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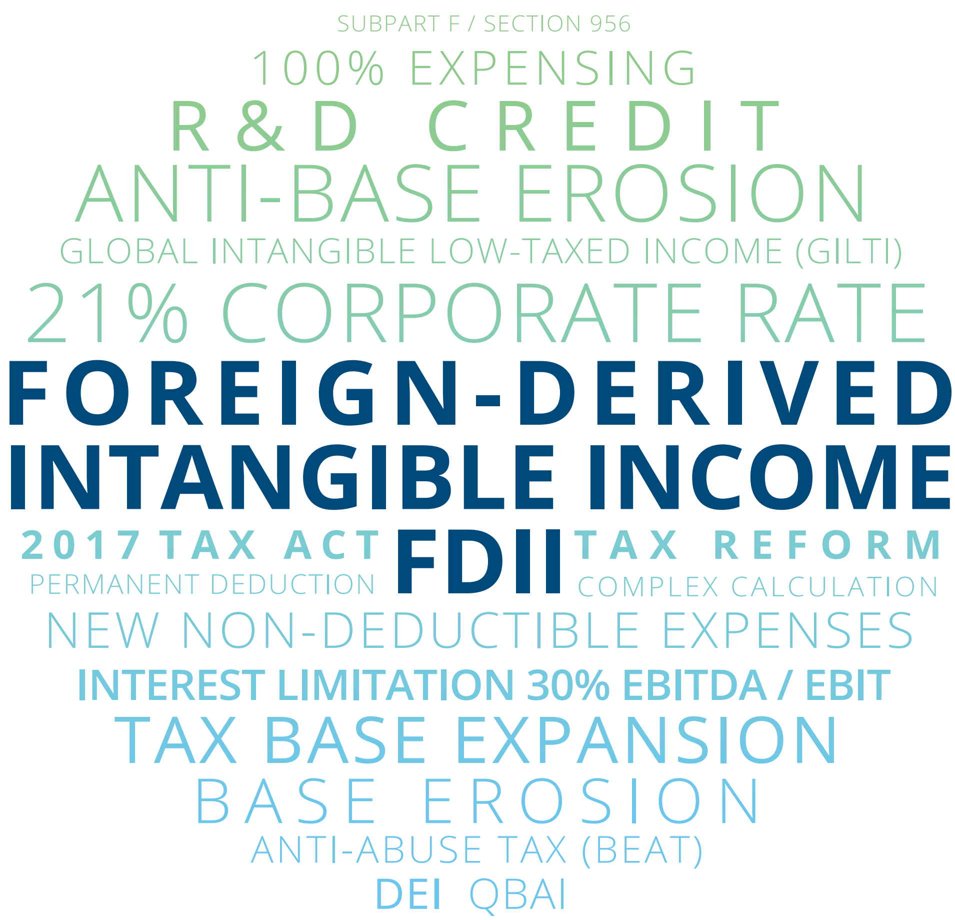


US tax reform: Foreign-Derived Intangible Income (FDII)

Uncover the potential impact of this new deduction

The 2017 Tax Act[1] provides US companies with a new permanent deduction: Foreign-Derived Intangible Income (FDII). An incentive for C corporations to generate revenue from serving foreign markets, the provision applies a preferential tax rate to eligible income.

Don't let the name fool you. FDII is a new category of income and it does not have to come from intangible assets. Instead, the new tax law assumes a fixed rate of return on a corporation's tangible assets. Any remaining income is deemed to be generated by intangible assets.

The formula to determine FDII is complex and requires the identification of specific data, but the benefit of a **37.5% deduction** against taxable income deserves careful consideration.

Could your company benefit from FDII?

FDII may represent a significant deduction for your C corporation if you generate income from:

- Sale of property to a non-US person for foreign use. A sale includes any lease, license, exchange, or other disposition
- Services provided to any person or with respect to any property outside of the United States

Many related-party property and service transactions are also eligible for the deduction, although special rules apply.

1. An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018

Why the urgency to address FDII?

Taxpayers who undertake the rigorous analysis to compute the FDII deduction may potentially recognize:

- A **cash tax benefit** in 2018 due to lower quarterly estimated payments
- A **positive financial statement** impact due to a lower effective tax rate

FDII now and later: Understanding what's at stake

The deduction shrinks in 2025. Acting now may help you calculate and apply the higher deduction rate for the maximum number of years before it decreases.

2018 through 2025

37.5% deduction | **13.13%** tax on eligible income

7.9¢ savings per $1 of eligible income

2025 and beyond

21.87% deduction | **16.41%** tax on eligible income

4.59¢ savings per $1 of eligible income

Meeting **FDII** data requirements

To get the benefit of the FDII deduction, companies will need to identify and track specific data points for each part of the formula, including:

- All export transactions with related and unrelated parties.
- Sales transaction data by entity, product, customer, and ship-to.
- ADS depreciation for determination of Qualified Business Asset Investment (QBAI).

The required data often exists in source ERP and other systems within a company, but may not be readily available to the tax department. Deloitte's team of data analytics specialists—using our proprietary Taxalytics™ approach—can help you identify and collect the data you need for pursuing FDII eligibility.

Planning considerations

Deloitte can help you consider the options and intricacies involved in calculating FDII within the specific context of your business.

Calculation of DEI and QBAI

- Analyze ability to properly allocate items of expense to non-DEI.
- Consider and identify accounting method changes on revenue and deductions.

