Treatment of Intangibles under New US Tax Regime

Issues pertaining to intangibles always loom large in international taxation, and intangibles were indeed a focus of the recent US tax reform. The new law imposes many fundamental changes that will require advisors to challenge most of the conventional wisdom that has developed in connection with effective tax rate management and intangibles.

1. Introduction

With the Tax Cuts and Jobs Act (the “2017 US Tax Act”), the year 2017 finally saw tax reform in the United States.1 The headline for corporate taxpayers is the reduction of the maximum rate from 35% to 21% beginning in 2018. In an international context, the 2017 US Tax Act (i) embraces a hybrid territorial system; (ii) seeks to protect the US tax base from perceived cross-border erosion; and (iii) seeks to attract economic investment in the United States at a globally attractive effective tax rate (13.125%). There are also revisions to the definition of “intangibles” for US tax purposes, essentially designed to validate examination approaches asserted by the US Internal Revenue Service (the “US Tax Authority”) which had previously been rejected by the courts.

Perhaps the most important element of the 2017 US Tax Act from a long-term planning perspective is the adoption of what is essentially a profit split theory to protect the US tax base, which is reflected in certain provisions of primary application to US and/or non-US based multinationals (MNEs). On the one hand, these provisions are not specifically framed in terms of exceptions to the arm’s length principle or the definition of “intangibles” of the OECD Guidelines, embodied in Section 2 of 482 of the US Internal Revenue Code. On the other hand, they certainly reflect a US Congressional conclusion that the existing transfer pricing and related principles of US law are not, on their own, sufficient to protect the US tax base from aggressive effective tax rate planning strategies (ETR Strategies) of MNEs. These mechanisms can also be viewed as introducing an underlying “intangible” in the form of a price to be paid for access to the US market.


The 2017 US Tax Act reflects the US response to the issues framed by the G20/OECD BEPS Project. Like other countries (including Australia, India, the United Kingdom and, potentially, the European Union),1 the US Congress addressed the issues of principal importance from its own tax base enhancement and protection standpoints.

There are a variety of provisions relating to cross-border activity, outbound from or inbound to the United States, which will have an important impact on future ETR Strategies of all MNEs with activities in the United States.5 Intangibles-related provisions are critical foundational elements of the new provisions.

2.1. Specific provisions for intangibles

With specific regard to intangibles, the 2017 US Tax Act enacted changes to support valuation arguments that the US Tax Authority had sought unsuccessfully to establish in litigation. For example, in the most recent case of Amazon.com Inc. v. Commissioner,6 the government computed the buy-in payment under a cost-sharing arrangement not by valuing the specific intangible assets transferred but by determining an enterprise value for Amazon’s entire European business. The government deemed the pre-existing intangibles to have a value equal to the enterprise value less the initial tangible assets. But by employing an enterprise valuation, the government “necessarily sweeps into his calculation assets … that were not compensable ‘intangibles’ to begin with” – namely, “workforce in place, going concern value, goodwill, and what trial witnesses described as ‘growth options’ and ‘corporate resources’ or ‘opportunities’”7 Thus, there was no authorization in the

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2. Unless otherwise stated, all references to “section” or “paragraph” are references to the US Internal Revenue Code of 1986, as amended [hereafter US Code].
cost-sharing regulations for the government’s inclusion of those intangibles in determining the buy-in payment for pre-existing intangibles or using the resulting enterprise valuation theory.

In the 2017 US Tax Act, Congress resolved this debate by amending the definition of Section 936(b)(3)(B) intangibles to include “any goodwill, going concern value, or workforce in place … or any other item the value or potential of which is not attributable to tangible property or the services of any individual”. The 2017 US Tax Act furthermore ratified provisions in the 2015 Section 482 Temporary Regulations to authorize the US Tax Authority to utilize “aggregate” or “realistic alternatives” intangible valuation methodologies, also plain intended to validate a US Tax Authority litigation strategy rejected by the courts. While there is ample evidence that the US Tax Authority is attempting to actively manage and reduce its inventory of transfer pricing cases, this “change” could encourage more transfer pricing disputes.

These specific intangibles-related provisions will also certainly have an impact on future ETR Strategic planning since the definitional parameters of intangibles is materially expanded, as is the range of valuation approaches that may be embraced by the US Tax Authority. These elements are critical in transfer pricing and ETR Strategies because “intangibles” are the critical element for the allocation of income for transfer pricing and related purposes. As the definition of intangibles is expanded, together with the range of enterprise valuation theories available for use, the viability of many ETR Strategies may be subject to material question in the future.

