A woman worth knowing

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On June 9th, 2020 many of us had the privilege of meeting one of the most important women in the International Fiscal Association and for the international tax practice – **Carol Tello**.

Carol was announced as the guest speaker in a webinar organized by WIN IFA Mexico and I immediately knew that I could not miss the opportunity to meet her. I had just finished my studies, I didn't have many years of tax experience, but at that moment, I understood how valuable Carol's words could be to me, not only as a practitioner but also as a woman in taxation.

How often do you get the opportunity to interact with the first woman to lead IFA in the United States of America? How could I miss the chance to ask questions to one of the founders of the Women of IFA Network?

Well, probably not very often. However, on June 9th, she was there, talking openly and listening intently to us, engaging everyone there in a lecture that will remain with me for the rest of my life.

She was a partner at Eversheds Sutherland, participated as an IRS officer in a number of income tax treaty negotiations, she was the IRS National Office adviser in several U.S. Tax Court cases and was recognized as one of the top "Women in Business Law" for Tax *as well as* one of the top 20 in Tax in the United States in Women in Business Law. Moreover, Carol was clearly a generous, passionate human being in love of what she did.

On the day of the lecture, I was nervous. I wasn't the speaker but I felt overwhelmed because of being in front of Carol and other remarkable women. My mind was full of questions I wanted to ask, yet I didn't. Now the only thing left to say is: thank you Carol. Thank you because you taught to us much more than taxes. That day, with your easygoing and pleasant personality, you became a role model for many of us.

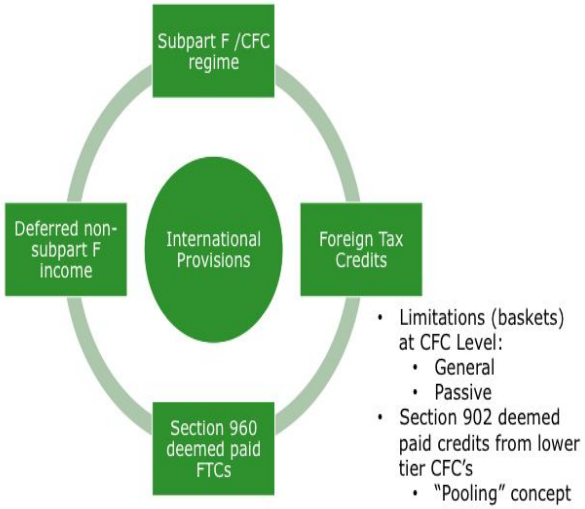
We wanted to open our first WIN Mexico Newsletter with an article by Carol on her wonderful lecture on June 9th. Unfortunately, as of August 9th, Carol is no longer with us. As an homage, let me share some of the things I learned from her that day:

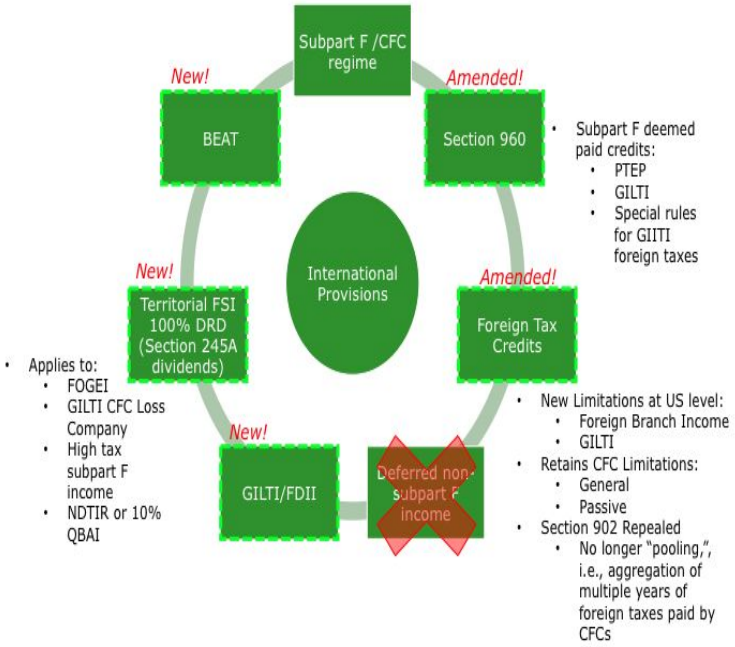
The lecture was entitled "Some Important Aspects of the United States of America ("US") Tax Law for Mexican Companies". Carol started by referring to the important changes derived from the Tax Cuts and Jobs Act ("TCJA").

Before 2018, most of the US multinationals deferred US taxes, since more than 50% of their income was from outside the US and either the income was untaxed or it was taxable but allowing foreign tax credits that significantly reduced the tax to pay in the US.

On the one hand, US deemed a separate income from many subsidiaries that were not covered under Subpart F, Controlled Foreign Corporation ("CFC") entities. Consequently, that income was untaxed in the US.

On the other hand, there was a broader foreign tax credit system that reduced the US income tax to pay on taxable foreign income.





However, after TCJA published on November 2nd, 2017, the US tax system changed and it became more complex.

Now, the US system maintains the Subpart F regime / CFC regime; but amended the foreign tax credit system by adding what is called the "Basket new limitation category" (Section 960).

