



International Tax ADVISORY ■

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Talk About a Summer Beach Read – Final FDII and GILTI Regulations Released

On July 9, 2020, Treasury and the IRS issued a [295-page package](#) providing final regulations relating to the Section 250 deduction for foreign-derived intangible income (FDII) and global intangible low-taxed income (GILTI). The package contains rules for computing the deduction, particularly its FDII-related components, and applying the taxable income limitation. These final regulations follow up on [proposed regulations released in March 2019](#). While the final regulations retain the basic approach and structure of the proposed regulations, there are some substantial departures.

Background

The tax on GILTI was intended to preserve the U.S. tax base in the wake of the Tax Cuts and Jobs Act's move to a participation exemption regime. But to keep U.S. corporations competitive, the law lowered the effective tax rate on GILTI via the GILTI deduction. The FDII deduction, in turn, was meant to create parity for domestic corporations that earn FDII directly, rather than through controlled foreign corporations (CFCs). Per the preamble to the final regulations, Section 250 helps "neutralize" the role of tax considerations in the decision to locate intangibles and related income in a domestic corporation or in a CFC.

Section 250 allows a deduction for up to 37.5% of FDII and 50% of GILTI (including the Section 78 gross-up attributable to GILTI) for tax years beginning after December 31, 2017, and before January 1, 2026. The percentages drop to 21.875% and 37.5%, respectively, for tax years beginning after 2025. If a corporation's FDII and GILTI exceed its taxable income for the year, the amount of FDII and GILTI are reduced proportionately for purposes of computing the Section 250 deduction. The deduction is generally available only to domestic C corporations, though not regulated investment companies (RICs) or real estate investment trusts (REITs).

Substantial Departures and Items of Interest

While this may not be at the top of your list of summer beach reads, there are definitely some items of interest included in the final regulations.

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One of the most substantial departures from the proposed regulations relates to the documentation and substantiation requirements for taxpayers to show that they are entitled to the FDII deduction. The proposed regulations provided that to establish that a recipient is a foreign person, property is for a foreign use, or a recipient of a general service is located outside the U.S., the taxpayer must obtain specific types of documentation. Numerous comments indicated that the proposed documentation requirements were prohibitively burdensome. Among other things, comments noted that customers are highly reluctant to provide some of the types of documents that the proposed regulations described and also that the proposed regulations could require taxpayers to renegotiate contracts or make inquiries of their customers that could interfere with the customer relationship.

As a result of these comments, the final regulations adopt a much more relaxed approach and remove the specific documentation requirements to establish foreign person status, foreign use on sales of general property made directly to end-users, and the location of general services provided to consumers. The final regulations also adopt a more flexible approach regarding the types of substantiation required for foreign use regarding sales of general property to non-end-users and sales of intangible property, and for determining whether services are performed for business recipients located outside the U.S. While substantiation is required, taxpayers are no longer limited to only certain documents. The final regulations also eliminate the specific reliability requirement included in the proposed regulations—Treasury and the IRS understand that the reliability of documents or information can differ depending on the circumstances. The final regulations continue to require that the substantiating documents be supported by credible evidence.

Another departure from the proposed regulations is the removal of an example that applied an ordering rule that relates to the interaction of Sections 250, 163(j) (business interest expense), and 172 (net operating losses). The preamble to the final regulations explains that Treasury and the IRS determined that further study is required to determine the appropriate rule for coordinating Sections 250(a)(2), 163(j), and 172 and other Code sections that limit the availability of deductions based, directly or indirectly, on a taxpayer's taxable income. Treasury and the IRS are considering a separate guidance project to address this topic. Before further guidance is issued on how allowed deductions are taken into account in determining the taxable income limitation in Section 250(a)(2), taxpayers may choose any reasonable method that is applied consistently for all tax years beginning after December 31, 2020.

Some departures from the proposed regulations were made to reflect changes made in other regulations. For example, in light of the December 2019 proposed regulations relating to foreign tax credits (2019 Proposed FTC Regulations), the final regulations make changes to how certain expenses are apportioned. The preamble to the final regulations states that Treasury and the IRS will consider the issues raised about the application of exclusive apportionment for purposes of Section 250 as part of finalizing the 2019 Proposed FTC Regulations.

Of interest to taxpayers in the software industry, the final regulations clarify how a taxpayer establishes foreign use for digital sales and a recipient's foreign location for electronically supplied services and advertising. As several comments noted, the proposed rules did not offer clarity on how foreign use is established on transferred copyright articles delivered electronically rather than on a physical medium. The final regulations provide that the sale of copyrighted articles is examined under general property rules rather than intangible property rules, regardless of how the copyrighted articles are transferred. An example in the final regulations illustrates that digital content can be part of an eligible sale if the end-user downloads or accesses it on a device outside the U.S. Additionally, the final regulations provide two new subcategories of general services: electronically supplied services and advertising services. As in the case of a digital content sale, an electronically supplied service qualifies for the FDII deduction if the recipient accesses the service from a location outside the U.S. For purposes of Section 250, the final regulations assign the location of the recipient of advertising services as the location where the advertisements are viewed.