Of potentially greater long-term significance is the addition of provisions intended to provide an incentive for investment in US economic activity and additional taxation of foreign economic activity of US MNE groups which, in essence, use a benchmark of intangible activity that reflects an underlying global profit split methodology. These provisions do not as such alter the definitional elements of the Section 482 regulations with respect to intangibles, but will have a material impact on future ETR Strategies.

2.2. Territorial tax regime

The US system is converted from a global to a hybrid territorial regime, somewhat similar to Japan and other countries. It is “hybrid” because it retains the controlled foreign corporation (CFC) provisions with certain modifications. In essence, the new US system is a quasi-global consolidation. This is implemented by the provision of a 100% participation deduction for foreign-source dividends in post-2017 periods and the elimination of the foreign tax credit for such distributions. For earnings accumulated in prior periods, there is a mandatory repatriation inclusion (Section 965 of the US Code) with a tax rate of 15.5% imposed on accumulated cash or equivalents and 8% on all other earnings (with an election to pay the tax over eight years). The US Treasury has issued guidance on reg-

assets, each of which has "substantial value independent of the services of any individual". Each definition also included a sixth category consisting of "other similar items" if it derives its value not from its physical attributes but from its intellectual content or other intangible properties. Unlike those enumerated categories, workforce in place, goodwill, growth options, corporate resources and opportunities ‘cannot be bought and sold independently; they are an inseparable component of an enterprise’s residual business value and often do not have ‘substantial value independent of the services of any individual’”. See Amazon.com v. Comm’r (2017), at p. 80. Furthermore, these items are not ‘similar’ to the enumerated items because they do not derive their value from their ‘intellectual content or other intangible properties’. See Amazon.com v. Comm’r (2017), at p. 80.

9. Specifically, sec. 482 is amended to provide at the end:

For purposes of this section, the Secretary shall require the valuation of transfers of intangible property (including intangible property transferred with other property or services) on an aggregate basis or the valuation of such a transfer on the basis of the realistic alternatives to such a transfer, if the Secretary determines that such basis is the most reliable means of valuation of such transfers. Similarly, sec. 367(d)(2)(D) is amended to provide that the Secretary shall require: (i) the valuation of transfers of intangible property, including intangible property transferred with other property or services, on an aggregate basis, or (ii) the valuation of such a transfer on the basis of the realistic alternatives to such a transfer, if the Secretary determines that such basis is the most reliable means of valuation of such transfers. Both changes are effective for transfers in taxable years beginning after 31 Dec. 2017. The legislation also provides that the change is not "similar" to the enumerated items because they do not derive their value from their "intellectual content or other intangible properties".

10. See, e.g., Veritas Software Corp. v. Comm’n, 133 T.C. 297 (2009) (concluding that because the government’s aggregation theory did not produce the most reliable result, the government was not authorized to aggregate the transactions and treat them as a sale); Medtronic, Inc. v. Comm’n, T.C. Memo. 2016-112 (concluding that “aggregating the transactions did not result in a reasonable determination of true taxable income”); Amazon.com v. Comm’n, 148 T.C. No. 8 (2017) (rejecting the government’s aggregation and “realistic alternatives” arguments).

11. The aggregate method of valuation and realistic alternatives concepts have long been present in the US Treasury Regulations. For example, former Treas. Reg. § 1.482-1T(f)(2)(i)(A) (now replaced by Temp. Reg. § 1.482-1T(f)(2)(i)(A)-(E)) provided that transactions may be aggregated if they were so interrelated that considering them together was the most reliable means of determining the arm’s length consideration. Similarly, realistic alternatives must be considered as part of the comparability analysis. See Treas. Reg. § 1.482-1T(d)(3)(iv)(H).

12. Both theories, of course, will be subject to taxpayer challenges in that they do not meet reliability criteria under the US Treasury Regulations, and the pursuit of realistic alternatives is more likely to require the taxpayer’s transaction to be restructured - an additional burden for the US Tax Authority to overcome.


