Bloomberg Tax

Tax Management
International Journal™

Brazilian Interest on Equity After U.S. Tax Reform

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U.S. multinationals are revisiting their cross-border ownership and financing structures in light of the changes brought about by the 2017 tax act (''Act'').[1] There is a renewed focus, in particular, on effective rate reduction for foreign subsidiaries in high-tax jurisdictions. With the introduction of the global intangible low-taxed income (GILTI) regime and related changes, foreign taxes paid in countries with high headline rates might not be fully creditable in the United States and can be permanently lost.[2] Focusing on the rate of source-country taxation has taken on added importance, in part because of the reduced 21% corporate income tax rate in the United States,[3] the 20% haircut on foreign income taxes that are otherwise available to offset a GILTI inclusion,[4] and the inability to carry back or carry forward any excess foreign taxes in the new GILTI basket.[5] The need to consider the rate of source-country taxation is particularly acute for U.S. multinational companies with Brazilian subsidiaries given Brazil's combined statutory corporate tax rate of 34%.[6]

In this article, we examine investments in Brazilian subsidiaries and the use of Interest on Equity (IOE) to reduce the effective rate of tax in Brazil.[7] In particular, we consider the interaction of the IOE rules with the post-Act international tax regime and how best to navigate within the new provisions. First, we provide an overview of IOE and a description of the changes to the Code that are most relevant to the decision of whether to use IOE. We then illustrate some tax plan-

* The authors would like to thank Wouter Diederen of Baker McKenzie, Amsterdam for his contributions to this article. The authors are also grateful for the thoughtful comments provided by Carl Dubert, PricewaterhouseCoopers; Derek Wallace, Wilson Sonsini Goodrich & Rosati; Dan Stern, Baker McKenzie, Washington, D.C.; Sam Pollack, Baker McKenzie, Chicago; and Shelbi Smith, Baker McKenzie, Chicago.

1 Pub. L. No. 115-97, 131 Stat. 2054 (Dec. 22, 2017). The formal name of the 2017 tax act is ''An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018.'' It was referred to during legislative proceedings as the Tax Cuts and Jobs Act (TCJA).

2 Unless otherwise noted, all section references are to the U.S. Internal Revenue Code of 1986, as amended (the ''Code''), and all Reg. section references are to the regulations promulgated thereunder. For a discussion of GILTI and its impact on U.S. tax planning, see Ethan Kroll et al., *GILTI, FDII, and the Future of International IP Planning*, 96 Taxes 5 (May 2018).

3 §11(b). Prior to December 31, 2017, corporations with taxable income in excess of $10,000,000 were subject to a marginal corporate income tax rate of 35%. Former §11(b)(1)(D). For purposes of this article, we refer to the pre-Act corporate income tax rate as 35%.

4 The U.S. shareholder generally can credit 80% of the foreign taxes that are ''properly attributable'' to the ''tested income'' of its CFCs against the U.S. tax on its GILTI. §960(d)(1). The U.S. shareholder must have sufficient §904 limitation in the year the foreign taxes accrue to be able to claim any foreign taxes in its U.S. tax return. The amount of available foreign taxes may be further reduced by operation of the inclusion percentage under §960(d)(2) if the U.S. shareholder owns interests in CFCs which have tested losses or a net deemed tangible income return, as defined below in n.34.

5 §904(c), §904(d)(1)(A).

6 The 34% rate is an approximate figure that derives from the sum of the maximum 25% Corporate Income Tax (the Imposto de Renda da Pessoa Jurídica or ''IRPJ'') rate applicable to Brazilian companies and a 9% Social Contribution on Net Income Tax (the Contribuição Social sobre o Lucro Líquido or ''CSLL''). The CSLL is levied separately from the IRPJ, has a different mechanism of calculation, and is designed to finance the Brazilian social security system. Certain taxpayers such as financial institutions may be subject to a different rate of tax.

7 IOE or ''Juros sobre o capital próprio.'' Brazilian Law No. 9,249/95 provides that a domestic legal entity can pay or credit its equity holders with IOEs provided that the company has retained or current-year earnings.

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ning opportunities with respect to IOE, or a combination of IOE and regular dividends, and analyze the consequences of each. Finally, we provide our thoughts regarding the optimal financing structures a U.S. multinational company should consider with respect to entities in Brazil.

AN INTRODUCTION TO IOE

IOE is a mechanism for Brazilian companies to return invested capital to equity holders while generating a deductible expense at the Brazilian company level. The payment of IOE has the potential to be favorable from a tax perspective because it gives rise to a deduction against taxable profits in the source country. Specifically, for companies calculating taxable income under the actual profits method, IOE is deductible against the Brazilian corporate income tax base.[8]

In the context of the U.S. parent of a Brazilian subsidiary, Brazilian law treats IOE as deductible equity remuneration owed by the subsidiary to the parent company. The IOE provisions allow a Brazilian subsidiary the option of booking an amount of interest payable to its shareholder. The shareholder of the Brazilian subsidiary then can (i) have the subsidiary satisfy the IOE payable with a cash payment; (ii) leave the payable outstanding; or (iii) capitalize the payable by contributing it to the Brazilian subsidiary's capital.

The Brazilian payor treats IOE as an operational deductible expense for income tax and for social contribution on net income purposes. The amount of IOE that the Brazilian subsidiary can pay or credit cannot exceed 50% of its retained or current-year earnings.[9] Generally, the basis for calculating the amount of IOE includes capital and profit reserves, in addition to any capital contributed. The Brazilian Government sets the interest rate applicable to the ''equity'' amount according to a government-monitored long-term interest rate (''Taxa de Juros de Longo Prazo'' or ''TJLP''), calculated on a pro rata basis. The TJLP is currently set at a rate of 6.56%.[10] For Brazilian withholding tax purposes, the IOE is treated as a payment of interest (and not as a dividend). Brazil imposes a 15% withholding tax on interest payments and the U.S. does not have a tax treaty with Brazil. Thus, for U.S. resident or domiciled equity holders, a 15% withholding tax applies on the amount of interest paid, accrued, or capitalized with respect to an IOE payable.

In light of the above, U.S. companies have used IOE as an effective way to repatriate funds to the United States while also reducing the effective tax rate in Brazil.[11] Prior to enactment of the 2017 tax act, the United States generally imposed corporate income taxes on the earnings and profits (E&P) of controlled foreign corporations (CFCs)[12] upon repatriation of E&P or when taxable under the anti-deferral rules of Subpart F. With respect to IOE, the U.S. shareholder generally had to include the amount of IOE the Brazilian CFC remitted to the U.S. shareholder as income in its U.S. tax return upon receipt.[13] Thus, in taxable years preceding enactment of the 2017 tax act, payment of IOE to a U.S. parent company resulted in a corresponding inclusion in the U.S. shareholder's U.S. tax return in the amount that was remitted, taxed at the prior 35% corporate income tax rate plus any applicable state taxes. The savings in Brazil, in turn, of a deduction against income taxed at 34%, compared to the inclusion in the U.S. of income taxed at the prior 35% corporate tax rate (plus state taxes), generally resulted in net tax due in the United States. With respect to corporate taxes paid to the Brazilian tax authorities, a U.S. shareholder then could generally claim a credit for foreign taxes in the payor CFC's post-1986 unused foreign tax pool.[14] The creditability of Brazilian withholding tax on the IOE is addressed below.

