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Reassessing the Beloved Double Irish Structure in Light of FDII

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In this article, the authors discuss the new foreign-derived intangible income provisions of the Tax Cuts and Jobs Act and reassess the double Irish structure in light of those provisions to determine if it continues to deliver tax savings.

The Tax Cuts and Jobs Act (P.L. 115-97) added three new international tax regimes to the Internal Revenue Code:

- an anti-deferral rule — global intangible low-taxed income — in new section 951A;
- an incentive for U.S. companies to exploit intellectual property internationally — the foreign-derived intangible income (FDII) rules — in new section 250; and
- a tax on some outbound payments — the base erosion and antiabuse tax — in new section 59A.

In our last article (*Tax Notes Int'l*, Apr. 23, 2018, p. 523), we reviewed the new GILTI provisions and reassessed the continued tax savings of the beloved double Irish structure in light of those provisions. Now, we turn to the FDII provisions in the new section 250. We review this new regime and — once again — reassess the beloved double Irish structure, this time using a case study that compares the double Irish structure with a U.S.-centric structure designed to maximize the FDII benefit. As in our previous article, we conclude that the beloved double Irish structure continues to deliver tax savings, albeit not quite as dramatically as before the TCJA.

The FDII Provisions

For tax years beginning after December 31, 2017 — but before December 31, 2025 — section 250(a)(1)(A) allows a domestic corporation to take a deduction equal to 37.5 percent of its FDII. For tax years beginning after December 31, 2025, the deduction is changed to 21.875 percent.

If, for any year, the sum of FDII and GILTI exceeds the domestic corporation's taxable income (determined without regard to section 250), then the amount of FDII and GILTI taken into account for purposes of section 250 must be reduced. For this purpose: (i) FDII shall be reduced using the same ratio to that total excess as FDII bears to the sum of the FDII and the GILTI, and (ii) the GILTI amount shall be reduced by the remainder of such excess.

A corporation's FDII equals its foreign-derived deduction eligible income divided by its deduction eligible income and multiplied by its deemed intangible income:

$$FDII = \textit{deemed intangible income} \times \frac{\textit{foreign-derived deduction eligible income}}{\textit{deduction eligible income}}$$

For this purpose, "deemed intangible income" means any excess of the domestic corporation's deduction eligible income over the corporation's deemed tangible income return.

The term "deemed tangible income return" means 10 percent of the corporation's qualified business asset investment as defined in section 951(A)(d), but substituting deduction eligible income for tested income and without regard to whether the corporation is a controlled foreign corporation. As noted in our previous article, "qualified business asset investment" is the entity's average aggregate adjusted basis (as of the close of each quarter of the tax year) in specified tangible property. "Specified tangible property" means property used in a trade or business that is of a type for which a deduction is allowable under section 167.

"Deduction eligible income" is the excess of a domestic corporation's gross income, over the deductions (including taxes) properly allocable to that gross income. For this purpose, the following items are excluded from gross income:

- any amount included in gross income under section 951(a)(1), that is, subpart F income;
- GILTI;
- financial services income;
- dividends from CFCs of the domestic corporation;
- domestic oil and gas extraction income; and
- foreign branch income.

The term "foreign-derived deduction eligible income" means any deduction eligible income that is derived from:

- property that:
  - is sold by the taxpayer to any person who is not a U.S. person; and
  - the taxpayer establishes to the satisfaction of the Treasury is for foreign use; or
- services that the taxpayer establishes to the satisfaction of the Treasury are provided by the taxpayer to any person — or regarding any property — not located in the United States.[1]

Case Study

XYZ Technology Corp. (XYZ US) is — as it was in our previous article — a U.S. publicly traded company that produces software and distributes it globally.

Several years ago, XYZ US formed XYZ International, a nonresident Irish company that is tax resident in Malta. XYZ US transferred the non-U.S. rights to its IP to XYZ International through a license agreement (the buy-in). Coterminous with the buy-in, XYZ US and XYZ International entered into a cost-sharing agreement to jointly fund the continuing and future development of the XYZ IP.