14. New sec. 245A provides the dividends received deduction for the foreign-source portion of dividends received by a US C corporation from specified 10%-owned foreign corporations (including a broad range of shareholders), which is not available for hybrid dividends or CFC to CFC hybrid dividends (which are treated as Subpart F income of the recipient CFC). The provision is effective for distributions made after 31 Dec. 2017.
ulations that it intends to issue concerning the pertinent repatriation and related issues.\textsuperscript{15}

2.3. Return to routine versus non-routine functions

The BEPS Actions 8-10 Final Report recommendations focused on establishing an appropriate balance in the allocation of income between routine and non-routine functions of affiliates. The US approach embraces this model to: (i) coordinate its new territorial regime with the former worldwide regime, including prior tax base protection mechanisms in the CFC and related foreign tax credit (FTC) provisions of the US Code; and (ii) encourage economic activity within the United States. For these purposes, such non-routine income is derived by defining “intangible income” as the margin in excess of a normative return of 10% on tangible assets.\textsuperscript{16}

Two elements are plainly intended to provide incentive for economic activity in the United States as well as a disincentive for investment abroad: (i) identification of offshore low-taxed income and (ii) encouragement of US-source deemed intangible income. The former is brought into the US tax base at an effective rate of 10.5% (ending prior deferral and being in a separate CFC/FTC basket) and the latter is intended to provide a “patent box”-type incentive for US produced goods and services provided to foreign unrelated persons (at a 13.125% effective tax rate).

(i) Identification of low-taxed income – Global intangible low taxable income: Section 951A adds a new category of subpart F income/separate FTC basket for global intangible low taxable income (GILTI), which is the excess of each US shareholder’s net “CFC tested income”\textsuperscript{17} over its share of net deemed tangible income return (NDTIR). FTC and expense apportionment to the GILTI basket can have further adverse results.

The GILTI rules do not declare that the underlying transfer pricing is wrong. Rather, they simply provide that the US will tax some of this return under a CFC model (with a 50% deduction and 80% FTC for US entities taxed as C corporations; not for pass-through entities), reflecting, in essence, a 50-50 profit split with the local country, subject to potential treaty discussion.

(ii) Encouragement of US-source deemed intangible income – Foreign-derived intangible income: The second category is foreign-derived intangible income (FDII), which is deemed intangible income derived by the taxpayer from\textsuperscript{18} (i) property sold to any non-US person\textsuperscript{19} and (ii) services provided to any persons or with respect to any property not located in the United States.\textsuperscript{20}

The FDII provisions reflect the intention to provide an incentive for the location of economic activity in the United States via the FDII lower effective tax rate (of 13.125% vs. 21%) for income from qualifying activities. The objective is to incentivize domestic intellectual property development (“intangibles” in transfer pricing terminology), with R&D and other technology-related functions performed in the United States, which will, in turn, expand employment and growth that might otherwise occur in foreign countries. Inevitably, the new incentive will produce challenging planning complexities, as with any new provision. This US approach to economic development is similar in terms of overall objective as the so-called “patent box” regimes enacted in recent years in several European and other countries,\textsuperscript{21} though with its own wrinkles.\textsuperscript{22} It is also similar to the efforts of the US Congress to provide incentive for location of economic activities in Puerto Rico, which were utilized by MNEs to generate ETR Strategy benefits for many years.\textsuperscript{23}

(iii) Deduction: As a means of determining the amount of such deemed intangible income for US tax purposes, Section 250 provides a deduction for 37.5% of FDII\textsuperscript{24} and 50% of GILTI.\textsuperscript{25} With a corporate tax rate of 21% and the mechanics of Section 250, the effective rate of tax on FDII is 13.125% and 10.5% on GILTI (with FTCs available with a 20% haircut). The FDII deduction is available to US corporations owned by foreign persons.


\textsuperscript{16} New sec. 951A(b)(2) defines “net deemed tangible income return” (NDTIR) as the excess of (i) 10% of each shareholder’s share of the qualified business asset investment (QBAI) of each CFC over (ii) the amount of interest expense taken into account in determining the shareholder’s net CFC tested income to the extent such interest income is not taken into account. The QBAI is, in essence, the aggregate adjusted basis in tangible assets. Sec. 951A(d). Sec. 951A is applicable for CFC tax years beginning after 31 Dec. 2017. New sec. 250(b)(2) defines deemed intangible income as the excess of (i) the deduction eligible income (DEI) of the domestic corporation, over (ii) the deemed tangible income return (DTIR) of the corporation. DTIR means, with respect to any corporation, 10% of the corporation’s QBAI. Sec. 250(b)(2)(B).