IOE AND FOREIGN TAX CREDIT SPLITTER RULES

The shares of a Brazilian subsidiary that pays IOE continue to be respected as equity for U.S. federal income tax purposes.[15] The payment of IOE, however, can cause the shares to be treated as a hybrid instrument splitter arrangement under §909. In particular, an instrument is considered a U.S. equity hybrid instrument if the instrument (i) gives rise to foreign income tax for the owner or holder; (ii) gives rise to a deduction for the issuer under foreign law; and (iii)

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[8] Taxpayers may calculate the IRPJ under the actual profits method (''Lucro Real'') which is based on taxable income as adjusted. Taxpayers with gross income not in excess of BRL 78 million (approximately 19 million USD at current exchange rates) may opt to calculate IRPJ using a presumed profits method (''Lucro Presumido''). The presumed profits method is calculated on a quarterly basis on gross revenue multiplied by different percentages (based on the entity's line of business), as adjusted. Brazilian Law No. 9,430/96.

[9] Brazilian Law No. 9,249/95.

[10] *See* BNDES, *Taxa de Juros de Longo Prazo* — TJLP (last visited Oct. 23, 2018).

[11] *See* John D. Mcdonald, Stewart R. Lipeles & Juliana P. Assis, *New Code Sec. 909 Regulations Could Reduce Benefits from Brazilian Interest on Equity Rules*, 90 Taxes 5 (May 2012).

[12] §957(a).

[13] Payments of IOE are generally characterized as distributions.

[14] The 2017 tax act repealed §902 for taxable years beginning after December 31, 2017, and for taxable years of U.S. shareholders in which or with which a CFC's taxable years ends. *See* Pub. L. No. 115-97, §14301.

[15] *See* below n.53 and accompanying text.

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does not give rise to income for U.S. federal income tax purposes.[16] In the case of IOE, the payment of IOE gives rise to tax for the owner (e.g., the U.S. parent that is responsible for the withholding tax payment), gives rise to a deduction for Brazilian purposes, and, if the payable is contributed to the capital of the Brazilian subsidiary, may not give rise to income for U.S. federal income tax purposes. As a result, the availability of an interest deduction in Brazil can cause the shares to be viewed as a U.S. equity hybrid instrument even though the instrument in question is generally considered ''equity'' for both Brazilian and U.S. federal income tax purposes.[17]

In such cases, §909 can delay the date when Brazilian taxes associated with the IOE may be credited by the U.S. parent. The §909 splitter rules generally prevent taxpayers from claiming credits for the split taxes unless and until the related income is taken into account. In the case of a U.S. equity hybrid instrument, the split taxes are equal to the total amount of foreign income taxes paid or accrued by the owner or holder of the instrument, less the amount that would have been paid or accrued had the owner or holder not been subject to foreign tax on income from the instrument.[18] The related income is income of the issuer in an amount equal to the amounts giving rise to the split taxes that are deductible by the issuer for foreign tax purposes (here, the amounts deductible for Brazilian tax purposes).[19] The amount of related income is determined without regard to the amount of income or E&P of the issuer for U.S. federal income tax purposes.[20]

As a result, §909 historically could prevent taxpayers from claiming a foreign tax credit (FTC) with respect to the 15% withholding tax paid on IOE to the U.S. parent unless and until the related income was taken into account through the distribution of a dividend (as determined under U.S. federal income tax law) by the Brazilian subsidiary to the U.S. shareholder. After passage of the 2017 tax act, however, the related income of the Brazilian subsidiary is much more likely to be taxed to the U.S. shareholder on a current basis under the GILTI provisions.[21] Although it remains to be seen how Treasury will update the §909 rules to account for the changes made by the Act, it seems likely that the anti-splitter provisions will not have as great of a practical impact on IOE as in pre-Act years.[22]

OTHER IMPACTS OF THE ACT ON STRUCTURES WITH BRAZILIAN SUBSIDIARIES

One of the most significant changes in the way that the United States taxes foreign earnings is the much-discussed introduction of a partial ''participation exemption'' regime under new §245A. Section 245A generally provides a 100% dividends received deduction for the foreign-source portion[23] of dividends received by a domestic corporation from a specified foreign corporation with respect to which it is a U.S. shareholder.[24] The new system is at best a partial participation exemption regime because it only exempts certain types of income from U.S. taxation, mainly earnings that are not otherwise taxed under GILTI or under Subpart F.[25]

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[16] Reg. §1.909-2(b)(3)(i).

[17] *See, e.g.,* Stewart R. Lipeles, John D. McDonald & Caryn L. Smith, *Mixed Blessings: The FTC Splitter Regulations*, 90 TAXES 5 at 11–13 (2012); Mcdonald, Lipeles & Assis, above n.11.

[18] Reg. §1.909-2(b)(3)(i)(B).

[19] *Id.*

[20] *Id.*

[21] Under current law, deemed distributions, such as those that are a result of a §951(a) inclusion, generally are treated as being made pro rata out of the issuing corporation's related income and other income for purposes of the splitter rules. Reg. §1.909-6(d)(4). This pro rata approach to accessing related income could lead to leakage if it similarly applies to inclusions under the GILTI regime (e.g., if the issuer has earnings that are not deemed distributed under the GILTI rules because of tested losses or QBAI).

[22] Mindy Herzfeld, *News Analysis: Tax Cuts Chaos, Part IV: Can Congress Fix It*, Tax Notes (June 4, 2018) (After passage of the 2017 tax act certain ''code sections retain some rationale but have found their purpose much diminished.... Under [§909], a U.S. person can claim an FTC only when she takes the related income into account for U.S. tax purposes. Section 909 might still have relevance ... [b]ut a taxpayer's ability to take advantage of splitting arrangements has been sharply curtailed, calling into question the need for such a complex provision.'')

[23] The foreign-source portion is defined in §245A(c) as the ''amount which bears the same ratio to such dividend as — (A) the undistributed foreign earnings of the specified 10-percent owned foreign corporation, bears to (B) the total undistributed earnings of such foreign corporation.''

[24] A U.S. shareholder is defined in §951(b) as ''a United States person (as defined in §957(c)) who owns (within the meaning of §958(a)), or is considered as owning by applying the rules of ownership of §958(b), 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such foreign corporation, or 10 percent or more of the total value of shares of all classes of stock of such foreign corporation.''

