



Wolters Kluwer



GLOBAL TAX WEEKLY

a closer look

ISSUE 307 | SEPTEMBER 27, 2018

SUBJECTS TRANSFER PRICING INTELLECTUAL PROPERTY VAT, GST AND SALES TAX CORPORATE TAXATION INDIVIDUAL TAXATION REAL ESTATE AND PROPERTY TAXES INTERNATIONAL FISCAL GOVERNANCE BUDGETS COMPLIANCE OFFSHORE

SECTORS MANUFACTURING RETAIL/WHOLESALE INSURANCE BANKS/FINANCIAL INSTITUTIONS RESTAURANTS/FOOD SERVICE CONSTRUCTION AEROSPACE ENERGY AUTOMOTIVE MINING AND MINERALS ENTERTAINMENT AND MEDIA OIL AND GAS

COUNTRIES AND REGIONS EUROPE AUSTRIA BELGIUM BULGARIA CYPRUS CZECH REPUBLIC DENMARK ESTONIA FINLAND FRANCE GERMANY GREECE HUNGARY IRELAND ITALY LATVIA LITHUANIA LUXEMBOURG MALTA NETHERLANDS POLAND PORTUGAL ROMANIA SLOVAKIA SLOVENIA SPAIN SWEDEN SWITZERLAND UNITED KINGDOM EMERGING MARKETS ARGENTINA BRAZIL CHILE CHINA INDIA ISRAEL MEXICO RUSSIA SOUTH AFRICA SOUTH KOREA TAIWAN VIETNAM CENTRAL AND EASTERN EUROPE ARMENIA AZERBAIJAN BOSNIA CROATIA FAROE ISLANDS GEORGIA KAZAKHSTAN MONTENEGRO NORWAY SERBIA TURKEY UKRAINE UZBEKISTAN ASIA-PAC AUSTRALIA BANGLADESH BRUNEI HONG KONG INDONESIA JAPAN MALAYSIA NEW ZEALAND PAKISTAN PHILIPPINES SINGAPORE THAILAND AMERICAS BOLIVIA CANADA COLOMBIA COSTA RICA ECUADOR EL SALVADOR GUATEMALA PANAMA PERU PUERTO RICO URUGUAY UNITED STATES VENEZUELA MIDDLE EAST ALGERIA BAHRAIN BOTSWANA DUBAI EGYPT ETHIOPIA EQUATORIAL GUINEA IRAQ KUWAIT MOROCCO NIGERIA OMAN QATAR SAUDI ARABIA TUNISIA LOW-TAX JURISDICTIONS ANDORRA ARUBA BAHAMAS BARBADOS BELIZE BERMUDA BRITISH VIRGIN ISLANDS CAYMAN ISLANDS COOK ISLANDS CURACAO GIBRALTAR GUERNSEY ISLE OF MAN JERSEY LABUAN LIECHTENSTEIN MAURITIUS MONACO TURKS AND CAICOS ISLANDS VANUATU

Tax Reform Insight: US Tax Costs Significantly Reduced On Sale Of CFC Stock

by Lowell D. Yoder, Timothy S. Shuman, Michael J. Wilder & Jonathan D. Lockhart, MWE



Following the 2017 Tax Act, the US tax costs to a corporate US shareholder that sells stock in a controlled foreign corporation (CFC) are significantly reduced. Beginning in 2018, the amount of gain will be generally less than in prior years and most or all such gain will frequently not be subject to any US federal income taxation.

The amount of gain recognized in a sale of course is the difference between the amount realized and the selling shareholder's adjusted tax basis in the stock of the CFC. The initial basis in the stock of a CFC is increased by the amount of earnings of the CFC and its subsidiaries that was included in the gross income of the domestic corporation under Subpart F (*i.e.*, previously taxed earnings). The increase in basis can be significant as a result of the transition tax Subpart F inclusion of post-1986 earnings of CFCs and the expansion of Subpart F inclusions for global intangible low-taxed income (GILTI).

The gain recognized by a domestic corporation upon the sale of stock in a CFC generally is capital gain subject to a 21 percent tax rate. Section 1248, however, recharacterizes as a deemed dividend all or a portion of the gain. The amount of gain recharacterized generally equals the amount of non-previously taxed earnings of the CFC and its foreign subsidiaries. Provided the domestic corporate shareholder held the CFC stock for at least one year, the amount of the gain recharacterized as a dividend generally is eligible for a 100 percent dividends received deduction under Section 245A.

For example, a domestic corporation owns stock in CFC1 with an initial basis of \$100. It sells the stock for USD1,000. Assume CFC1 owns CFC2 and CFC3. On a combined basis the three CFCs have previously taxed earnings of USD400 and non-previously taxed earnings of USD375

while owned by the domestic corporation. The domestic corporation would recognize \$500 of taxable gain on the sale (because its initial USD100 basis in CFC1 is increased to \$500 as a result of the previously taxed earnings), and \$375 would be treated as a deemed dividend that carries an offsetting deduction under Section 245A. The remaining USD125 would be subject to a 21 percent tax rate (USD26 of tax, which is approximately a 3 percent tax rate on the USD900 realized over the initial investment).

If the stock of CFC1 is sold before the last day of a taxable year and the three CFCs retain their status as CFCs following the sale, only a portion of the current year earnings and profits of the CFCs would be taken into account for purposes of Section 1248. This portion is calculated by prorating the earnings of the three CFCs for the entire year between the pre-sale period and the post-sale period. Transactions undertaken by the buyer following a sale can affect the amount of the Section 1248 dividend and therefore should be addressed in the sales agreement.

If the buyer is foreign and the three CFCs lose their status as CFCs, the seller will report any Subpart F income (21 percent tax rate) and GILTI (10.5 percent tax rate) for the portion of the year prior to the sale. This is determined by taking into account the income of the three CFCs for the entire year and then prorating it between the pre-sale and post-sale period. The current year earnings taxable under Subpart F would correspondingly reduce the amount of gain and replace the non-taxable dividend portion of the gain. Again, transactions engaged in by the buyer following a sale could affect the amount of the Subpart F inclusions, and therefore should be addressed in the sales agreement.

In summary, the US tax costs of selling stock in a CFC generally will be significantly less for a domestic corporation beginning in 2018 as a result of the increase in the tax basis in the stock being sold from undistributed previously taxed earnings and the 100 percent deduction of the dividend portion of the gain. The sales agreement should address transactions after the sale that can affect the tax results to the seller as well as the allocation any Subpart F income or GILTI during the year of the sale. In addition, a Section 338 election by the buyer can materially impact the seller's consequences described above, which should also be addressed in the sales agreement.