\textsuperscript{17} Technically, the excess of the CFC’s tested income over the CFC’s tested loss. Sec. 951A(c). Tested income is the excess of (i) the CFC’s gross income excluding (a) US-source income; (b) Subpart F income; (c) any gross income excluded from foreign base company income under the high-tax exception; (d) any dividend received from a related person; and (e) any foreign oil and gas extraction income; over (ii) deductions (including taxes) properly allocable to the gross income. Sec. 951A(c)(2)(A). Tested loss is the excess of the CFC’s deductions over the CFC’s gross income (calculated with the same exclusions as provided above). Sec. 951A(c)(2)(B).

\textsuperscript{18} See sec. 250(b)(4).

\textsuperscript{19} Property sold to a non-related party for further manufacture or production in the United States is excluded. Sec. 250(b)(3)(B)(i).

\textsuperscript{20} Services provided to a non-related party in the United States are excluded. Sec. 250(b)(3)(B)(ii).

\textsuperscript{21} See International Transfer Pricing para. 5.01[1].


\textsuperscript{23} Learning from this period is set out at US International Transfer Pricing para. 5.01[1][b].

\textsuperscript{24} The purpose of FDII is to exclude from the calculation income that is already subject to US tax. Accordingly, FDII is gross income less (i) subpart F income under sec. 951(a)(1); (ii) GILTI; (iii) financial services income under sec. 904(d)(2)(i); (iv) dividends received from a CFC; (v) domestic oil and gas extraction income; and (vi) foreign branch income under sec. 904(d)(2)(i). Sec. 250(b)(3).

\textsuperscript{25} Sec. 250(a)(1) (which are reduced after 2025 to, respectively, 21.875% and 37.5%). Sec. 250(a)(3).
Comments regarding GILTI and FDII on transfer pricing

While the GILTI and FDII provisions are not expressly framed in terms of intangibles or transfer pricing concepts, it seems clear that the intention is to utilize concepts of routine and non-routine functions in the BEPS Actions 8-10 Final Reports to craft a US tax base defence strategy. This, in turn, will raise a variety of issues to be sorted out via regulations or otherwise in the future, which will impact the ETR planning of all MNEs, including:

- Coordination with the existing Section 482 regulations, which have their own definitions of “intangibles” and related terms.
- The GILTI and FDII provisions add a wide range of new terms and concepts to the US Code, which will raise a variety of practical issues to be addressed in the ETR Strategies of all MNEs with US activity, directly or indirectly, which are addressed in our writing elsewhere. There are a wealth of new terms that will require definition for regulatory purposes, as well as coordination with existing concepts. For example:
  - Coordination of NDTIR with Section 482 regulation concepts.
  - The 2017 US Tax Act expands the definition of intangibles to include goodwill and related elements, and authorizes the US Tax Authority to utilize “aggregate” or “alternative” intangible valuation methodologies, without any cross-reference to the GILTI or FDII provisions, as noted above.
  - Coordination with other transfer pricing-related provisions, such as the outbound transfer of intangibles provisions of Section 367(d).
  - The distinction between related and unrelated parties, including circumstances where the sale or provision of services to related parties may qualify for the FDII incentive.
  - In view of the GILTI, FDII, and BEAT (discussed below) provisions, is the relevance of transfer pricing materially impacted with respect to US-related operations?
  - In the case of US-based groups, global income is, in essence, aggregated with all NDTIR (return in excess of 10% of tangible asset value) subject to current US tax.
  - Does this render the details of outbound transfer pricing far less important than under prior law? Not really. A US-based group could adopt the NDTIR as its global methodology, so that only the 10% return on tangible assets would remain in treaty countries.
  - Reaction of local countries?
  - In the case of non-US-based groups, the applicable transfer pricing principles remain the same (except for their US subsidiaries with their own CFCs).
  - A distinction may arise in this regard between transfer pricing issues for US and foreign purposes (following OECD or UN Guidelines).
  - How should the GILTI, FDII, and BEAT provisions be addressed in transfer pricing documentation in the future?
  - What about CbC documentation, especially with respect to Master Files and CbC reports?
  - Should GILTI, FDII, and BEAT be addressed in new or renewed APAs?
  - These issues should plainly be subject to treaty processes as business profits subject to the transfer pricing and related articles, including dispute resolution (MAP).
  - Bilateral APAs may become even more important in the outbound context.