[25] The new system also generally does not exempt U.S. shareholders from recognizing gain on a sale of first-tier CFC shares. In the event of such a sale, gain from the sale of the first-tier CFC may be treated as a deemed dividend under §1248. Section 1248(j) provides that the deemed dividend may be eligible for the §245A dividends received deduction. However, a gain in excess of the amount of the §1248 dividend may still be taxed in the United States at the full 21% corporate income tax rate. *See, e.g.,* Jasper L. Cummings, Jr., *The Foreign Dividends Received Deduction*, 158 Tax Notes 1487 (Mar. 12, 2018) (noting that ''[t]he dividends received deduction does not apply to the gain portion. Some

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As described above, §245A provides that eligible dividends received by a U.S. corporation (other than a RIC or REIT) from an eligible foreign corporation[26] may be entitled to a deduction equal to the amount of the dividend sourced as foreign earnings.[27] Therefore, eligible dividends received by U.S. corporations may be exempt from taxation in the United States. Under the new rules, the U.S. shareholder is, in turn, not entitled to any FTC against its U.S. income for foreign taxes paid by the distributing corporation.[28] As a consequence, assuming the requisite holding period and ownership requirements are met, dividends of untaxed E&P from a Brazilian subsidiary to its U.S. parent may be treated as non-taxable in the United States. Given that Brazil does not impose withholding taxes on dividends under its domestic law,[29] a distribution of previously untaxed E&P from a Brazilian company to its U.S. parent is a tax-free means of repatriating E&P into the United States.

In many cases, in spite of the participation exemption, the GILTI regime will subject almost all of a U.S. multinational's foreign subsidiaries' income to tax, leaving little, if any, E&P to be eligible for the §245A dividends received deduction.[30] This is the case because in taxable years beginning after December 31, 2017, most income earned abroad by foreign subsidiaries will be subject to GILTI and, as a result, distributions from foreign subsidiaries to a U.S. entity will more often than not be treated as distributions from E&P that constitute previously taxed income (PTI) under GILTI, rather than distributions of E&P that are eligible for the dividends received deduction.[31] A corporate U.S. taxpayer's GILTI generally is subject to tax at a 10.5% effective rate that may be reduced by foreign taxes allocated to GILTI under a special statutory formula.[32]

A U.S. shareholder's GILTI for the shareholder's taxable year generally equals the amount by which the shareholder's ''net CFC tested income''[33] for the year exceeds the shareholder's ''net deemed tangible income return'' for the year.[34] To compute the net CFC tested income of the U.S. shareholder, the U.S. shareholder must first calculate the tested income or tested loss of each relevant CFC. The statute provides that gross income for purposes of tested income and tested loss is the gross income of a CFC earned during a taxable year without regard to certain excluded categories of income.[35] One such excluded category of income is, in part, ''any gross income excluded from the foreign base company income (as defined in section 954 . . . by reason of section 954(b)(4)).''[36] Proposed Regulations confirm that, for purposes of calculating GILTI, a CFC's tested income does not include gross income earned by a CFC if the income is excluded

commentators are already calling that gain the gain on the CFC's 'GILTI assets,' as contrasted with its 'subpart F assets.' '').

[26] The U.S. shareholder must hold a 10% or greater interest in stock in the foreign corporation, by vote or value, continuously throughout a one-year holding period. More specifically, the 10% or greater ownership interest must be held for more than 365 days during a 731-day period beginning on the date that is one year before the date on which the shares become ex-dividend with respect to the dividend. §245A, §246(c)(5).

[27] Section 245A generally applies to dividends made after December 31, 2017, regardless of when the U.S. shareholder's fiscal year begins. *See* Pub. L. No. 115-97, §14101.

[28] However, FTCs may be available if they relate to PTI, other withholding taxes, GILTI, or Subpart F income. *See* §960(a), §960(b), §960(d).

[29] Withholding under the *Imposto de Renda Retido na Fonte* (''IRRF'') does not apply to dividend payments by Brazilian companies out of profits earned as of January 1, 1996. In contrast the IRRF may apply to payments of interest, royalties, and certain payments for services among other categories of income.

[30] *See, e.g.,* Andrew Haave & Kristen Konschnik, *GILTI Until Proven Innocent: Down the Rabbit Hole of Global Intangible Low-Taxed Income*, 90 Tax Notes Int'l 943 (May 21, 2018); Ken Brewer & Nicolaus F. McBee, U.S. International Tax Reform: *The Good, the Bad, and the GILTI*, 159 Tax Notes 839 (May 7, 2018); Jasper L. Cummings, Jr., *GILTI Puts Territoriality in Doubt*, 159 Tax Notes 161 (Apr. 9, 2018); Alexander Lewis, *Taxpayers Should Prepare Now for GILTI and FDII*, 89 Tax Notes Int'l 520 (Feb. 5, 2018).

[31] *See* H.R. Conf. Rep. No. 115-466, Joint Explanatory Statement of the Committee on Conference, at 599 n.1490 (2017) (the ''Conference Explanation'') (''Pursuant to section 959(d), a distribution of previously taxed income does not constitute a dividend even if it reduces earnings and profits.'').

[32] A domestic corporation is entitled to a deduction that is equal to 50% of the corporation's GILTI. §250(a)(1)(B). The deduction is reduced to 37.5% for GILTI for taxable years beginning after December 31, 2025, at which time, the effective rate on a corporation's GILTI will increase to 13.125%. §250(a)(3)(B).

[33] A U.S. shareholder's ''net CFC tested income'' for any taxable year is the excess (if any) of the aggregate of such shareholder's pro rata share of the tested income of each of its CFCs over the aggregate of such shareholder's pro rata share of the tested loss of each of its CFCs. §951A(c)(1). For these purposes, ''tested income'' means, with respect to any CFC for any taxable year of such CFC, the excess (if any) of the gross income of such CFC determined without regard to the excluded categories of income listed in §951A(c)(2)(A)(i)(I)–(V) and less the deductions that are properly allocable to the production of the residual gross income amount. §951A(c)(2)(A). In addition, a ''tested loss'' exists when, with respect to a particular CFC, the deductions that are properly allocable to the gross income earned by the CFC, not including the excluded categories of income (e.g., Subpart F income), exceed the amount of such gross income earned. §951A(c)(2)(B).

[34] §951A(b)(1); Prop. Reg. §1.951A-1(c). The U.S. shareholder's net deemed tangible income return for the year is the aggregate of the amount by which 10% of each CFC's qualified business asset investment (QBAI) exceeds the amount of the CFC's excess interest expense. §951A(b)(2). QBAI, in turn, is the taxpayer's aggregate adjusted basis (determined using a quarterly average) of all of the corporation's depreciable business property used in the production of tested income. §951A(d)(1), §951A(d)(2).

[35] §951A(2)(A)(i), §951A(2)(B)(i).

[36] §951A(c)(2)(A)(i)(III).

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from Subpart F by reason of an election to apply the high-tax exception.[37] If the high-tax exception is applied, the Brazilian subsidiary may later repatriate the untaxed E&P to the United States and claim the §245A dividends received deduction.[38]

Net U.S. federal income tax on GILTI generally is designed to be reduced to zero to the extent that GILTI is subject to an aggregate foreign income tax rate of 13.125%.[39] Viewed in isolation, a Brazilian CFC generally will have earnings taxed at a rate much higher than 13.125% and excess foreign taxes in the GILTI basket from a Brazilian CFC could potentially shelter GILTI from other low-tax CFCs. This is because the mechanics of GILTI allow a U.S. shareholder to apply excess foreign taxes paid in countries with high statutory corporate income tax rates against net tested income of CFCs in countries with low statutory corporate income tax rates, as the credit calculation, with respect to GILTI, is done on an aggregate basis.[40]

As an alternative, it may be beneficial for the taxpayer to plan into the Subpart F high-tax exception.[41] This may be accomplished by adjusting the way certain income streams are earned to ensure that they are characterized as foreign base company sales income or foreign base company services income.[42] This type of planning should allow the U.S. parent to repatriate the foreign earnings that are high-taxed to the U.S. tax free. This is the case because the high-tax exception would result in the relevant E&P being excluded from tested income (and loss) for purposes of GILTI[43] while similarly not being subject to inclusion in the year earned under Subpart F. When the U.S. parent does repatriate the E&P to the United States, it would then be able to avail itself of the §245A dividends received deduction with respect to the untaxed earnings.

