Foreign-Derived Intangible Income (FDII)

- How we got here.
- Who it applies to.
- How to apply it.

*Presented by:*
Kathy S. Schultz, CPA, AEP®
Background – Section 250 FDII & GILTI Deduction

• FDII implemented as part of TCJA
• Transition to Participation Exemption – efficient redeployment of foreign earnings in the US
• § 965 repatriated the accumulated post-1986 deferred foreign income – determined 11/2 or 12/31/2017
• Implementation of GILTI (Global Intangible Low Taxed Income) under § 951A taxes current foreign earnings, but at a lower rate via §250 deduction
  o Aim is to disincentivize taxpayers from moving IP out of the US by currently taxing foreign earnings deemed attributable to IP
  o Effectively taxes foreign earnings at a lower rate to allow US multinationals to remain competitive with Foreign multinationals
Implementation of FDII (Foreign-Derived Intangible Income) deduction

- Aim is to neutralize tax benefits of lower effective tax rate on GILTI earned by a Controlled Foreign Corporation (CFC) by offering a deduction for foreign derived income earned by a US Corporation
- § 250 – Deduction for foreign-derived intangible income of a US corporation
- Potentially available to every US corporation that exports property or services outside of the US
- § 250 Deduction is calculated at the partnership level
- US Shareholder individuals that make a § 962 election to be treated as a US Corporation are also eligible for § 250 deduction
What is the § 250 Deduction?

• §250 Deduction = 37.5% of FDII + 50% of (GILTI + §78 gross-up)
• Creating Effective Tax Rates (ETR)
  o 13.125% ETR on income constituting FDII, after the “FDII Deduction”
  o 10.5% ETR on GILTI inclusion, after the “GILTI Deduction”
  o Note: Starting in 2026, §250 Deduction is reduced to 21.875% of FDII + 37.5% of GILTI and §78 gross-up.
    ▪ ETR increases to 16.406% on FDII and 13.125% on GILTI inclusion
Steps in Determining FDII - Definitions

• Conceptually – Slimming down US Corp’s taxable income to get to the portion derived from foreign markets and attributable to intangible property of the US Corp

• FDII = DII * Foreign-Derived Ratio
  o FDII = Foreign-derived intangible income
  o DII = Deemed Intangible Income

• DII = DEI – DTIR
  o DEI = Deduction Eligible Income
  o DTIR = Deemed Tangible Income Return

• Foreign-Derived Ratio = FDDEI / DEI
  o FDDEI = Foreign-derived deduction eligible income
  o DEI = Deduction eligible income
• Step 1 (Part I of Form 8993) = Determining Deduction Eligible Income (DEI)
• DEI = Gross Income – Exclusions - Properly Allocable Deductions
• Exclusions
  o Subpart F income - §951(a)
  o GILTI
  o Foreign branch income
  o Dividends from CFCs
  o Financial services income
• Properly Allocable Deductions – all deductions (including taxes) properly allocable to gross income less exclusions using “any reasonable method”
• Step 2 (Part II of Form 8993) = Determining Deemed Intangible Income (DII)
  • DII = DEI - QBAI
• Deemed Tangible Income Return (DTIR) = 10% of Qualified Business Asset Investment (QBAI)
  o Only want to allow a deduction on income attributable to intangible property. Rules apply a deemed 10% rate of return on tangible property, rather than calculating the portion of a corporation’s income attributable to tangible property
• QBAI = Average aggregate adjusted basis at the close of each quarter of specified tangible property used in the trade or business
  o Specified tangible property = Tangible property (eligible for a §167 depreciation deduction) used in the production of Gross DEI
• Adjusted Basis = Determined by using alternative depreciation system
Calculating the FDII – Reportable on Form 8993 (Cont.)