Comments regarding future controversy

Since tax returns are likely to be filed before regulations explicating these provisions are finalized, it is inevitable that there will be uncertainty prior to such publication. In the event of adjustment on examination, calculations will need to be further adjusted. For example, could transfer pricing adjustments have a material impact on the GILTI and FDII mechanisms? It can certainly be anticipated that the level of domestic tax controversy will continue to expand in the future, as reflected in the seemingly ever-increasing level of international tax controversy (as reflected in Competent Authority dockets).

Comments regarding a governmental agreement

In view of the dramatic changes in the 2017 US Tax Act, as well as the range of international taxation considerations underway (such as BEPS, EU initiatives, country-specific tax regimes, taxation of digital commerce, and so on), MNE groups may want to consider the potential of approaching their home country tax authorities from the perspective of seeking a global tax agreement (perhaps in exchange for commitments about maintaining or expanding economic activity in the home country). This will be noted below with respect to the exploratory OECD ICAP programme.

26. Numerous US officials have indicated that legislative fixes may be in order.
27. See US International Transfer Pricing para. 2.02(22)[c] and [g].
28. For example, does FDII include items deemed commensurate with income under sec. 367(d)?
29. See sec. 250(b)(3)(C).
30. A related question is how are these new provisions affecting APA negotiations in general? While they are obviously a game-changer for MNEs, it is interesting to note that the US Tax Authority appears to be taking this opportunity to reassess its prior negotiating positions and, as result, APA renewals are going much more slowly – even in cases where the transfer pricing methods have remained unchanged through several generations of APAs and the issues are relatively bland.
2.4. BEAT

Having protected the US tax base from denuding via earning non-routine income in offshore locations, and encouraging domestic activities to produce non-routine income, Congress also took a step to protect the tax base from reduction via outbound payments. The base erosion and anti-abuse tax (BEAT) could apply to US or non-US-parented groups. Under Section 59A(a), an “applicable taxpayer” (a corporation with gross receipts for a three-year period of at least USD 800 million and a base erosion percentage of 3%, as defined below) is required to pay an additional US tax with respect to “base erosion payments.” The tax is equal to the base erosion minimum tax amount (BEMTA) which is the excess of 10% (5% for years beginning in 2018; 12.5% beginning in 2026) of its modified taxable income over its regular tax liability reduced by the excess of credits allowed against such regular tax liability over the sum of certain credits. The respective elements are discussed below.33

Base Erosion Payments: A base erosion payment includes any amount paid or accrued by a taxpayer to a foreign person that is a related party for which a deduction is allowable.35 This category is open-ended, but would seem to include at least the following:36
- interest;
- royalties;
- payments under a qualified cost-sharing agreement;37
- service payments (other than as excluded for cost-only SCM payments, discussed further below);38
- items disguised as derivatives (as discussed below);
- purchase of depreciable/amortizable property;39
- reinsurance premiums;40
- payments to inverted groups (i.e. “surrogate foreign corporations” having inverted after 9 November 2017).31

31. The BEAT is applicable for tax years beginning after 31 Dec. 2017. Sec. 59A(b)
32. Other rates are provided for certain taxpayers, such as banks and regulated securities dealers.
33. The final version of the BEAT is materially different than the version passed by the House, which was much simpler and would have made a roughly similar calculation at 10% and included COGS. Like the BEAT, the prior version would have raised a troubling, and fascinating, analysis of traditional transaction planning structures. See US International Transfer Pricing para. 2.02[21][e][i].
34. Sec. 59A(d)(1)
35. While interest, royalties, and service payments are not explicitly noted in the broadly inclusive language of sec. 59A(d)(1), they are mentioned in the disguised derivative context of sec. 59A(h)(3)(A).
36. This refers to intangible cost-sharing arrangements.
37. An interesting debate has evolved as to whether the exclusion applies in situations where there is a mark-up on the services. For example, if the costs incurred are USD 100 and there is a USD 10 markup, is the USD 100 eligible for exclusion via bifurcation of the service cost versus markup? Compare M. A. Sullivan, Marked-Up Services and the BEAT, Part II, 158 Tax Notes 1169 (26 Feb. 2018) (review of legislative history and concluding that the USD 100 would not be eligible for exclusion as it is not literally within the SCM; comparison to views of others declaring that such bifurcation is appropriate). M. A. Sullivan, Can Marked-Up Services Skip the BEAT, Tax Notes 705 (5 Feb. 2018) and M. S. Corwin, R. Dabrowski, M. H. Plowgan, D. Rolle, & T. P. Wessell, A Response to an Off-BEAT Analysis, Tax Notes 933 (12 Feb. 2018).
38. Sec. 59A(d)(2).
39. Sec. 59A(d)(3).
40. Sec. 59A(d)(4).