Separation of DEI into foreign and other eligible income

- Evaluate foreign use or consumption of your goods and services.
- Analyze transfer pricing issues.
- Analyze ability to properly allocate items of expense specifically to other DEI.

Tracking of data and required characteristics

- Understand where the constraints are in your systems.
- Evaluate data analytics tools to extract the data from various systems within your company (e.g., accounts receivable, transactional-level general ledgers).
- Consider how to update your tax system to consistently track necessary attributes going forward.

Computing **FDII**

The FDII calculation process is highly complicated, requiring eligible income to be disaggregated and then bifurcated in compliance with new provision rules.

$$\textbf{FDII} = \text{Deemed Intangible Income } \textbf{(DII)} \times \frac{\text{Foreign Derived Deduction Eligible Income (FDDEI)}}{\text{Deduction Eligible Income (DEI)}}$$

$$\textbf{(DII)} = \text{(DEI)} - \text{Deemed Tangible Income Return } \textbf{(DTIR)}$$

$$\textbf{(DTIR)} = 10\% \times \text{QBAI}$$

Move forward with confidence

Deloitte's experienced team of tax specialists can help you plan, execute, and support your course of action for FDII eligibility.

Our four-phased approach to FDII services

Scope

- Analyze supply chain, IP, and product flows for location of income, expenses, and fixed assets.
- Identify sources of required data.
- Develop preliminary estimate of FDII deduction.
- Coordinate with GILTI, BEAT, and FSI integrated modeling.

Implement

- Collect and analyze required data.
- Conduct detailed analysis of components of FDII formula and properly allocable expenses.
- Create transparent calculations and detailed procedural and technical memorandum to substantiate positions taken.

Deliver

- Provide IRS "audit-ready" binder including detailed documentation of DEI, FDDEI, and FDII calculation model.

Sustain

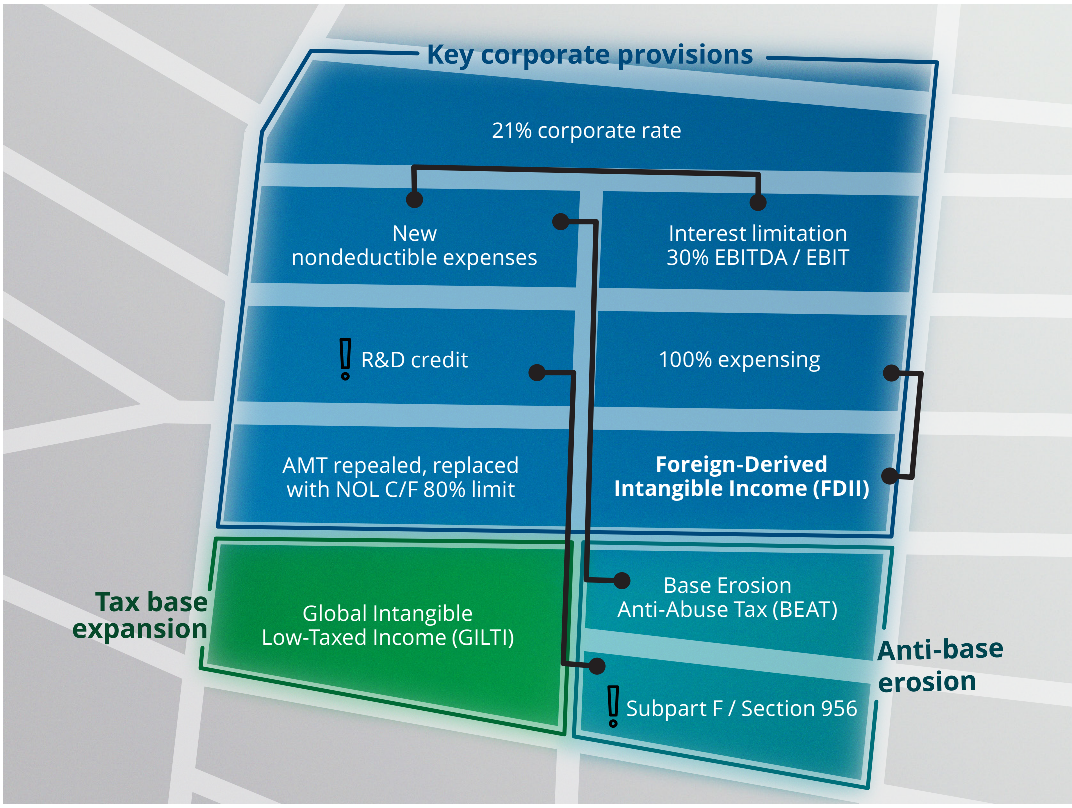
- Conduct pre-conference audit readiness.
- Provide examination consultation and representation.
- Offer proactive resolution services.

FDII in context

FDII is just one of many potentially significant changes in the 2017 Tax Act.

Understanding how FDII interrelates with other provisions and modeling the implications is key to addressing the complexities and opportunities of your own tax picture.

! Provisions existing prior to tax reform



Why Deloitte?

- Integrated, end-to-end modeling tool that considers the interplay of GILTI, BEAT, FDII, and 163(j)
- Deep experience in federal, international, multistate tax, and transfer pricing planning
- National team of dedicated tax cost recovery specialists with a powerful engine for tax depreciation and QBAI calculations, our Depreciation Analysis & Reporting Tool (DART)
- Deep analytics capabilities: Taxalytics,™ our tested approach for helping tax departments analyze and manage data, and our national team of analytics specialists, experienced at helping clients identify and collect relevant and usable data for tax decision making

Contact us

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