

The Contemporary Tax Journal

Volume 8
Issue 2 *The Contemporary Tax Journal Volume
8, No. 2 – Summer 2019*

Article 6

8-2-2019

Summaries from the 34th Annual High Tech Tax Institute

Amy Yue CPA
San Jose State University

Langzun Li
San Jose State University

Rachana Khandelwal
San Jose State University

Nam Nguyen
San Jose State University

Follow this and additional works at: <https://scholarworks.sjsu.edu/sjsumstjournal>



Part of the [Taxation Commons](#), [Taxation-Federal Commons](#), [Taxation-State and Local Commons](#), [Taxation-Transnational Commons](#), and the [Tax Law Commons](#)

Recommended Citation

Yue, Amy CPA; Li, Langzun; Khandelwal, Rachana; and Nguyen, Nam (2019) "Summaries from the 34th Annual High Tech Tax Institute," *The Contemporary Tax Journal*: Vol. 8 : Iss. 2 , Article 6.
<https://doi.org/10.31979/2381-3679.2019.080206> <https://scholarworks.sjsu.edu/sjsumstjournal/vol8/iss2/6>

This Feature is brought to you for free and open access by the Lucas Graduate School of Business at SJSU ScholarWorks. It has been accepted for inclusion in The Contemporary Tax Journal by an authorized editor of SJSU ScholarWorks. For more information, please contact scholarworks@sjsu.edu.

Summaries from the 34th Annual High Tech Tax Institute Say Goodbye? Executive Compensation & Fringe Benefits Planning By: Amy Yue, CPA, MST Student

The Tax Cuts and Jobs Act (TCJA) was enacted on December 22, 2017 (Public Law 115-97). The new law significantly changed tax deductibility for certain employee compensation and benefits for tax years beginning after December 31, 2017. At the 34th Annual TEI-SJSU High Tech Tax Institute conference, held on November 5, 2018, a panel of tax experts comprised of Anne G. Batter, Partner at Baker & McKenzie LLP, Jennifer George, Partner at PwC, and Rick Berge, Executive Director at EY, addressed updates and insights on this topic. The panel discussed the tax changes regarding compensation limits for covered employees, qualified equity grants, and fringe benefits.

Compensation Limit for Covered Employees

Section 162(m) limits the deduction related to remuneration of covered employees to \$1 million. Applicable remuneration paid to covered employees exceeding \$1 million is not tax deductible. Prior to the TCJA, Section 162(m) applied only to publicly traded corporations. TCJA extended the limitation to those corporations who are required to file a registration statement for debt or equity securities under the Securities Act of 1933 but are not publicly traded. Therefore, more taxpayers are subjected to the Section 162(m) limitation after TCJA.

In addition, the new law includes more employees as covered employees. It defines a covered employee as a CEO and a CFO at any time during tax year, and the other three highest compensated officers. If an individual is a covered employee in any tax year beginning after December 31, 2016, the individual remains a covered employee for all future years, even if the employment is terminated.

TCJA eliminates the exception for performance-based compensation and commissions. Under the new law, performance-based compensation and commissions are subject to the \$1 million limit, while prior law excluded such compensation as applicable employee remuneration. The new law broadens the tax base by applying the limit to more corporations, broadening the definition of covered employees and including additional types of compensation.

Qualified Equity Grants

TCJA added Section 83(i) to provide favorable tax treatment to certain employees with qualified equity grants. Employees from private companies can elect to defer taxes related to equity awards such as restricted stock units (RSUs), stock options and employee stock purchase plans for up to five years.

Generally, under the new law, qualified employees can recognize the income at the earlier of the date when stock becomes transferable or the date the stock is publicly traded. Prior to

TCJA, taxpayers were required to include amounts in revenue when fully vested RSUs were received or non-statutory stock options were exercised.

Employee Qualifications

The Section 83(i) tax deferral is not available for the following individuals:

- Independent contractors
- Non-employee directors
- CEO and CFO
- Shareholders holding stock of 1 percent or more in the preceding 10 years
- Any of the four highest-compensated officers for the current or preceding 10 years

Eligible Corporation

To be eligible for Section 83(i), a corporation cannot have stock that is readily tradable on the securities market during any preceding years. Stock options or RSUs must be granted to more than 80 percent of all employees with the same rights and privileges.