Comment on BEAT

The practical impact of BEAT is to impose, in essence, a 10% minimum tax rate (a rate that is approximately 52.3% less than the 21% regular tax rate). In this sense, it also fits into a model of imposing a 50-50 or so profit-split on the combined income arising from US economic activities (without any modification of transfer pricing methodologies or further definition of “intangibles”).47 In this sense, it could also be viewed to function as a similar base protection measure as the diverted profits tax regimes adopted in the United Kingdom and other countries or the EU State aid campaign.49

The BEAT may have a material impact on inbound groups, as well as on certain outbound groups, that have in place arrangements that potentially fall within the definition of base erosion payments. While Section 59A lists certain types of such payments, it is inevitable that material characterization issues will arise. In this regard, Section 59A provides authorization for future regulations to be issued pursuant to broad discretionary authority to “carry out the provisions of this section,” specifically other payments identified in future regulations to be issued pursuant to broad discretionary authority to “carry out the provisions of this section,”42

- cost of goods sold (COGS) exclusion: Any amount constituting a reduction in gross receipts, including payments for COGS (not applicable in the case of ‘surrogate foreign’ groups);43
- services cost method (SCM) exclusion: Any amount meeting the requirements of the Section 482 regulations;44
- qualified derivative payment exclusion: Any payment to a derivative meeting certain requirements;45
- and
- taxed amounts and withholding exclusion: Any tax benefit subject to Section 871 or 881 and with respect to which tax has been withheld.46

42. Sec. 59A(i), as discussed further below.
43. COGS had been deemed a base erosion payment under the House of Representatives version of the 2017 US Tax Act. The COGS exclusion will inevitably become a source of potential conflict. For example, if there are elements of royalties booked as COGS, will it be necessary or appropriate to bifurcate such elements from the balance of the COGS components? See B. Yap, Japanese Car Makers Assessing Scope of U.S. BEAT Provision, Daily Tax Rep., p. 9 (20 Feb. 2018).
44. Sec. 59A(d)(5). Sec. Treas. Reg. §1.482-9. Sec. 59A(d)(5) also provides that determination of payments qualifying for the exclusion is determined without regard to the requirement in the regulations that the services not contribute significantly to fundamental risks of business success or failure and only if the payments are made for services that have no markup component.
45. Sec. 59A(h) (with a variety of limitations and exceptions). The exception does not apply if a payment is in substance the kind of payment that would be treated as a base erosion payment if it were not made pursuant to a derivative, including any interest, royalty, or service payment, any other payment subject to this provision, and, in the case of a contract which has derivative and non-derivative components, the payment properly allocable to the non-derivative component. Sec. 59A(i)(3).
46. Sec. 59A(c)(2)(B)
48. See International Transfer Pricing para. 14.64[1][b].
49. Id., at para. 2.06[4][b].
50. Sec. 59A(i). Such regulations or other guidance should include whatever is necessary to prevent avoidance of sec. 59A. For example, through
including matters relating to characterization of specific types of payment. Additional issues are likely to arise with respect to for instance: (i) aggregation or disaggregation of specific payments for these purposes; (ii) coordination with the 2017 US Tax Act provisions adding categories of subpart F CFC income for GILTI; (iii) defining COGS; and (iv) policing the USD 500 million BEAT floor (e.g. segregation of activities into separate corporations), as well as the other issues framed in the new law.51

As could be anticipated, reaction to the BEAT spans the spectrum of views depending on the posture of specific MNE groups. For groups having serious problems with its provisions, reaction is understandably critical. In this regard, there is an active debate underway as to whether the BEAT could be viewed to violate the anti-discrimination provisions of US treaties.52

All of these issues can be materially connected to the transfer pricing arrangements of impacted taxpayers. Accordingly, it may be appropriate to consider addressing the BEAT and related issues as collateral matters in existing APA proceedings or renewals, at least with respect to the characterization of specific transactional streams.53 In any event, the existence of BEAT and the other elements of the US 2017 Tax Act can be expected to raise incremental levels of issues in examination and future controversy contexts. On the other hand, such new provisions inevitably offer planning incentives for other groups.