[1] Section 250(b)(5) provides special rules for when property or services are provided to domestic intermediaries and for related-party transactions.

Figure 1. Double Irish Structure

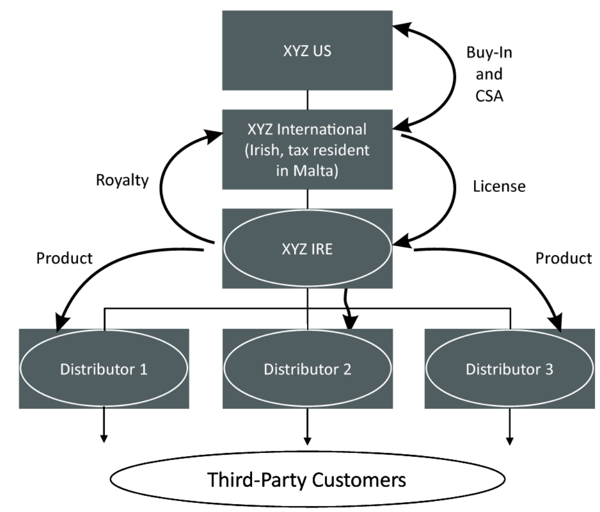

Table 1. Inputs and Assumptions

1. U.S. Tax Rate	21.0%
2. Irish Tax Rate	12.5%
3. Maltese Tax Rate	0.0%
4. Allowed Return on QBAI Investment	10.0%
5. Deemed Paid Credit Proportion	80.0%
6. Deduction for GILTI Amount Through 2025	50.0%

Thereafter, XYZ International formed XYZ Ireland, a resident Irish company that was checked to be treated as a disregarded entity for U.S. federal tax purposes. XYZ International licensed its IP (the non-U.S. rights to the XYZ IP) to XYZ Ireland, which sells its IP and software through various wholly owned cost-plus marketing subsidiaries located throughout Europe and the Pacific Rim (the distributors). The distributors were all checked to be treated as disregarded entities for U.S. federal tax purposes. (See Figure 1.)

Table 2 provides the profit and loss (P&L) statement for the double Irish structure. For the sake of simplicity, it is assumed that all profits from distribution are earned in Ireland. Table 3 then calculates the GILTI, taxes attributable to the GILTI, and deemed paid credit available under this structure. Table 4 calculates the worldwide income tax and effective tax rate under the double Irish structure.

Table 2. P&L Statement (Amounts in US $ (thousands))

	U.S.	International	Ireland*
Revenue			
Sales	-	-	23,000
Royalty	400	3,300	-
CSA Payment	200	-	-
Total Revenue	600	3,300	23,000
Total COGS	-	-	2,700
OPEX			
Bad Debt	-	-	200
G&A	-	-	3,000
CSA Payment	-	200	-
Marketing	-	-	2,200
Sales	-	-	7,500
OPEX - D&A	-	-	2,500
Royalty	-	400	3,300
Total OPEX	-	600	18,700
Other Expenses			
Interest & Other Expense	-	-	20
Sales Tax	-	-	700
Other Expenses	-	-	720
Profit	600	2,700	880
Income Taxes	126	-	110

*For simplicity, it is assumed that all profits from distribution are earned in Ireland.

Table 3. GILTI Calculation (Amounts in US $ (thousands))

Foreign Operating Profits		3,580
Foreign Income Taxes		110
Net CFC Tested Income (Loss)		3,470
PP&E		2,300
Depreciation		<450>
Qualified Business Asset Investment (QBAI)		1,850
Interest Expense		20
Net Deemed Tangible Income Return	10.0%	165
Global Intangible Low-Taxed Income (GILTI)		3,305
Inclusion Percentage		95.24%
Taxes Attributable to GILTI		105
Deemed Paid Credit Available (FTC)	80.0%	84

In contrast, in the U.S.-centric structure, XYZ US produces software and holds both the U.S. and non-U.S. rights to its technology. XYZ has formed distribution subsidiaries in various jurisdictions that are treated as corporations for U.S. tax purposes (the distributors). XYZ US sells its software to the distributors, and the distributors sell the software to third-party customers in their countries of incorporation. (See Figure 2.)