Making the election

The election must be made within thirty days after shares or options are issued in the manner similar to a Section 83(b) election.

Fringe Benefits

a. Transit and Commuting

Employers lose the deduction of certain transit and commuting benefits provided to employees. Prior to TCJA, those benefits were excluded from employees’ income for both federal income and FICA taxes and were deductible business expenses for employers. The following table compares the changes under the new law, which mostly affect employers, not employees.

	Employee Includable in Income		Employer tax deductible	
	Prior Law	TCJA	Prior Law	TCJA
Commuter shuttles/vans	Exclude from income	Exclude from income	Tax Deductible	Not Deductible
Transit passes	Exclude from income	Exclude from income	Tax Deductible	Not Deductible
Qualified parking	Exclude from income	Exclude from income	Tax Deductible	Not Deductible
Qualified bicycle commuting reimbursement	Exclude from income	Include in income	Tax Deductible	Tax Deductible

b. Moving Expenses

Moving expenses paid by the employer on behalf of an employee, either through reimbursements or by direct payments, are now included in the income of the employee, except for members of the Armed Forces on active duty. Moving expenses continue to be deductible for employers as a business expense.

c. Meals and Entertainment

The expenses related to entertainment, amusement, or recreation are no longer tax deductible after the new law. However, employers can continue to deduct 50 percent of business meals if the expense is not lavish and the taxpayer or an employee of the taxpayer is present at the meal. Business meal means food and beverage provided to customers, clients, consultants or other similar business partners in carrying on a trade or business.

Before TCJA, food and beverage provided to employees for the convenience of the employer were fully deductible. Under TCJA, such meals are 50 percent deductible for 2018 through 2025 and are nondeductible after 2025. These meals remain non-taxable to the employees. In sum, while corporations enjoy the tax rate cut, they as well as non-corporate employers lose certain deductions related to employee compensation and benefits, resulting from expanding the tax base. A comprehensive analysis is necessary to determine the overall tax effects to any employer.

Cryptocurrency, ICO and Whatever Else is New **By- Langzun Li, *MST student***

At the 34th Annual TEI-SJSU High Tech Tax Institute conference held on November 5-6, 2018 in Palo Alto, a panel of tax experts provided an overview of blockchain, ICOs (initial coin offerings) and cryptocurrency. The panelists were Rob Massey with Deloitte, Brian Rowbotham with Crowe LLP, David Forst with Fenwick & West LLP, and Dawn Rhea with Moss Adams. The panel walked the attendees through multiple topics such as the evolution in commerce, the innovation empowered by blockchain, the definition of virtual currency, and different tax considerations of cryptocurrency.

Evolution in Commerce

Throughout human history, technology has the most significant impact on moving society forward. From the commerce landscape, it started in the caves. The cavemen started the earliest transactions which were barter transactions. A barter transaction is exchanging goods without the use of a monetary medium. To the cavemen, a barter transaction can be trading a cub for meat. As technology progressed, people started using mail, common courier and live services in commerce. Soon after the internet was introduced in the 1990s, Software as a Service (SaaS) and cloud service were also introduced and became an invaluable part of the world of commerce. Now, new technology such as blockchain is introduced, and it has the essential characteristics as barter transaction which does not have fiat currently involved in this process.

Cryptocurrency is one of the products that operates using blockchain technology. Cryptocurrency can be highly volatile. The price of the cryptocurrency can vary significantly within short time periods within a couple of hours. It can be challenging for people to keep track of their basis in this asset, because a cryptocurrency coin can be divided into multiple smaller fractions. For example, a cryptocurrency coin worth \$1,000 can be divided into ten pieces of \$100 or a hundred pieces of \$10. The options regarding splitting coins into smaller values are unlimited.

Furthermore, a barter transaction¹ involving cryptocurrency also triggers gain or loss when holders of the virtual currency use them to purchase goods or services. For example, a taxpayer acquired cryptocurrency early in 2010 for \$200. By 2018, the value of his cryptocurrency had increased to \$120,000. If he decides to use his cryptocurrency to purchase a Tesla Model S which costs around \$75,000, he has a capital gain of \$74,875 which is subject to capital gain tax after the barter transaction.² This capital gain tax can be a heavy burden to the taxpayer if he

¹ In Notice 2014-21, 2014-16 I.R.B. 938, the IRS held that convertible virtual currency should be treated as property for tax purposes. Thus, when someone uses virtual currency, such as bitcoin to purchase something, a barter transaction occurs.