2.5. Future intangibles planning considerations

Given the far-reaching nature of the 2017 US Tax Act, it is apparent that the provisions noted above (as well as non-international provisions) will have a material impact on MNE planning.54 The intangibles elements (both explicit and implicit) will be material elements of such processes. Each of the respective provisions is likely to have implications that vary depending on the nature of the situation under consideration. For example:

- while the enactment of a territorial regime on its face would seem to limit US tax to domestic source activities, the reality is that the United States may have adopted an even more global regime with GILTI, BEAT, and continued subpart F provisions – perhaps a global minimum tax, from a US standpoint;55

(i) the use of unrelated persons, conduit transactions, or other intermediaries, or (ii) transactions or arrangements designed in whole or in part to (a) characterize payments otherwise subject to sec. 99A as payments not subject to it, or (b) substitute payments not subject to sec. 99A for payments otherwise subject to sec. 99A.56


See M. A. Sullivan, Where Will the Factories Go? A Preliminary assessment, 158 Tax Notes 470 (29 Jan. 2018) (providing a variety of tables with respect to potential planning scenarios). Materials for such planning processes, including checklists for planning in the current world of US tax reform, BEPS, and the other considerations in the international tax world are provided in US International Taxation: Agreements, Checklists and Commentary para. 1.07 and International Transfer Pricing para. 13A.01.58

See A. Bennett, Reform Marks “Aggressive” Move to Halt Tax Base Erosion, Treasury, 2018 Daily Tax Rep. p. 11 (5 Feb. 2018); N. Bodman, the rate reduction will provide incentive for investment in the United States, by both domestic and foreign MNEs;59

the GILTI provisions would seem to penalize foreign source intangible income, though its burden is reduced by foreign tangible property investment;60

the FDII provisions would seem to encourage US economic activity, though such investment may have negative impacts in certain situations;

material US base erosion payments will be penalized under BEAT, perhaps offsetting benefits sought to be achieved by prior law foreign investment;

will it be beneficial to consider potential benefits of moving intangibles, capital, functions, risks, and so on to the United States from foreign locations – via sale, incremental steps, or otherwise – which could assist in fortifying an effective tax rate strategy as well as minimize BEAT exposures?

- if the functions/risks are presently in a low-tax jurisdiction, how likely is it that material QBAI will be generated? and

- with respect to existing intangibles held offshore, will it be relatively more beneficial to leave them in place, transfer, or incrementally evolve depending on the effective tax rate benefits in specific situations?

is there benefit in using a US-based entity versus a pass-through entity to hold foreign operating subsidiaries?

will it be beneficial to transfer foreign branch assets to a foreign corporate subsidiary?

incentives for structuring cross-border acquisition, divestiture, or restructuring transactions will also be impacted, altering the relationships prevailing for many years under prior law;

what will be the reaction of US states to the new provisions?

foreign country reaction to these provisions will inevitably expand the geometry of planning;

how should intercompany transactions be documented in the future and will bilateral APAs become an even more important tool in the outbound context?

such declarations have often been made in conjunction with significant developments in applicable principles:

The U.S.’s Illusory Turn to Territoriality, 89 Tax Notes Int’l 1619 (12 Feb. 2018).61


That the GILTI burden is reduced by foreign tangible property investments is one of many contradictions present in the new law.

See para. 9.04[10].


See Wells, supra n. 47.

See para. 12.04[5].
3. Conclusion

Section 482 is the longstanding foundation for protection of the US tax base. As leaks in its architecture have been identified, Treasury or Congress endeavoured to implement appropriate plugs. The development of the G20/OECD BEPS Project reflects the overall, perceived (by global tax authorities) failure of existing domestic law and treaty mechanisms to protect domestic tax bases, a process in which the US was an active participant. However, the ink of the BEPS Final Reports was not yet dry when countries began implementing unilateral measures to protect their respective tax bases, including so-called “general anti-avoidance” provisions (which purport to impose taxation in the absence of specific standards). The US was quick to join this parade with the 2017 US Tax Act. Its pertinent provisions are plainly unilateral in nature, reflecting the current goals of the US government and dramatically altering the nature of the US cross-border tax system.