- Step 3 (Part III of Form 8993) = Determining Foreign Derived Ratio
- FDDEI = Gross FDDEI – Properly FDDEI allocable deductions (including taxes)
- Gross FDDEI
  - The portion of a Corp’s Gross DEI that is derived from its sales, leases, exchanges or other dispositions of property to a foreign person for a foreign use
  - The portion of a Corp’s Gross DEI that is derived from a license of property to a foreign person for a foreign use
  - The portion of a Corp’s Gross DEI that is derived from services provided to a person or with respect to property located outside of the US
- Foreign-derived ratio = FDDEI / DEI
  - This calculation only allows a deduction on foreign derived portion of deemed intangible income.
  - Foreign-derived ratio cannot exceed 1
Step 4 (Part IV of Form 8993) = Determining FDII and/or GILTI Deduction

- FDII = DII * Foreign-derived ratio
- Calculate GILTI (Form 8992)
- Add FDII and GILTI
- IF FDII + GILTI > taxable income without §250 deduction, then reduce FDII and GILTI proportionately so that sum of reduced FDII + reduced GILTI = taxable income (i.e. excess of (FDII + GILTI) over taxable income*FDII/(FDII + GILTI))
- Calculate §250 Deduction = 37.5% * FDII + 50% * (GILTI + §78 gross-up)
How is the FDII Deduction Calculated

**STEP 1**

\[ \text{DEI} - (10\% \times \text{QBAI}) = \text{DII} \]

**STEP 2**

\[ \text{DII} \times \frac{\text{FDDEI}}{\text{DEI}} = \text{FDII} \]

**STEP 3**

\[ \text{FDII} \times \text{APPLICABLE \%} = \text{FDII \ DEDUCTION} \]
Documentation of Foreign Use

- A written statement from the recipient that the recipient’s use or intended use of the property meets the foreign use requirement
- A binding contract with the recipient that the recipient’s use or intended use of the property meets the foreign use requirement
- Documentation of shipment outside the US – for example, the export bill of lading from the carrier

- **De Minimis Exception**
  - Sellers who received less than $10 million in gross receipts during the prior year or who receive less than $5,000 in gross receipts during the current year from a single recipient
  - Can rely on the recipient’s shipping address to meet documentation requirements
Sale of Property Between Related Parties is FDDEI if

• The foreign related party resells the property or includes it as a component of other property sold
  o To a foreign unrelated party to the domestic seller for foreign use on or before the FDII filing date
  o If an unrelated-party transaction occurs after the FDII filing date, an amended return must be filed to claim a FDII deduction

• As of the FDII filing date, the seller in the related party sale must reasonably expect that
  o The property will be used in connection with a subsequent sale by related party to an unrelated party
  o The unrelated party transaction would otherwise be an FDDEI sale
  o More that 80% of the revenue earned by the foreign related party will be from the unrelated party transaction

Note: Related-party sale rules do not apply to sale of IP
**Example Form**

**U.S. Corporation Income Tax Return**

**Form 1120**

**For calendar year 2018 or for year beginning**

**EXTENSION GRANTED TO 10/15/19**

**2018**

**Name of Corporation:** SAVING MONEY, INC.

**Employer Identification Number:** 12-1231231

**Date Incorporated:** 09/26/2013

**City or town, state or province, country, and ZIP or foreign postal code:** WASHINGTON, DC 12345

**Total assets (prior year):** $818,490

### Income

1. **Gross receipts or sales:** $1,500,000.00

### Exemptions

1. **Compensation of officers:** $1,550,000.00

### Deductions

#### Operating losses deduction (see instructions)

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expts (Schedule C, line 24a, column (c))</td>
<td>$212,200.00</td>
</tr>
</tbody>
</table>

#### Non-operating losses deduction (see instructions)

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Special deductions (Schedule C, line 24c, from line 28c)</td>
<td>$-</td>
</tr>
</tbody>
</table>

### Other deductions

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total deductions (Schedule D, line 39)</td>
<td>$870,000.00</td>
</tr>
</tbody>
</table>

### Sign Here

- **Due Date:** 04/15/2019
- **Signature of officer:**
- **President:**
- **Preparer:**
- **Paid Preparer Use Only:**