² Calculated as $\$75,000 - (\$200 \times \$75,000 / \$120,000) = \$74,875$.

decides to make the purchase with his cryptocurrency rather than using cash. He needs to be sure he has sufficient cash to pay the tax on the capital gain.

Enabling Innovation

Even though transactions with cryptocurrency can present challenges, it is only one of the products derived from blockchain technology. The blockchain helps solve many problems. For example, it has always been difficult to protect music rights because people can quickly and illegally download a song and misuse it. However, blockchain can convert song rights into tokens and only people who purchase these tokens have access to the songs. The owner of the song can use blockchain to keep track of who has paid to access the songs.

Another example given by the panel is smart contracts. The agricultural industry relies on the weather. To mitigate the damages due to undesirable weather, farmers usually have crop insurance. If crop insurance is converted into smart contracts, it can minimize human intervention and tremendously improve the efficiency of the payment process. For example, in the smart contracts, the number of days of rain can be verified from third party sources and per specified conditions, the blockchain can enable smart contracts to be executed automatically, and payment will be sent to farmers, as specified in the insurance contract.

Furthermore, each panelist shared examples they encountered in their work. They included IBM setting up blockchain to enable business ledger for customers, entrepreneurs wanting to set up blockchain platforms to trade tokens to mirror U.S. stock exchanges, selling a fraction of a house by tokenizing real estate, and the government using blockchain technology to prevent Value Added Tax (VAT) fraud.

The Definition of Virtual Currency

There is not much authoritative guidance regarding the definition of virtual currency. The only guidance that directly addresses this issue is IRS Notice 2014-21.³ According to this notice, virtual currency (cryptocurrency) is not considered a currency but is considered a property. Within the definition of property, it can be sub-categorized as investment, trade or business property, commodity, security, and cash equivalent.

If individuals use virtual currency in exchange for goods or services or to acquire other virtual currency, a realization event occurs based on the fair market value of the virtual currency at that time less its basis. When virtual currency is acquired via mining, it is taxable as ordinary income. If it is used by employers to pay their employees, it is considered compensation subject to withholding and reporting requirements. Finally, the notice also states that whether the character of the virtual currency is considered as capital assets or ordinary asset is determined by how taxpayers hold and use it.

³ Notice 2014-21, 2014-16 I.R.B. 938.

Tax Considerations of Cryptocurrency

For domestic tax considerations, enterprises should pay attention to areas such as revenue recognition and compensation when they use cryptocurrency. The panel also stated that taxpayers should be careful about the tax accounting methods of cryptocurrency. Because there is different basis for different coins, it can be difficult to keep track of the basis of each of the coins. Therefore, they recommend having thorough and proper documentation to record the basis.

As for international tax considerations, enterprises should focus on areas such as VAT considerations, Intellectual Property (IP) migration, Subpart F and Global Intangible Low Tax Income (GILTI).

Conclusion

The creation of blockchain and cryptocurrency has and will have a significant impact on every industry. It creates efficiency and enables innovation to solve many challenging problems. It also presents many challenges and tax considerations like tracking the basis of the cryptocurrencies. However, if tax professionals understand the essence of these transactions involving cryptocurrency, they can still appropriately address the tax treatment.

Locating Intangibles - Generating and Using Foreign Derived Intangible Income (“FDII”)

By: Rachana Khandelwal, *MST*

A panel of four experts from the international tax field presented at the High Tech Tax Institute held on November 5-6, 2018 in Palo Alto. They discussed the new tax rule, Foreign Derived Intangible Income (FDII), introduced by the Tax Cuts and Jobs Act (TCJA), P.L. 115-97. The panelists were Sanjay Agarwal from MGO LLP, Lisa Felix from Armanino LLP, Ken Harvey from Moss Adams LLP and Allan Smith from Grant Thornton LLP.

