** applicable FDII rules and necessary steps in a variety of situations
- **Describe** FDII documentation requirements
- **Apply** the steps to compute FDII in various scenarios
- **Examine** Form 8993 to determine allowable deduction under IRC 250

Questions

Contacts & Resources

If you need additional assistance or information:

- Visit the Deferral Planning PN SharePoint site and refer to our units in the practice library

- Contact the Deferral Planning PN

Thank You

Thank you for your participation!