In addition, even without the high-tax exception, the generation of income that is not excepted from Subpart F may be beneficial. For example, if foreign earnings are characterized as GILTI, the associated taxes are subject to the 20% haircut, whereas if such earnings are not subject to GILTI but are instead Subpart F income, the FTCs that are generated may more than offset the U.S. federal income tax that would otherwise be owed with respect to such earnings. Unlike FTCs that are used to offset GILTI income, FTCs attributable to Subpart F income that is not GILTI may be carried back one year or carried forward 10 years.

THE PARTICIPATION EXEMPTION AND THE NEW ANTI-HYBRID RULES

The provisions described above are supplemented by new anti-hybrid rules, which may limit the benefits of Brazilian IOE to a U.S. multinational company. The intent behind the anti-hybrid rules is to eliminate duplicative benefits with respect to hybrid arrangements.

Under §267A, taxpayers are denied a deduction for any "disqualified related party amount" paid or accrued pursuant to a "hybrid transaction" or by, or to, a "hybrid entity."[44] For these purposes, a "disqualified related party amount" is any interest or royalty paid or accrued to a related party[45] to the extent that (i) there is no corresponding inclusion of such pay-

[37] Prop. Reg. §1.951A-2(c)(1)(iii). To get the benefit of the exception from GILTI, the relevant income must (i) be highly taxed (e.g., taxed at a rate higher than 90% of the maximum U.S. corporate income tax rate) and (ii) otherwise be Subpart F income for which the taxpayer has elected to use the high-tax exception. *See* Notice of Proposed Rulemaking, REG-104390-18 (Sept. 13, 2018) ("the proposed regulations clarify that [the exclusion under the high-tax exception] applies only to income that is excluded from foreign base company income . . . solely by reason of an election made to exclude the income under the high-tax exception of §954(b)(4). Accordingly, the exclusion does not apply to income that would not otherwise be subpart F income or to categories of income that do not constitute subpart F income due to exceptions other than the high-tax exception.").

[38] If the taxpayer repatriates the untaxed E&P pursuant to the §245A dividends received deduction, no FTCs will be available with respect to foreign taxes paid on the repatriated E&P. Note that the §245A dividends received deduction may also be used to bring back E&P on a tax-free basis in other circumstances; for example, in the relatively rare case when the income earned during the taxable year would not produce earnings in excess of 10% of QBAI.

[39] Conference Explanation at 626–27.

[40] In a 2017 report, the OECD highlighted the trend in the reduction of corporate income taxes among surveyed countries. OECD, *Tax Policy Reforms 2017: OECD and Selected Partner Economies*, OECD Publishing, Paris. For example, the average standard corporate income tax rates in OECD countries fell from 32.2% in 2000 to 24.7% in 2016. This average rate will be lower after taking into account the new U.S. corporate income tax rate and other rate reductions in selected countries.

[41] The high-tax exception, with respect to foreign base company income, provides that "foreign base company income . . . shall not include any item of income received by a controlled foreign corporation if the taxpayer establishes to the satisfaction of the Secretary that such income was subject to an effective rate of income tax imposed by a foreign country greater than 90 percent of the maximum rate of tax specified in section 11." §954(b)(4). Given that the current U.S. corporate income tax rate is a flat 21%, the high-tax exception generally applies to income taxed at a rate of 18.9% or greater.

[42] For a discussion of potential means of affirmatively planning into the high-tax exception, see Stewart R. Lipeles et al., *Foreign Tax Credit Planning: The Potential Benefits of Subpart F Income*, 96 Taxes 5 (Sept. 2018).

[43] §951A(c)(2)(A)(i)(III).

[44] §267A(a).

[45] §267A(b)(2) (defining a related party); Conference Explanation at §14223 ("A related party for these purposes is determined under the rules of section 954(d)(3), except that such section applies with respect to the payor as opposed to the CFC otherwise

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ment as income to the related party under its country's tax laws or (ii) the related party is allowed a deduction with respect to the payment under its country's tax laws.[46] A ''hybrid transaction,'' in turn, is a transaction which treats a payment as an interest or royalty payment for U.S. federal income tax purposes but does not treat that same payment as an interest or royalty payment under the recipient's country's tax laws.[47] Finally, a ''hybrid entity'' is either (i) a ''fiscally transparent'' entity (e.g., a disregarded entity, partnership, etc.) for U.S. federal income tax purposes that is not treated as such under the foreign country's tax laws in which it is resident or (ii) a fiscally transparent entity for foreign income tax purposes that is not treated as such for U.S. federal income tax purposes.[48]

In the context of IOE payments, the question is whether IOE payments from a Brazilian CFC to a U.S. shareholder could implicate §267A when determining the amount of deductible expenses used to compute tested income and tested losses for purposes of GILTI. Proposed regulations issued under §951A provide rules to determine which deductions a taxpayer is allowed to use to offset income earned by the CFC.[49] For purposes of determining a CFC's income and expenses for the taxable year, one such rule applies a fiction that requires a taxpayer to treat the relevant CFC as if such CFC were instead a domestic corporation for certain purposes.[50] In the context of the application of §267A, it is not clear whether a CFC should be treated as a domestic corporation, and, if it is, whether a deduction is allowed with respect to a deemed hybrid arrangement under the fiction created by the rules. In this regard, the Preamble to the GILTI regulations notes that ''[c]omments have also requested guidance on the interactions of section 163(j) *and section 267A* with section 951A. Issues related to sections 163(j), 245A, and 267A will be addressed in future guidance.''[51]

In the event that Treasury issues final regulations stipulating that §267A can apply for purposes of GILTI, the question becomes whether IOE payments are subject to the §267A provisions. For U.S. federal income tax purposes, IOE payments should be treated as distributions on equity.[52] Based on the debt versus equity factors under case law, §385, and the regulations thereunder, shares with IOE should not be recast as debt for U.S. federal income tax purposes.[53] Therefore, it seems clear that §267A should not apply to the IOE payment amount because the IOE payment is not a disqualified related party amount — i.e., it is not an interest or royalty payment made to the U.S. parent — rather, a payment on IOE should be characterized as a dividend or a distribution of PTI.[54]

Assuming that §267A should not apply to a payment on IOE, the next question is whether the anti-hybrid rules of new §245A(e) may apply. Section

referred to in such section.'').

[46] §267A(b)(1). The flush language also indicates that a disqualified related party amount ''shall not include any payment to the extent such payment is included in the gross income of a United States shareholder under section 951(a).''