Additionally, the US system now has new provisions such as the Base Erosion and Anti-Abuse Tax ("BEAT"); the new Global Intangible Low Tax Income ("GILTI"), the concept of Foreign-Derived Intangible Income ("FDII"); as well as the new Territorial Foreign Source Income ("FSI") (Section 245A dividends).

Now the US no longer has the deferral option, since there is Subpart F income that is no longer deferred or the GILTI.

Before describing the new taxes and concepts adopted by TCJA, Carol referred to the reduction of the US corporate rate (now 21%) as the big centerpiece of the US reform. She said that the reduced rate allows the US to compete with other international rates and

discourages the deferral of US income tax through offshore structures. However, many US companies have not restructured yet, because they consider this new corporate income tax rate is too-good-to-be-true and it's probably not sustainable considering the needs of public budget.

Regarding BEAT, Carol explained that it is based on the idea of an alternative Minimum Tax base. She said that its design was influenced by the OECD BEPS report. BEAT generally imposes a 10% minimum tax (5% in 2018)[1] on a taxpayer's determined income without considering tax deductions arising from "base erosion" payments.[2]

BEAT applies to US corporations (other than RICs, REITs or S corporations) which have average annual gross receipts of at least USD$500 million for the preceding three taxable years, and which have a base erosion percentage, generally, deductible payments to foreign affiliates over total deductions, of 3% or higher for the taxable year. So, If you have 3.01% as base erosion percentage you're subject to the BEAT, but if you have 2.99 you're not.

There are some proposed regulations that allow taxpayers to waive deductions. This would eliminate the "cliff" effect where a small amount of deduction would put a taxpayer over the 3% threshold and subject to the BEAT. Additionally, there are some exceptions to the concept of base-erosion payments, such as the Cost of Goods Sold (COGS), the Services Cost Method (SCM) and the Effectively Connected Income (ECI). COGS is deemed not as a deduction, but as a reduction in the taxpayer's income and it refers to the payments for inventory or inventoriable costs. SCM allows taxpayers to exclude intercompany services fees charged at cost or subject to less than 7% markup from the BEAT calculation. ECI refers to those payments to a foreign person in the form of a US branch that is subject to US tax as profit of a PE or ECI of a US trade/business.

Then, Carol referred to the FDII and GILTI as the "carrots and sticks of the US system" regarding the ownership of US developed intangibles.

She explained that the "stick" is the GILTI, which is meant to be punitive because you've got your IP offshore generating income tax by other countries. GILTI is generally the aggregate excess of income earned by all CFCs of a US corporate taxpayer over 10 percent of the value of the tangible business assets,[3] and it is subject to tax in hands of US shareholders in the year earned by the foreign subsidiary. There is a foreign tax credit but limited to 80% of the taxes paid, segregating GILTI foreign taxes in a separate basket from those applied to other incomes.

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[1] For taxable years beginning after December 31, 2025, the minimum tax rate increases to 12.5%

[2] "Base erosion" payments are amounts paid by a US corporation to a related foreign person that are deductible by the US Corporation.

[3] The reference to "intangible" income is a mere proxy.

Meanwhile, the "carrot" is the FDII, which means a reduced effective rate of 13.125% through a 37.5% deduction for certain excess income (calculated similarly to GILTI) earned in the US attributed to foreign exploitation of US-owned intangibles. This deduction is reduced to 21.875% for taxable years beginning after December 31, 2025.

To explain how FDII works, Carol presented the following chart:

- **Foreign Derived Deduction Eligible Income.-** Income derived in connection with the property sold by the taxpayer to a foreign person for foreign use[4], and Income derived in connection with services provided by the taxpayer to any person, or with respect to property, not located in the US.

- **Deduction Eligible Income.-** Excludes certain foreign income: Subpart F income, GILTI, dividends received from CFCs, and foreign branch income. It also excludes certain domestic income: domestic oil and gas extraction income and financial services income.

Both, FDII and GLITI, carrots and sticks, are focused on the taxation of income from the intangible property and some of the most valuable US companies such as FAANG (*Facebook, Amazon, Apple, Netflix, Google*). Their purpose is to incentivize US

[4] Foreign use, means any use, consumption, or disposition, which is not within the United States. Sales of property to a non-US person must be for foreign use, and the services are performed for persons, or with respect to property, not located in the US. Foreign use must be shown to the satisfaction of the Secretary this added a standard that you must prove that the property or the sales were for foreign use.

companies to keep their valuable IP in the US, where it would generate taxable US Source income.

Another important TCJA's amendment was on Section 863(b) to source income from produced inventory sales solely to the location of manufacture for both outbound and inbound sales. Before 2018, it was provided a split source between place of manufacture/production and place of sale. The income followed a rule of 50% to manufacturing US source and 50% to the sales income outside the US. Now, source of income is based solely on place of manufacture/production with a possible FDII benefit.

The webinar ended, yet the attendees wanted to know more about US taxation, and on Carol's opinion regarding the effects of the new US measures and on being a woman tax practitioner. Time flied, teaching us once more the importance of treasuring every minute. That day, among smiles and a screen colored by many valuable women's faces, one more session of WIN Mexico finished giving us the last opportunity to extend a sincere recognition to Carol Tello for her support in the WIN Mexico activities, for being the inspiration of many tax practitioners and a pioneer in building what makes us proud of being the Women of IFA Network.

Thank you Carol, you will be remembered.

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