The panel discussed briefly the sweeping changes brought by the TCJA in the taxation of intellectual property (IP) by creating new tax laws such as the Base Erosion and Anti-abuse Tax (BEAT), Foreign-Derived Intangible Income (FDII) and Global Intangible Low Taxed Income (GILTI). These new rules will significantly impact high-technology companies with cross-border operations involving intangibles located outside of the U.S. In addition, the change from the worldwide tax system to a quasi-territorial system and reduction in the corporate tax rate to 21 percent is viewed as an incentive for corporations to structure their operations in the U.S. rather than in low tax jurisdictions.

The panel went through the concept and the factors involved in the calculation of FDII, its rate structure, effective tax rate for corporations and briefly explained the interaction between FDII and GILTI.

Foreign Derived Intangible Income (FDII)

The introduction of Section 250 is essentially an attempt to make corporates rethink their earlier tax planning strategy of locating intellectual property (IP) in low-cost jurisdictions. However, the panel noted that corporations need to evaluate costs and benefits of shifting IP back to the U.S. or from the U.S. considering factors such as onshore and offshore operational volumes, political uncertainty, and international laws.

Section 250 allows a domestic C corporation to take a deduction based on the foreign income derived by such corporation. The FDII is defined as income derived by U.S. taxpayer’s selling or licensing property, including IP or providing services to its foreign clients. This income from export activities is divided into deemed earned income from tangible assets which is subject to 21 percent and the remaining income is deemed to be from intangible assets (FDII).

Calculation of FDII

The FDII deduction involves multi-step calculations as follows:

1. Deduction Eligible Income (DEI) The starting point in calculating FDII is gross income of a domestic C corporation, reduced by subpart F income, GILTI income, foreign branch

income, domestic oil and gas extraction income and dividend from a controlled foreign corporation (CFC). These items of income are further reduced by properly allocable expenses. This will yield deduction eligible income.

2. Qualified Business Asset Investment (QBAI) This is the average of the basis based on the quarter end amounts in the tangible property used in the trade or business. The adjusted basis is determined using the alternative depreciation system such as straight-line method or pre-determined recovery period (class life). The QBAI does not include assets that do not produce DEI.
3. Deemed Intangible Income (DII)- This amount is arrived at by reducing DEI by 10 percent of QBAI. Formula: $DII = DEI \text{ less } 10\% \times QBAI$.
4. Foreign Derived Deduction Eligible Income (FDDEI) This includes direct and related party foreign sales and services reduced by allocable deductions. However, it does not include foreign branch sales.

$$5. \text{ FDII} = \text{Deemed Intangible Income (DII)} \times \frac{\text{Foreign-Derived Deduction Eligible Income}}{\text{Deduction Eligible Income (DEI)}}$$

The amount of FDII computed above is 37.5 percent deductible from the taxable income, thereby yielding an effective tax rate of 13.125 percent.

Rate Structure

The new regime allows a domestic corporation to take an additional deduction based on the amount of such corporation's FDII.

Tax Year	% Deduction of FDII	Effective tax rate
Beginning 2018 through 2025	37.5%	13.125%
Beginning after 2025	21.875%	16.406%

FDII Income and Deductions

The panel discussed the intricacies of the new law with respect to the nuances and interpretations involved in determining the FDII. A corporation needs to carefully interpret definitions and rules set out in Section 250 to compute the FDII income. The key concepts

under Section 250 include foreign-derived deduction eligible income, foreign use of property or services, related party transactions.

The panel then briefly discussed how the cost of goods can be allocated with respect to the above-mentioned income derived. The panel suggested that the allocation of the cost of goods sold can be done using a reasonable method provided in Treasury Reg. 1.199-4. Further, for deductions other than the cost of goods sold, the panel indicated that before the final version of Section 250, the Senate version provided that deductions should be properly allocable applying the rules similar to the rules under Section 954(b)(5).

State and Local Taxation

The introduction of Section 250 is a conformity consideration for states, and the extent to which they conform to the federal law is an important factor in determining the overall effective tax rate for a corporate taxpayer. The key issues involved are the definition of taxable income and the deductions by the state for the purpose of computing FDII. The number of variations can be a major factor influencing the corporation's decision to shift operations to its foreign entity.