To the relief of some individuals who are CFC shareholders, the final regulations retain the provision in the proposed regulations that allowed individuals making an election under Section 962 to be treated as a corporation to take into account the deduction for GILTI under Section 250. Treasury and the IRS are considering issuing further guidance on how to make a Section 962 election on an amended return. In the meantime, the preamble to the final regulations states that, until any final guidance on this issue is published, individuals may make an otherwise valid election on an amended return for 2018 and later, provided the interests of the government are not prejudiced by the delay.

To give taxpayers additional time to develop systems and procedures for complying with the final regulations, the proposed applicability dates in the proposed regulations are modified. Generally, the final regulations are applicable for taxable years beginning after December 31, 2020. However, taxpayers are able to rely on the proposed regulations, in their entirety, for taxable years beginning before January 1, 2021.

For more information, please contact [Edward Tanenbaum](#) at 212.210.9425, [Richard Slowinski](#) at 202.239.3231, or [Stefanie Kavanagh](#) at 202.239.3914.

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Our tax team also joined our Intellectual Property Group for a webinar to discuss "[Tax and Litigation Implications of Intellectual Property Ownership & Licensing](#)."

If you have any questions or would like additional information, please contact your Alston & Bird attorney or any of the following:

International Tax Group

John F. Baron
Chair
704.444.1434
john.baron@alston.com

George B. Abney
404.881.7980
george.abney@alston.com

Jasper L. Cummings, Jr.
919.862.2302
jack.cummings@alston.com

Clay A. Littlefield
704.444.144
clay.littlefield@alston.com

Richard L. Slowinski
202.239.3231
richard.slowinski@alston.com

John F. Baron
704.444.1434
john.baron@alston.com

Scott Harty
404.881.7867
scott.harty@alston.com

April McLeod
212.210.9487
april.mcleod@alston.com

Edward Tanenbaum
212.210.9425
edward.tanenbaum@alston.com

Henry J. Birnkrant
202.239.3319
henry.birnkrant@alston.com

Brian D. Harvel
404.881.4491
brian.harvel@alston.com

Ashley B. Menser
919.862.2209
ashley.menser@alston.com

Shawna Tunnell
202.239.3040
shawna.tunnell@alston.com

Seth M. Buchwald
404.881.7836
seth.buchwald@alston.com

Stefanie Kavanagh
202.239.3914
stefanie.kavanagh@alston.com

Daniel M. Reach
704.444.1272
danny.reach@alston.com

James E. Croker, Jr.
202.239.3309
jim.croker@alston.com

Sam K. Kaywood, Jr.
404.881.7481
sam.kaywood@alston.com

Heather Ripley
212.210.9549
heather.ripley@alston.com

ALSTON & BIRD

WWW.ALSTON.COM

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ATLANTA: One Atlantic Center ■ 1201 West Peachtree Street ■ Atlanta, Georgia, USA, 30309-3424 ■ 404.881.7000 ■ Fax: 404.881.7777
BEIJING: Hanwei Plaza West Wing ■ Suite 21B2 ■ No. 7 Guanghua Road ■ Chaoyang District ■ Beijing, 100004 CN ■ +86.10.85927500
BRUSSELS: Level 20 Bastion Tower ■ Place du Champ de Mars ■ B-1050 Brussels, BE ■ +32 2 550 3700 ■ Fax: +32 2 550 3719
CHARLOTTE: Bank of America Plaza ■ 101 South Tryon Street ■ Suite 4000 ■ Charlotte, North Carolina, USA, 28280-4000 ■ 704.444.1000 ■ Fax: 704.444.1111
DALLAS: Chase Tower ■ 2200 Ross Avenue ■ Suite 2300 ■ Dallas, Texas, USA, 75201 ■ 214.922.3400 ■ Fax: 214.922.3899
LONDON: 5th Floor ■ Octagon Point, St. Paul's ■ 5 Cheapside ■ London, EC2V 6AA, UK ■ +44.0.20.3823.2225
LOS ANGELES: 333 South Hope Street ■ 16th Floor ■ Los Angeles, California, USA, 90071-3004 ■ 213.576.1000 ■ Fax: 213.576.1100
NEW YORK: 90 Park Avenue ■ 15th Floor ■ New York, New York, USA, 10016-1387 ■ 212.210.9400 ■ Fax: 212.210.9444
RALEIGH: 555 Fayetteville Street ■ Suite 600 ■ Raleigh, North Carolina, USA, 27601-3034 ■ 919.862.2200 ■ Fax: 919.862.2260
SAN FRANCISCO: 560 Mission Street ■ Suite 2100 ■ San Francisco, California, USA, 94105-0912 ■ 415.243.1000 ■ Fax: 415.243.1001
SILICON VALLEY: 950 Page Mill Road ■ Palo Alto, California, USA 94304-1012 ■ 650.838.2000 ■ Fax: 650.838.2001
WASHINGTON, DC: The Atlantic Building ■ 950 F Street, NW ■ Washington, DC, USA, 20004-1404 ■ 202.239.3300 ■ Fax: 202.239.3333