[47] §267A(c).

[48] §267A(d). As an example, an entity that is treated as a partnership for U.S. federal income tax purposes but that is treated as a corporation under the laws of the relevant foreign country would be characterized as a hybrid entity under the provision.

[49] Prop. Reg. §1.951A-2(c)(2).

[50] Reg. §1.952-2. The regulation provides that ''[e]xcept where otherwise distinctly expressed, the provisions of subchapters F, G, H, L, M, N, S, and T of chapter 1 of the Internal Revenue Code shall not apply and, for taxable years of a controlled foreign corporation beginning after March 3, 1997, the provisions of section 103 of the Internal Revenue Code shall not apply.''

[51] Notice of Proposed Rulemaking, REG-104390-18 (Sept. 13, 2018) (emphasis added). *See also* Alexander Lewis & Andrew Velarde, *Proposed GILTI Regs Could Result in Taxable Phantom Income*, 91 Tax Notes Int'l 1369 (Sept. 24, 2018) (''While the regs also fail to address GILTI's interaction of section 163(j) and the anti-hybrid rules of section 267A, Shuman said answers to these questions could make a complex regime even more so for multinationals.'').

[52] *See* Bret Wells & Mike Wilczynski, *Tax-Effective Methods to Finance Latin American Operations*, 28 Int'l Tax J. 21 (2002) (''For U.S. tax purposes, the distribution by the [Brazilian] CFC [with respect to IOE] should be treated as a dividend or return of capital (depending on the CFC's earnings and profits as calculated for U.S. tax purposes), regardless of whether the CFC elects to treat the distribution as interest on capital. The following facts support the dividend treatment: (1) the CFC makes the distribution only to its shareholders; (2) the CFC chooses whether to make the distribution at its discretion (i.e., there is no loan agreement between the CFC and its shareholders, no principal or interest that must be repaid, and no risk of default for failing to make a distribution); and (3) the distribution is from the CFC's current or accumulated earnings and profits (as calculated for local tax purposes).'').

[53] The weight of the debt-equity factors demonstrate that payments of IOE on shares should not cause the instrument to be treated as debt for U.S. federal income tax purposes. *See, e.g.,* Romero J.S. Tavares, John T. Womack & Donald E. Wilson, *New Brazilian Equity Interest Rules: Efficient Financing for U.S.-Owned Subsidiaries*, 14 Tax Notes Int'l 45 (Jan. 6, 1997) (describing factors the courts have used to determine whether a particular interest is debt or equity and concluding that ''it is evident that a typical stock investment in a Brazilian subsidiary represents, in all material aspects, equity, and, therefore, the payment of equity interest would represent a corporate distribution with respect to stock subject to IRC section 301 for U.S. tax purposes.'').

[54] Note that the taxpayer may still be subject to tax on any currency gain or loss recognized on a distribution of PTI under §986(c) and, in addition, to avoid recognizing gain under §961(b)(2), the U.S. shareholder must have sufficient basis in the stock of the CFC to absorb any PTI distribution amount.

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245A(e) provides that the deduction for certain dividends distributed by a specified 10%-owned foreign corporation[55] to a U.S. shareholder does not apply in the case of a payment of a hybrid dividend.[56] For these purposes, a ''hybrid dividend'' is an amount received from a CFC for which a deduction would generally be allowed under §245A, and for which the CFC received a deduction (or other tax benefit) with respect to any income, war profits, or excess profits taxes imposed by any foreign country or possession of the United States.[57] The statute also provides that if a CFC with respect to which a domestic corporation is a U.S. shareholder receives a hybrid dividend from any other CFC with respect to which the domestic corporation is also a U.S. shareholder, the hybrid dividend shall be treated as Subpart F income of the receiving CFC in the year of receipt, and, in turn, the U.S. shareholder must include its pro rata share of such income in the relevant taxable year.[58] For example, as discussed in further detail below, where a U.S. parent owns a Brazilian subsidiary through a Dutch holding company, a payment of IOE to the Dutch holding company from the Brazilian subsidiary may trigger §245A(e)(2) and result in Subpart F income to the U.S. parent.

In addition, §245A(e) appears to apply to a particular *payment* — not to a particular instrument. In the context of IOE, if a Brazilian CFC receives a deduction for payments on IOE to a U.S. parent,[59] such payments likely are considered hybrid dividends that are ineligible for the §245A dividends received deduction. As a result, the deduction in Brazil for IOE causes a payment to the U.S. parent to be treated as a hybrid dividend for U.S. federal income tax purposes, in which case the U.S. parent receiving the hybrid dividend cannot claim the 100% dividends received deduction and generally cannot claim any FTCs.[60] In contrast, if the Brazilian CFC makes a non-IOE distribution to the U.S. parent, the distribution would not be a hybrid dividend because it would not give rise to a deduction in Brazil, and, therefore, the distribution would still be eligible for the §245A dividends received deduction. This should be the case even if IOE payments were made on the same shares in prior years.[61]

OBTAINING THE BENEFITS OF IOE WITHOUT AN INCOME INCLUSION AT THE U.S. LEVEL

Despite the impact of the anti-hybrid and CFC rules, there are still options to reduce, or eliminate, the amount of IOE that must be included in the tax base of the U.S. shareholder. This section discusses the ways a taxpayer may arrange its affairs to secure the benefit of a deduction in Brazil while avoiding an income inclusion in the United States at the time IOE is remitted to the United States. As will be discussed below, taxpayers engaging in such planning may avail themselves of a net tax savings in Brazil of up to 19% of the amount of the IOE.

IOE Payment Without Contribution

Generally, in the years following the inclusion of all of a Brazilian CFC's untaxed E&P in the U.S. tax return as a result of the one-time transition tax under §965,[62] Brazilian CFCs are expected to have a positive balance in their §959(c)(2) PTI pool. That balance should cover a portion of future distributions to the U.S. parent. A distribution by a Brazilian CFC to a U.S. shareholder may not give rise to incremental U.S. tax because the distribution will be considered as

[55] The term ''specified 10%-owned foreign corporation'' means ''any foreign corporation with respect to which any domestic corporation is a United States shareholder with respect to such corporation.'' §245A(b)(1).

[56] §245A(e) (providing that §245A(a) does not apply to ''any dividend received by a United States shareholder from a controlled foreign corporation if the dividend is a hybrid dividend.'').

[57] §245A(e)(4)(A). The hybrid dividend definition, therefore, does not apply to all specified 10%-owned foreign corporations because not all such corporations are CFCs. Thus, a dividend paid from a foreign corporation to a U.S. shareholder that is not a CFC (e.g., a foreign corporate joint venture) may qualify for the §245A dividends received deduction even if the amount distributed by the foreign corporation is deductible under its local laws.

[58] §245A(e)(2).

[59] IOE is generally deductible for purposes of the corporate income tax (IRPJ) and the social contribution on net profits (CSLL).