Interaction of FDII and Global Intangible Low Taxed Income (GILTI)¹

The tax rate under GILTI is 10.5 percent on the income derived from IP outside the U.S., while the effective tax rate under FDII is 13.125 percent. The rate under FDII would increase to 16.406 percent after 2025. Currently, guidance on the new law lacks clarity. A taxpayer needs more guidance to ensure the expected benefits involved in bringing back the IP from offshore. The uncertain political climate might lower the benefits in the long run which might impede the operational growth of corporations. A taxpayer also needs to take into consideration the effects of GILTI and other provisions in bringing back the IP which might trigger additional tax liabilities.

The panel anticipated clearer guidance for determining the costs and benefits of shifting IP to the U.S. given the attractive benefits such as FDII currently offered by the TCJA.

¹ See Section 951A. GILTI imposes a tax on foreign earnings of US taxpayers earned through Controlled Foreign Corporations (CFCs) in excess of a 10 percent return on CFC's tangible assets.

U.S. International Tax Issues and Developments

By: Nam Nguyen, *MST Student*

The 34th Annual TEI-SJSU High Tech Tax Institute was honored to have Mr. James P. Fuller lead a comprehensive discussion on various international tax developments and issues. His topics, which were meticulously detailed in a 250-page outline,¹ covered a wide range of international tax developments such as Section 965 and related guidance, comments concerning Global Intangible Low Tax Income (GILTI) inclusion, foreign tax credit implications, and the Section 59A base erosion and anti-abuse minimum tax (“BEAT”). Mr. Fuller is a long-time tax partner at Fenwick & West LLP and is considered one of the world’s most leading authorities in corporate and international taxation. According to *Chambers Global* (2018), Mr. Fuller is the only U.S. tax advisor to receive top honors in both corporate and international tax categories and has been inducted in the *Legal 500’s* Tax “Hall of Fame.”² This article summarizes some of Mr. Fuller’s key points and concerns as it relates to the Tax Cuts and Job Act (TCJA), new regulations, and recent court decisions.

Disallowance of FTC for Foreign Taxes Paid on Previously Taxed E&P

Mr. Fuller spoke of Prop. Reg. §1.965-5(c)(1)(ii) and how it will significantly impact foreign tax planning for years to come. This proposed regulation explicitly disallows the foreign tax credit, under Section 901 or deduction for foreign income taxes paid or accrued with respect to any amount for which a Section 965(c) deduction is allowed. In addition, neither a credit nor a deduction is allowed for foreign income taxes attributable, as it relates to previously taxed earnings and profits (“E&P”) under Section 965(a) and Section 965(b). In plain English, the new tax law reduces the foreign tax credit that can be used against the Section 965 income inclusion.³ It also disallows the credit for foreign taxes paid by the foreign corporation on income distributed to its U.S. corporate shareholders. Before getting into details of this specific provision, let’s break down key concepts of Section 965.

As a result of the TCJA, a controlled foreign corporation (“CFC”) must increase its Subpart F income by its accumulated deferred foreign income. This means the CFC’s U.S. shareholders must include in their taxable income their pro rata shares of that Subpart F income now increased by this deferred foreign income, which Section 965(a) further defines as accumulated post-1986 E&P. This is hereafter called the mandatory inclusion and applies to CFCs having tax year beginning before January 1, 2018. But of course, not all foreign corporations will have

¹ Available online at: <http://www.sjsu.edu/taxinstitute/about/history/2018materials> /(under International High Technology U.S. Tax Current Developments).

² James P. Fuller biography; <https://www.fenwick.com/professionals/pages/jimfuller.aspx>; May 7, 2019 from Fenwick & West LLP.

³ SKL Tax, “The Grind down of Foreign Tax Credits and the Code Section 965 Inclusion,” <https://skltax.com/grind-foreign-tax-credits-code-section-965-inclusion/>; May 5, 2019.

positive accumulated post-1986 E&P—there are some CFCs with a foreign E&P *deficit*. This is where Section 965(b) comes into play.