Figure 2. U.S.-Centric Structure

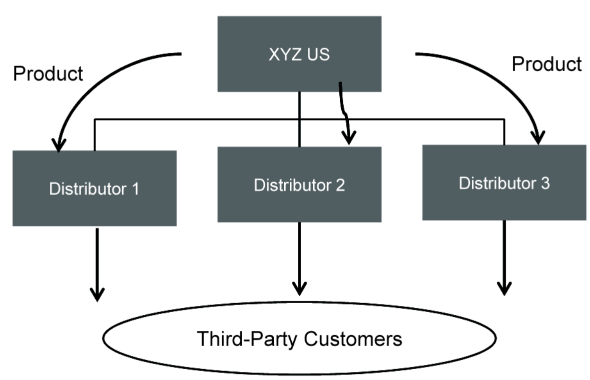

**Table 4. Post-TCJA Tax Liability
(Amounts in US $ (thousands))**

	U.S.	International	Ireland
Total Revenue	600	3,300	23,000
Total Expenses	-	<600>	<22,120>
Net Profit	600	2,700	880
Local Income Tax Rate	21%	0%	12.5%
Income Taxes Due Pre-GILTI	126	-	**110**
GILTI Inclusion	3,305		
Section 78 Gross-Up	105		
Section 250 Deduction	<1,705>		
Adjusted Income	1,705		
U.S. Tax on GILTI (21%)	358		
FTC Against GILTI	84		
Total U.S. Tax After FTC*	**400**		
Maltese Income Tax	-		
Irish Income Tax	**110**		
Worldwide Income Tax	**510**		
Effective Tax Rate**	**12.21%**		

*400 (Total U.S. Tax After FTC) = 126 (U.S. Income Taxes Due Pre-GILTI) + 358 (U.S. Tax on GILTI) - 84 (FTC Against GILTI)

**ETR = 510/4,180

Table 5 provides the P&L statement for the U.S.-centric model. Table 6 calculates the FDII deduction. Table 7 calculates the U.S. tax on XYZ US's income and its effective tax rate. Lastly, Table 8 compares the results of the double Irish structure with the U.S.-centric structure.

**Table 5. P&L Statement
(Amounts in US $ (thousands))**

	U.S.
Revenue	
Sales	23,000
Royalty	-
Total Revenue	23,000
Total COGS	2,700
OPEX	
Bad Debt	200
G&A	3,000
Marketing	2,200
Sales	7,500
OPEX - D&A	2,500
Total OPEX	15,400
Other Expenses	
Interest & Other Expense	20
Sales Tax	700
Other Expenses	720
Profit	4,180

**Table 6. FDII Calculation
(Amounts in US $ (thousands))**

Deduction Eligible Income		4,180
Foreign-Derived Deduction Eligible Income		4,180
PP&E		2,300
Book Depreciation		(450)
Qualified Business Asset Investment (QBAI)		1,850
Deemed Tangible Income Return	10.00%	185
Deemed Intangible Income		3,995
Foreign-Derived Intangible Income (FDII)		3,995
Deduction for FDII (37.5% until 2025)		1,498

Table 7. Post-TCJA Tax Liability (Amounts in US $ (thousands))

	U.S.
Total Revenue	23,000
Total Expenses	18,820
Net Profit	4,180
FDII Deduction	1,498
Adjusted Income	2,682
U.S. Tax (21%)	563
Effective Tax Rate**	13.47%

*For the sake of simplicity, direct foreign tax credits are not taken into account.

**ETR = (563/4,180)

Table 8. Comparison – Double vs. U.S.-Centric Structure (Amounts in US $ (thousands))

	Double Irish	FDII Structure	Difference
Worldwide Tax	510	563	53
International Operating Profit	4,180	4,180	—
Estimated Tax Rate	12.21%	13.47%	1.26%

On these facts, the double Irish structure continues to deliver tax savings over the U.S.-centric structure, albeit not quite as dramatically as before the TCJA. ■