[60] *See* Derek E. Wallace, *The Anti-Hybrid Rules of the New Dividends Received Deduction*, 161 Tax Notes 25 (Oct. 1, 2018) (''Because the indirect FTC under former section 902 has been fully repealed, it is unclear why section 245A disallows credits for hybrid dividends for foreign taxes of a type that would generally be creditable under section 901 if imposed on a payment of deductible interest (for example, withholding taxes and taxes imposed on foreign branches and hybrid entities through which a DC USS holds stock of a CFC).'').

[61] Section 254A(e)(4)(B) requires that the CFC receive a deduction (or other tax benefit) with respect to ''any income, war profits, or excess profits taxes imposed by any foreign country or possession of the United States.'' If the Brazilian CFC makes a non-IOE distribution which derives no benefit in Brazil, the distribution should not be a hybrid dividend.

[62] As a transition from the former deferral regime to the new quasi-territorial regime, existing untaxed earnings of ''specified foreign corporations,'' as defined in §965(e), are deemed repatriated and taxed at a reduced rate that depends upon, among other items, the extent to which the earnings are matched by cash held offshore.

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having first been made out of PTI, to the extent PTI is available.[63]

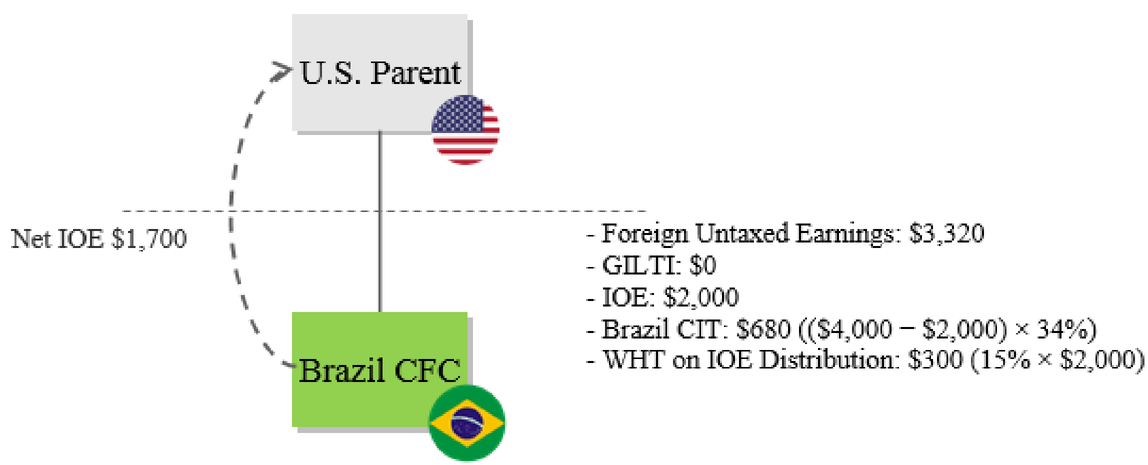
Going forward, Brazilian CFCs that generate GILTI or Subpart F income should have continuing access to distributable PTI. In such cases, §245A, and its anti-hybrid rule, may not be relevant because the Brazilian CFC's U.S. shareholder would merely receive a non-taxable distribution of PTI that is exempt from U.S. federal income tax, which does not implicate §245A. As a consequence, the anti-hybrid rules under §245A(e) should not apply because the distribution would not be considered a "hybrid dividend," which requires that amounts received from a CFC permit a deduction to the U.S. shareholder under §245A(a).[64] However, there are instances in which a Brazilian CFC may have substantial untaxed earnings, for example when the U.S. shareholder's CFCs have substantial QBAI or when tested losses from the U.S. shareholder's CFCs offset tested income at its other CFCs. In such cases, the reduction of Brazilian taxes by using the IOE may be partially offset by the loss of the §245A dividends received deduction.

The following example illustrates this point:

[63] *See* §959(c).

[64] §245A(e)(4)(B).

Example 1



U.S. Taxable Amount from Cash Distribution	$1,700 U.S. Tax Cost: $357 (21% × $1,700)
FTC available from distribution of IOE	$0
Potential Brazilian Savings	$380 (19%[65] × $2,000)
Net Tax Savings	$23 ($380 – $357)

[65] The amount is shown at a 19% rate because it is a deduction against income taxed at the general 34% rate less the 15% withholding tax due on the IOE (19% = 34% – 15%).

Example 1, for illustrative purposes, assumes that Brazil CFC has no GILTI and no PTI. This is to focus on the inefficiency caused by the interaction between the Brazilian IOE benefit and the U.S. participation exemption benefit under §245A. Specifically, as illustrated in Example 1, the IOE payment amount, which is $2,000, would be treated as a hybrid dividend and would be subject to U.S. federal income tax under §245A(e). As a result of application of §245A(e), it appears that no FTCs would be available with respect to the $300 of Brazilian tax withheld on the IOE payment. Such a result illustrates that the U.S. parent in some cases could be worse off as compared to the position it would have been in prior to enactment of the 2017 tax act. On the other hand, in many cases, a profitable Brazilian CFC will have PTI to distribute from the aftermath of §965 and from GILTI. In such cases, the downside that is illustrated by Example 1 will not be present because a distribution of PTI would not implicate §245A and the anti-hybrid rules of §245A(e).

Immediate Contribution of IOE Amount

To the extent any cash payments from IOE are immediately recontributed to the Brazilian subsidiary pursuant to a binding agreement, the combined steps

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may be treated as a nontaxable transaction under the circular cash flow doctrine.[66] This doctrine generally applies when a taxpayer moves cash or property between related entities, and, at the end of the series of transactions, the cash or property ends up in the same entity where such cash or property was prior to the first transaction in the series. In such situations, because the economic position of the parties is generally left unchanged, as if the series of transactions had never occurred, the Internal Revenue Service and the courts have applied substance-over-form principles to recharacterize the series of transactions based on the regarded steps, disregarding the transitory, intermittent steps.[67] To illustrate, in Rev. Rul. 78-397, the IRS disregarded certain steps when a parent company, in order to satisfy certain state capitalization requirements on the incorporation of a subsidiary, contributed cash to its subsidiary for shares that were subsequently repurchased by the subsidiary. The IRS's basis for disregarding the intermittent steps was that the transitory circulation of the cash had no permanent effect on the transacting parties, and, after the series of transactions was completed, the parties were left in the same economic position as if the series had never occurred.[68] Applying the doctrine in the instant case, if no new shares are issued, and the amount received from the IOE payment is immediately recontributed to the Brazilian CFC, the U.S. parent's transitory ownership over the payment amount should be disregarded and the transaction should be essentially treated as a tax ''nothing'' for U.S. federal income tax purposes. Alternatively, if new shares are issued by the Brazilian entity, the transaction should be eligible for nontaxable treatment as a stock distribution under §305.