Section 965(b) provides that in certain cases where a U.S. shareholder owns at least one foreign corporation with positive accumulated E&P (called a DFIC) and at least one E&P *deficit* foreign corporation, the post-1986 E&Ps used to calculate the mandatory inclusion is reduced by the U.S. shareholder's aggregate foreign E&P deficits. Because it is used to calculate the mandatory inclusion amount, both Section 965(a) and Section 965(b) are taken into consideration when calculating previously taxed income ("PTI").

Mr. Fuller mentioned that Prop. Treas. Reg. §1.965-5 is especially concerning because the foreign tax credit under Section 901 is disallowed for the applicable percentage of any foreign income taxes for the portion of the Section 965(a) previously taxed E&P reduced by allocable E&P deficit pursuant to Section 965(b). He provided us with a simple example to illustrate this issue:

Suppose a U.S. shareholder owns CFC1 which has \$100 of accumulated E&P and CFC2 which has an E&P *deficit* of \$25. According to Section 965(b), the U.S. shareholder can use the E&P deficit of \$25 from CFC2 against the \$100 of accumulated E&P from CFC1 to have an inclusion of only \$75 as income. Any foreign tax credits associated with the \$75 of income inclusion can be used. However, the remaining \$25 of E&P that was left in the positive CFC1 was not included as income under Section 965, but instead becomes previously taxed income under Section 965(b). Any foreign tax credits associated with this \$25 of PTI which is related to the positive CFC1, will be disallowed and lost forever. Mr. Fuller was of the view that taxpayers should be entitled to a foreign tax credit for this \$25 of PTI and that the IRS and the Treasury should rectify this soon because it "does not seem right or supportable under the statute."

Mr. Fuller emphasized that the preamble to Prop. Treas. Reg. §1.965-5 states that Section 960(a)(3) only allows a credit for foreign income taxes when it is imposed on an upper-tier foreign corporation on distributions of Section 965(a) or Section 965(b) previously taxed E&P from lower-tier foreign corporations. This is illustrated through an example detailed in the preamble, summarized next.

If a lower-tier CFC distributes PTI to an upper-tier CFC, and the upper-tier CFC pays a foreign withholding tax on it, such withholding tax would be creditable under Section 960(a)(3) upon distribution by the upper-tier CFC to an eligible domestic corporation. However, the domestic corporation cannot bring up the foreign tax credit for the applicable percentage of that withholding tax.⁴

⁴ Disallowance of foreign tax credit or deduction for foreign income taxes paid with respect to amount for which Section 965(c) deduction is allowed. (Jan. 1, 2019). *Federal Tax Coordinator (RIA)*, <https://riacheckpoint.com>.

Foreign Currency Gain or Loss with Respect to Distributions of Previously Taxed E&P

Although Section 986(c) is not a new regulation, Mr. Fuller emphasized that this section will impact a lot of companies with respect to distribution of PTI from their respective CFCs. According to the proposed regulation, when a CFC makes distributions of Section 965(a) PTI, the U.S. shareholder must recognize foreign currency gain or loss based on the movements in the exchange rate between December 31, 2017 and the time the distributions were actually made. This foreign currency gain or loss will be treated as ordinary income or loss from the same source as the associated income inclusion.

Initially, it was thought that the entire Section 956 inclusion would be considered PTI. In other words, all of a company's deferred foreign earnings since 1986 is going to be one big PTI account. For instance, suppose a CFC has \$1 billion of PTI and there was a 10 percent change in currency rate. That would be \$100 million of currency gain or loss if that PTI was distributed in cash. This would result in significant recognition of foreign currency gain or loss for CFCs with PTI. Fortunately, Section 986(c) and the subsequently issued Notice 2018-7⁵ provided clarification stating that not all of the Section 965 inclusion amount will be used to calculate foreign currency gain or loss. The calculation of foreign currency gain or loss is only on the distributions of Section 965(a) previously taxed E&P that is reduced in the same proportion as the reductions by a Section 965(c) deduction amount. Indeed, this is welcome news for those with foreign currency gains. However, if the CFC had foreign currency loss, there is currently no authority or statute to dictate this circumstance.⁶

Subpart F High-Taxed Income Exclusion as it Relates to GILTI

Another high point of Mr. Fuller's discussion corresponded to Subpart F and whether to elect the high-tax income exclusion under Section 954(b)(4) as it pertains to GILTI and maximizing of foreign tax credits. In general, U.S. shareholders of CFCs must include their pro rata share of the CFC's Subpart F income which comprises foreign base company income ("FBCI") and is subject to U.S. tax minus applicable foreign tax credits. However, there are certain types of income which are excluded from FBCI. Under Section 954(b)(4), a high-tax exception is any income taxed at more than 90 percent of the highest U.S. corporate tax rate and, if elected, is excluded from Subpart F income.