*JWA: For Paperwork Reduction Act Notice, see separate instructions.*

**Form 1120 (2018)**
<table>
<thead>
<tr>
<th>Schedule C</th>
<th>Dividends, Inclusions, and Special Deductions</th>
<th>(a) Dividends and Inclusions</th>
<th>(b) %</th>
<th>(c) Special deductions (a) x (b)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Dividends from less-than-20%-owned domestic corporations (other than debt-financed stock)</td>
<td>60</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Dividends from 20%-or-more-owned domestic corporations (other than debt-financed stock)</td>
<td>85</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Dividends on certain debt-financed stock of domestic and foreign corporations</td>
<td>see instructions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Dividends on certain preferred stock of less-than-20%-owned public utilities</td>
<td>23.3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Dividends on certain preferred stock of 20%-or-more-owned public utilities</td>
<td>20.7</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Dividends from less-than-20%-owned foreign corporations and certain FSCs</td>
<td>50</td>
<td></td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Dividends from 20%-or-more-owned foreign corporations and certain FSCs</td>
<td>50</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>Dividends from wholly owned foreign subsidiaries</td>
<td>100</td>
<td></td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Subtotal. Add lines 1 through 8</td>
<td>see instructions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>Dividends from domestic corporations received by a small business investment company operating under the Small Business Investment Act of 1958</td>
<td>100</td>
<td></td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Dividends from affiliated group members</td>
<td>100</td>
<td></td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>Dividends from certain FSCs</td>
<td>100</td>
<td></td>
<td></td>
</tr>
<tr>
<td>13</td>
<td>Foreign-source portion of dividends received from a specified 10%-owned foreign corporation (excluding hybrid dividends) (see instructions)</td>
<td>100</td>
<td></td>
<td></td>
</tr>
<tr>
<td>14</td>
<td>Dividends from foreign corporations not included on line 3, 6, 7, 8, 11, 12, or 13 (including any hybrid dividends)</td>
<td>100</td>
<td></td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>Section 956(a) inclusion</td>
<td>see instructions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>16a</td>
<td>Subpart F inclusions derived from the sale by a controlled foreign corporation (CFC) of the stock of a lower-tier foreign corporation treated as a dividend (attach Form(s) 5471) (see instructions)</td>
<td>100</td>
<td></td>
<td></td>
</tr>
<tr>
<td>16b</td>
<td>Subpart F inclusions derived from hybrid dividends of tiered corporations (attach Form(s) 5471) (see instructions)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>16c</td>
<td>Other Inclusions from QFCs under subpart F not included on line 15, 16a, 16b, or 17 (attach Form(s) 5471) (see instructions)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>17</td>
<td>Global Intangible Low-Taxed Income (GILTI) (attach Form(s) 5471 and Form 8892)</td>
<td>38,084</td>
<td></td>
<td></td>
</tr>
<tr>
<td>18</td>
<td>Gross-up for foreign taxes deemed paid</td>
<td>11,916</td>
<td></td>
<td></td>
</tr>
<tr>
<td>19</td>
<td>IC-DISC and former DISC dividends not included on line 1, 2, or 3</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>20</td>
<td>Other dividends</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>21</td>
<td>Deduction for dividends paid on certain preferred stock of public utilities</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>22</td>
<td>Section 263 deduction (attach Form 8930)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>23</td>
<td>Total dividends and inclusions. Add lines 9 through 22. Enter here and on page 1, line 4</td>
<td>50,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>24</td>
<td>Total special deductions. Add lines 9 through 22, column (c). Enter here and on page 1, line 28b</td>
<td>212,200</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Form 1120 (2018)
Example Form (Cont.)