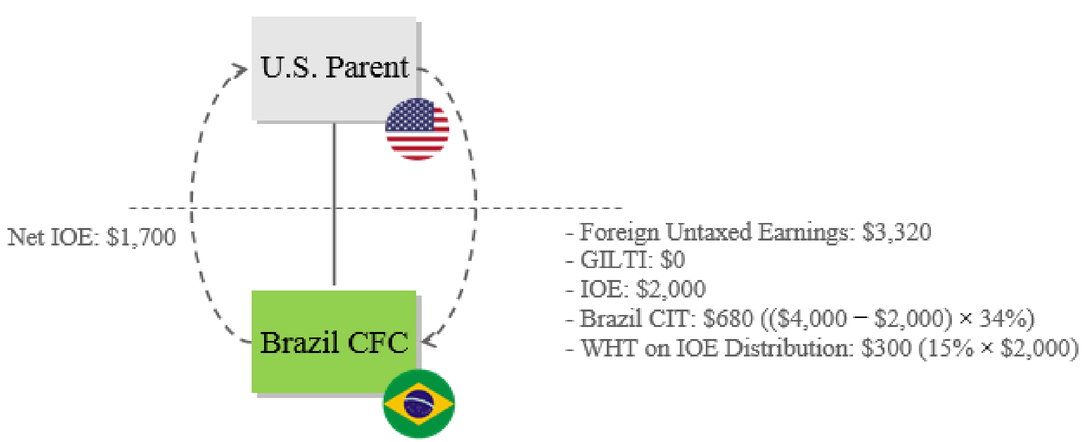
Example 2

For purposes of Example 2, assume that all of the facts from Example 1 remain the same, except that the amount of declared IOE is immediately contributed back to the Brazil CFC pursuant to a binding agreement between the companies.

[66] *See* Rev. Rul. 80-154 (disregarding declaration of cash dividend when intent all along was to pay with stock and finding that the effect of the taxpayer's resolution was to capitalize the profits of the corporation in a transaction treated as a nontaxable stock distribution under §305(a)).

[67] *See, e.g.,* Rev. Rul. 83-142 (observing that the circular flow of cash was ''a transitory step that has no federal income tax consequences'' and therefore that a portion of the distribution of cash that was returned to a corporation that engaged in the transactions giving rise to the circular flow of cash was disregarded); Rev. Rul. 78-397 (providing that it is a ''well established principle of tax law'' that steps are disregarded when they are ''transitory steps occurring as part of a plan,'' especially when the interim steps are ''undertaken in order to comply with applicable law''); FSA 200135020 (Sept. 4, 2001) (concluding that a U.S. parent was not eligible for an FTC for a dividend received from a foreign subsidiary because the dividend was tantamount to a nontaxable stock dividend under the circular cash flow doctrine and step transaction principles).

[68] Rev. Rul. 78-397. *See also Six Seam Co., Inc. v. United States*, 524 F.2d 347 (6th Cir. 1975) (disregarding cash contribution when cash contributed was used to purchase assets from contributor); *Intertan, Inc. v. Commissioner*, T.C. Memo 2004-1 (disregarding circular cash flow when cash was contributed to acquire preferred stock and the preferred stock was subsequently redeemed); *but see Stevens Pass, Inc. v. Commissioner*, 48 T.C. 532 (1967) (dismissing a circular cash flow argument, but only when ''the parties were capable of independent action'' and were not bound to complete a circular flow).



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U.S. Taxable Amount from Cash Distribution	$0 (IOE Payment disregarded)
FTC available from distribution of IOE	$0[69]
Potential Brazilian Savings (deduction against income taxed at 34% minus 15% withholding tax due on the IOE)	$380 (19% of $2,000)
Net Tax Savings	$380

[69] For the purpose of simplicity, this example assumes that the U.S. shareholder is not able to utilize FTCs. However, U.S. Parent may be entitled to $300 of FTCs arising from the $300 of Brazilian withholding tax imposed on the U.S. Parent. Such withholding tax may be viewed as a foreign tax ''imposed under the law of a foreign country or possession of the United States on an amount which does not constitute income under United States tax principles,'' which is creditable. In such a case, U.S. Parent's approach in this Example 2 would be an even further improvement over U.S. Parent's approach in Example 1.

By recontributing the exact amount of the IOE back to Brazil CFC, pursuant to a binding agreement entered into between U.S. Parent and Brazil CFC prior to the payment of IOE by Brazil CFC, the payment and contribution of the IOE will be disregarded for U.S. federal income tax purposes. This arrangement provides Brazilian tax savings in the amount of 19% of the IOE, as shown in the table above, while having no adverse U.S. tax consequences. After taking into account withholding taxes paid on the IOE payment, the binding agreement will have no other cash impact for either U.S. Parent or Brazil CFC.[70]

As a variation on the series of transactions described above, the company could, in some years, pay IOE and recontribute the funds in order to ensure that §245A(e) does not apply, while, in other years, pay a regular dividend to repatriate cash to the United States by not making payment on the IOE in the year of desired repatriation.

IOE Payment Through a Holding Company

When a holding company of a U.S. shareholder receives a payment of a hybrid dividend from a lower-tier CFC, that payment will be treated as Subpart F income under §245A(e)(2). While not clear under the current rules, it is expected that the withholding taxes paid in connection with the IOE payment may not be creditable as FTCs in the case of a hybrid dividend received by a CFC.[71] However, distributions from a foreign disregarded entity to its CFC parent should not be affected by the hybrid dividend rule, as illustrated below.

Example 3

For purposes of Example 3, assume that all of the simplified facts from Example 1 remain the same, except that the Brazilian entity is a disregarded entity (''Brazil Sub'') that is wholly owned by a Dutch holding company (''Dutch Holdco''), which is in turn wholly owned by the U.S. parent. Further assume that Dutch Holdco receives a payment of IOE from Brazil Sub and declares a regular dividend payment to U.S. Parent. In addition, assume that Brazil Sub has no PTI in the year of payment of the IOE.

[70] Brazilian law permits the immediate recapitalization of IOE amounts. If the CFC pays the withholding tax, the U.S. shareholder is treated as though it received a dividend with respect to the amount of withholding tax paid. If the U.S. shareholder pays the withholding tax, then it has a cash cost with respect to the amount of withholding tax paid but would be able to avail itself of an FTC with respect to the amount paid unless such amount was paid voluntarily. See §901(a); Reg. §§1.901–2(e)(5); FSA 200049010 (Dec. 11, 2000) (disallowing a credit when a subsidiary voluntarily incurred an additional charge on its tax liability).

[71] The Conference Explanation provides that ''[i]f a controlled foreign corporation with respect to which a domestic corporation is a U.S. shareholder receives a hybrid dividend from any other controlled foreign corporation with respect to which the domestic corporation is also a U.S. shareholder, then the hybrid dividend is treated for purposes of section 951(a)(1)(A) as subpart F income of the recipient controlled foreign corporation (notwithstanding section 954(c)(6)) for the taxable year of the controlled foreign corporation in which the dividends was received and the U.S. shareholder includes in gross income an amount equal to the shareholder's pro rata share of the subpart F income, determined in the same manner as section 951(a)(2).'' Conference Explanation, at 471. The legislative history does not address whether an FTC is disallowed with respect to payment of a hybrid dividend in such situations.

