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The International Tax Provisions of the Tax Cuts and Jobs Act of 2017 – The Time to Act is Now

With the new Tax Act becoming law, taxpayers with international activities must plan to reduce their tax due. The purpose of this alert is to discuss issues that must be evaluated these last few days of 2017 and to consider possible planning for 2018.

Deemed Repatriation for 2017

Every U.S. owner of a foreign subsidiary must include the accumulated earnings of the foreign subsidiary as income in 2017.

This deemed repatriation regime applies to all types of U.S. owners, with varying impacts. C corporations can receive a partial foreign tax credit. S corporation owners can defer paying the tax indefinitely until they sell their S corporation's shares. LLCs and individuals must include the accumulated earnings as income without the benefit of either the foreign tax credit available to C corporations or the indefinite deferral available to S corporation owners.

If an individual or an LLC owns shares in a foreign subsidiary, it should consider implementing a deferral strategy before the start of 2018. If this applies to you, please contact us for a discussion about your alternatives.

IC-DISCs and Other Exporters

The IC DISC remains a viable tax planning technique for a U.S. manufacturer that exports. By implementing an IC-DISC, a U.S. manufacturer can convert ordinary income taxed at marginal rates into qualified dividends taxed at the 20% capital gains rate.

A new provision, oddly called the Foreign Derived Intangible Income deduction, will allow C corporations to incur tax on exports at only 13.125% in 2018 (a 35.7% reduction compared to the future 21% rate applied to C corporations). Combining the Foreign Derived Intangible Income deduction with the IC DISC will create tremendous tax savings on exports.

However, if you are a U.S. manufacturer who pays foreign taxes and takes a foreign tax credit, you may want to consider restructuring your foreign

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operations. A little-publicized provision in the Tax Act will effectively eliminate the foreign tax credit by treating all the export income as U.S. source income. Eliminating the foreign tax credit will result in double taxation. To the extent that a U.S. manufacturer can accelerate exports into the few remaining days of 2017, it can reduce double taxation in 2018. Moreover, if a U.S. manufacturer sells abroad through a disregarded foreign entity (*e.g.,* a check-the-box election), it should consider restructuring the foreign operation for 2018.

Participation Exemption for 2018

Although not requiring immediate action, the centerpiece of the new Tax Act is the participation exemption. Starting in 2018, C corporations—and C corporations only—will be able to receive dividends from their foreign subsidiaries on a tax free basis. Unfortunately, the participation exemption does not apply to pass through entities or individuals. Pass-through entities or individuals with profitable foreign subsidiaries should consider contributing or selling their foreign subsidiaries to C corporations.

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