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Form 8993
Section 250 Deduction for Foreign-Derived Intangible Income (FDII) and Global Intangible Low-Taxed Income (GILTI)

Name of person filing this return: SAVING MONEY, INC.
Identifying number: 12-1231234

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

Part II: Determining Deduction Eligible Income (DEI) (see instructions)
1. DEI (from Part I, line 6, above) ................................................................. 1
2. Deemed Tangible Income Return (10% of QEAQI) ................................... 2
3. Deemed Intangible Income (DII) (subtract line 2 from line 1) ................. 3

Part III: Determining Foreign Derived Ratio (see instructions)
1. 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
2. DEI derived from a license of property to a foreign person for a foreign
   use (see instructions) .................................................................................. 1b
3. DEI derived from services provided to a person or with respect to
   property located outside of the United States (see instructions) ............. 1c
4. Foreign Derived Deduction Eligible Income (FDDEI) (add lines 1a through 1c) ................................................................. 4
5. Deduction Eligible Income (DEI) (from Part I, line 6, above) ................ 5
6. Foreign Derived Ratio (FDI/DEI) (divide line 2 by line 5) ...................... 6

Part IV: Determining FDII and/or GILTI Deduction (see instructions)
1. Deemed Intangible Income (DII) (from Part II, line 1) .......................... 1
2. Foreign Derived Ratio (from Part III, line 4) .......................................... 2
3. FDII (multiply line 1 by line 2) ................................................................. 3
4. Global Intangible Low-Taxed Income (GILTI) Inclusion (see instructions for line 3b) ................................................................. 4
5. Total FDII and GILTI (add lines 3a and 3b) .............................................. 5
6. Taxable Income (see instructions for line 6) ........................................... 6
7. Excess FDII and GILTI over Taxable Income (subtract line 4 from line 5), if zero or less, enter 0. 7
8. FDII Deduction (see instructions for line 6) ........................................... 8
9. GILTI Deduction (see instructions for line 9) .......................................... 9

JWA For Paperwork Reduction Act Notice, see separate instructions.

Form 8993 (12-2019)
```
Example Worksheet

Saving Money, Inc.

<table>
<thead>
<tr>
<th>Sales:</th>
<th>DEI</th>
<th>FDDEI</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross sales</td>
<td>1,550,000</td>
<td>1,550,000</td>
</tr>
<tr>
<td>Less GILTI (951A)</td>
<td>(50,000)</td>
<td>(50,000)</td>
</tr>
<tr>
<td>less US sales</td>
<td></td>
<td>(300,000)</td>
</tr>
<tr>
<td>Gross DEI and FDDEI</td>
<td>1,500,000</td>
<td>1,200,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>deductions:</th>
<th>DEI</th>
<th>FDDEI</th>
</tr>
</thead>
<tbody>
<tr>
<td>total deductions</td>
<td>875,000</td>
<td>875,000</td>
</tr>
<tr>
<td>less deductions allocated to US income</td>
<td></td>
<td>(175,000)</td>
</tr>
<tr>
<td></td>
<td>875,000</td>
<td>700,000</td>
</tr>
</tbody>
</table>

| Net DEI and FDDEI                     | 625,000 | 500,000 |
| QBAI: Asset (10,000* .1)              | 1,000   |       |
| DII (DEI-QBAI)                        | 624,000 |       |
| Foreign derived ratio FDDEI/DEI       | 0.80    |       |
| FDII (DII * Foreign derived ratio)    | 499,200 |       |
| FDII deduction @ 37.5%                | 187,200 |       |
Saving Money, Inc
Tax reconciliation

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>GILTI</td>
<td>50,000</td>
</tr>
<tr>
<td>GILTI 250 deduction</td>
<td>25,000</td>
</tr>
<tr>
<td>FDII 250 deduction</td>
<td>187,200</td>
</tr>
<tr>
<td>Total</td>
<td>212,200</td>
</tr>
</tbody>
</table>

Tax with GILTI inclusion      | 141,750  | (1120 only GILTI, not FDII) |

Remove 100% of tax on FDII deduction to achieve an effective income tax rate of 13.125%:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
<th>(21% of GILTI 250 Deduction)</th>
<th>(21% of FDII 250 Deduction)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less: tax on GILTI 250 deduction</td>
<td>(5,250)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: tax on FDII 250 deduction</td>
<td>(39,312)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>(44,562)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Tax                                         | 97,188   |

Net tax savings                             | 44,562   |