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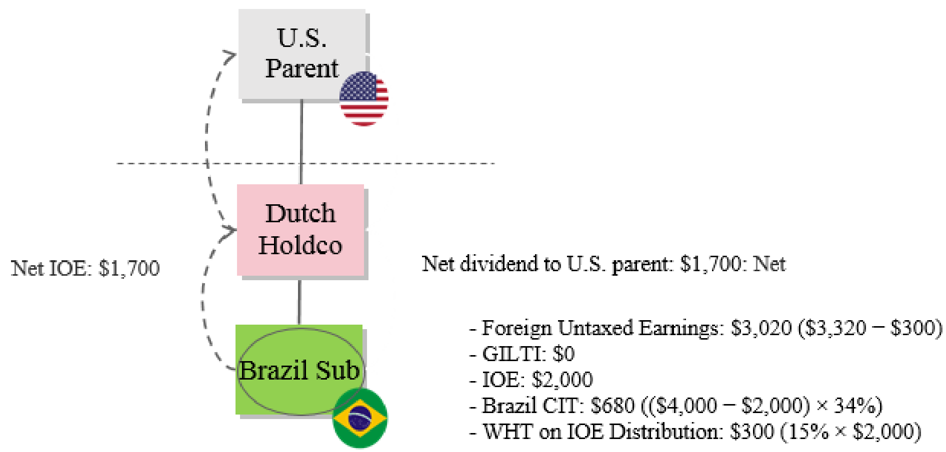

Without Planning	
U.S. Taxable Amount from Cash Distribution[72]	$0
FTC available from distribution	$0
Brazil Savings (deduction against income taxed at 34% minus 15% withholding tax due on the IOE)	$380 (19% of $2,000)
Dutch Tax Cost	$0
Net Tax Savings	$380

[72] This amount assumes that none of the E&P of Brazil CFC were subject to GILTI and that there are sufficient E&P to treat the entire distribution as a §301 dividend that is eligible for the §245A dividends received deduction.

In the example, to ensure that §245A(e)(2) does not apply, U.S. Parent seeks to cause the IOE payment to be disregarded for U.S. federal income tax purposes. This is accomplished by electing to classify Brazil Sub as a disregarded entity for U.S. federal income tax purposes, prior to the payment of the IOE to Dutch Holdco, which sits above Brazil Sub in the chain. This structure reduces taxable income in Brazil by the amount of the IOE payment while being generally disregarded from a U.S. tax standpoint. Thus, U.S. Parent eliminates the §245A(e)(2) concern; and the disregarded payment would not give rise to Subpart F income in the hands of Dutch Holdco.[73]

From a Dutch tax perspective, IOE is considered a hybrid instrument. The Netherlands has an anti-hybrid rule in its participation exemption regime which denies the application of the participation exemption, among other forms of deduction, when profits consist of payments derived from the participation (e.g., in Brazil) that are deductible from the taxable base at the level of the participation. In principle, the result is that the Netherlands taxes the benefits (e.g., the benefits derived from IOE payments) in the Netherlands when the Brazilian subsidiary is able to deduct such payments from its taxable base.[74]

Notwithstanding the above, it is still possible to reduce (or fully mitigate) Dutch taxation on IOE payments. For instance, IOE payments could qualify as dividends (i.e., income from shares) under the Brazil-Netherlands tax treaty (the ''Treaty''). If all of the conditions under the Treaty are satisfied, the Netherlands should provide for a tax credit for the amount of the withholding tax paid. Article 23 paragraph 4(a) of the Treaty provides for a tax credit (including a tax sparing credit) of 20% and, under certain conditions, 25%.[75] Thus, depending on the facts and circumstances, this credit could be sufficient to offset all

[73] Depending upon the particular facts involved, the disregarded payment in some cases could give rise to currency gain or loss under §987. Any resulting §987 gain could give rise to Subpart F income at the level of a CFC parent of the disregarded entity. *See* Reg. §1.987-6(b)(3).

[74] Such payments would currently be subject to corporate income tax at a rate of 25% (the first 200,000 euros of profits are taxed at a 20% rate). However, the corporate income tax rate will gradually decrease as of January 1, 2019, to 24.3% (19% for profits of 200,000 euros or less) in 2019 and will further decrease to 23.9% in 2020 (17.5% for profits of 200,000 euros or less) and to 22.25% (16% for profits of 200,000 euros or less) in 2021.

[75] The credit is 25% when the dividends are paid to a company in the Netherlands holding at least 10% of the voting capital of the Brazilian company, and 20% in all other cases.

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Dutch corporate income tax payments due on the IOE payments.

If the payment is then remitted to U.S. Parent, the Dutch dividend withholding tax (''DDWT'')[76] of 15% may apply, unless the domestic DDWT exemption applies. The DDWT exemption applies when (i) a non-Dutch corporate shareholder owns 5% or more of the capital of the Dutch resident participation; (ii) the non-Dutch resident corporate shareholder is, among other things, a resident of a jurisdiction with which the Netherlands has concluded a tax treaty with a dividend article (which is the case with the United States); and (iii) no anti-abuse provision applies, which is the case if none of the main purposes of the non-Dutch resident corporate shareholder holding shares in the Dutch entity is to avoid DDWT, and the structure is not considered artificial (e.g., having no business purpose). A structure will not be considered artificial if the direct foreign corporate shareholder conducts an operational business enterprise itself.

Thus, assuming the exemption applies in the case of U.S. Parent under the facts of Example 3,[77] the U.S. Parent similarly escapes U.S. tax on the IOE payment amount because the payment from the Dutch Holdco to the U.S. parent qualifies for the §245A dividends received deduction.

COMBINATION OF IOE AND INTERCOMPANY DEBT

Due to the Brazilian legislative limitations on the amount of IOE that a Brazilian corporation can pay to its shareholder, the optimal financing structure may be one that takes advantage of a combination of financing strategies. For example, a financing strategy could, based on the facts and circumstances of the group, combine IOE, interest payments on debt, and dividend distributions.

The most attractive aspect of debt injection is that any interest on intercompany debt is deductible against taxable profits in Brazil — subject to thin capitalization and transfer pricing rules — provided that the interest is a necessary expense for the Brazilian company's business activities.[78] As compared to the IOE scenario in Example 2, where the IOE payment is immediately recontributed to the Brazilian CFC, any interest would still be immediately taxable in the United States and the withholding tax on the interest payment could be creditable in the United States.[79] As a consequence, a debt financing structure could result in a potential tax rate benefit of 13% (34% – 21%).

CONCLUSION

The developments and examples that we discuss above illustrate how the Act fundamentally changes the manner in which U.S. taxpayers may use IOE to reduce local taxes in Brazil and repatriate earnings from Brazilian subsidiaries. As with other aspects of tax reform, future guidance on the new provisions, including application of the anti-hybrid rules, may impact the type of optimal structure for using IOE. Until such guidance is released, U.S. taxpayers with operations in Brazil should analyze their structures to determine whether benefits can be derived from using IOE either on its own or in conjunction with intercompany debt.

[76] DDWT will in principle be abolished as of 2020, unless specific anti-abuse rules apply.

[77] The example also assumes that the U.S. parent has held its interest in the Dutch Holdco for at least 365 days during a 731-day period described in §246(c)(5).

[78] Interest payments to a U.S. parent are also subject to a 15% withholding tax.

[79] This is the case because the interest payment is not made with respect to a hybrid dividend, under §245A(e).

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