The introduction of GILTI throws a wrench into the structuring of international tax operations particularly with allocating Subpart F income and utilizing foreign tax credits. GILTI excludes Subpart F income and income that would be Subpart F income but is exempted due to the high-tax exception under Section 954(b)(4). When this high-tax exclusion election is made, the income will no longer be included as Subpart F income under both GILTI and Subpart F rules. Any foreign tax credits associated with this excluded income will remain in the CFC and will not

⁵ Notice 2018-7, 2018-4 I.R.B. 317.

⁶ In addition, according to Prop. Treas. Reg. §1.986(c)-1(c), §986(c) does not apply to PTI under §965(b).

be available for use. If the high-tax exception is not made under Section 954(b)(4), the income will be included as Subpart F income and subject to the U.S. shareholder's tax rate, and thus, bringing up the high foreign tax credits to be used.⁷

Before the TCJA, many U.S. multinational companies structured their international operations around Subpart F. But with the introduction of GILTI, these companies must carefully model their tax liability using both GILTI and Subpart F rules. For certain taxpayers, it might make sense to not make the high-tax income exclusion election in order to include in Subpart F income and utilize excess foreign tax credits. Mr. Fuller believes that going forward, most people will choose this strategy in order to utilize their foreign tax credits.

The *Altera* Case and Its Impact on the Arms-Length Standard

On July 24, 2018, the U.S. Court of Appeals for the Ninth Circuit ("the Ninth Circuit") initially overturned the 2015 Tax Court decision in *Altera Corp. v. Commissioner*, thus requiring the inclusion of stock-based compensation in cost sharing agreements. According to Mr. Fuller, this is a landmark decision that would have lasting impact on companies with transfer pricing issues.

The Internal Revenue Service ("IRS") brought Altera Corporation ("Altera") to Tax Court finding that the company did not follow the 2003 tax regulation (Treas. Reg. §1.482-7) that requires stock-based compensation to be included in cost sharing agreements ("the 2003 Regulation"). According to Altera, the IRS and Treasury failed to satisfy the requirements of the Administrative Procedure Act ("APA") and did not provide sufficient data to show that Altera did not satisfy the arm's-length standard under Section 482. The Tax Court ruled in favor of Altera, and as a result, many U.S. companies relied on this judicial decision and began to exclude stock-based compensation from the cost-sharing pool, basically rendering the 2003 regulation unenforceable.⁸

However, shortly after the July opinion, the Ninth Circuit withdrew the opinion and called for a rehearing. The case was re-argued before the appeals court on October 16, 2018. In early June 2019, the 9th Circuit's new decision was issued, finding as in its original decision, that the IRS was correct, thus it reversed the earlier Tax Court decision (926 F.3d 1061).

Conclusion

This article summarizes only four of Mr. Fuller's vast array of international tax topics and developments. It is important to note that while the IRS and Treasury are doing their best to issue clear technical guidance, many of these issues are still quite murky and subject to intense

⁷ Zhang, Libin. (2018). To the Frying Pan: New Virtues of Subpart F Income Over GILTI. *Tax Notes*, Volume 160, No. 1, https://www.robertsandholland.com/siteFiles/Articles/To_the_Frying_Pan.PDF.

⁸ PWC Tax Insights. (2018). "Ninth Circuit reverses Tax Court in 'Altera,' requires stock-based compensation to be covered by cost sharing payments", <https://www.pwc.com/gx/en/tax/newsletters/pricing-knowledge-network/assets/pwc-tp-altera-ninth-cir-dec.pdf>.

interpretations and comments by tax practitioners. Because of this, tax professionals should strive to obtain a complete understanding of these new tax laws and should always remember to advise their clients with utmost caution, knowing that these regulations can be replaced with newer clarifications.