The developments reflect a tax base defence protection from both offensive and defensive standpoints. On the offensive, Congress has provided rather dramatic incentives to conduct economic activity within the US market, including rate reduction, FDII incentive, and GILTI-BEAT penalization of respective outbound-inbound planning strategies. In preparing regulations and other administrative practices to implement these provisions, the objective of the US Treasury should be to provide clear definition for compliance and examination purposes. The defensive elements ratify certain positions that the US Tax Authority has sought to utilize for policing outbound arrangements believed not to reflect arm’s length considerations. Again, in interpreting and applying these mechanisms, the US Tax Authority can be expected to reposition its regulatory and examination resources to take maximum advantage of its new mission and tools.

From the standpoint of MNEs, existing ETR Strategies will need to be revisited to take into account the developments in the United States as well as the range of similar base protection deployments in other countries. Most existing strategic models are premised on the historic definitions of intangibles for transfer pricing purposes, as well as use of one-sided transfer pricing methods to allow residual income to exist in a desired (typically low-tax) location. The US tax reform developments, like BEPS and other unilateral country actions, are plainly designed to attack such structures or, at least, reduce the incentive to utilize them in the future.

In undertaking such an ETR Strategy review, an important element will be to understand both the offensive and defensive developments of tax policy in pertinent countries. In this context, it is the US fisc’s hope that activities will be structured to expand economic activity in the United States. Experience with such efforts to encourage economic activity is that MNE ETR Strategies have a history of being efficient to take advantage of beneficial elements. For example, the US Congress enacted provisions that sought to achieve economic development in Puerto Rico long ago, which were utilized by MNEs to generate ETR Strategy benefits for many years. The same is true of rulings or other incentives provided by European countries to attract certain types of economic activity, most recently attacked in the ongoing EU State Aid process.

Will elements of the 2017 US Tax Act provide similar benefit to a new generation of MNEs? In situations where such benefit may exist, an MNE may also find other elements of the evolving environment to be beneficial from an overall ETR Planning perspective. For example, in 2018 the OECD announced a pilot for a potentially new programme dubbed the “International Compliance Assurance Program” (ICAP). In this pilot programme, eight countries with experience in Competent Authority and APA matters have coordinated to select a taxpayer from each country to, in essence, undertake a multi-jurisdictional compliance assurance programme. Such a programme could especially be of interest to an MNE in its home country, or the location of its principal economic activity, as a means of minimizing global conflicts relating to its ETR Strategy. It will be interesting to see how this model evolves.

In the post-2017 US Tax Act environment, the posture of the arm’s length standard, embodied in Section 482, is at least under a cloud of suspicion. How these events will develop of course remains to be seen. An interesting element to be observed in this regard is that the 50-50 global profit-split mechanisms in the 2017 Tax Reform Act provisions is consistent with the long-term results of transfer pricing litigation in the US courts.

Finally, perhaps the most important element of the 2017 US Tax Act from a long-term planning perspective is the adoption of, in essence, a profit-split theory to protect the US tax base, which is reflected in GILTI, FDII and BEAT. These provisions are not specifically framed in terms of exceptions to the arm’s length principle or definition of

64. See International Transfer Pricing para. 3.02[5][c].
65. See para. 2.02[22].
66. Learning from this period is set out in US International Transfer Pricing para. 3.01[1][b].
68. See US International Transfer Pricing para. 2.03 and Appendix B.03. See also Wells, supra n. 47.
“intangibles” of the OECD Guidelines or Section 482 of the US Code. On the other hand, they certainly reflect a US Congressional conclusion that the existing transfer pricing and related principles of US law are not, on their own, sufficient to protect the US tax base from aggressive ETR Strategies of MNEs. These mechanisms could be viewed as introducing an underlying “intangible” in the form of a price to be paid for access to the US marketplace. It can certainly be anticipated that other countries will continue to protect their own tax bases. If other countries embraced the same mechanisms, there would likely be many years of serious bilateral and multilateral controversy. This may, in the end, lead to the development of new global standards. Regardless of how this may evolve, the definitional parameters of intangibles, whether direct or indirect, will be a critical element.

69. Interestingly, these elements are a reflection of the original transfer pricing principles enunciated by the International Chamber of Commerce just after World War I, which were abandoned in favour of the arm’s length standard in the work of the League of Nations which continues to exist until the present. See B. Wells & C. Lowell, Tax Base Erosion and Homeless Income: Collection at Source is the Linchpin, 65 Tax. L. Rev. 535 (2012).