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International Tax Insider

Foreign-derived intangible income Deduction ("FDII"): The new tax benefit for corporate exporters

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Background

The 2017 Tax Cuts a Jobs Act ("2017 TCJA") was one of the most sweeping tax reforms in the past 30 years. The new tax law provided tremendous corporate tax planning opportunities. One exciting new corporate tax planning opportunity was prescribed under IRC §250(a), the Foreign-derived intangible income deduction ("FDII").

This new tax deduction was included in the 2017 TCJA with the intention of encouraging United States exports. The essence of this new regulation is that U.S. "C" Corporations that sell goods and services to foreign customers may be eligible to reduce the effective tax rate on certain qualifying income to 13.125%.

Conceptually, the United States Congress set the stage for this new "FDII" tax deduction to work in tandem with the new "GILTI" tax regime in order to make a favorable impact to the United States economy.

As you may be aware, the new "GILTI" regulations impose U.S. taxes on certain foreign income earned by foreign corporations that are controlled by U.S. taxpayers. This was implemented as a deterrent to U.S. taxpayers from making foreign investments and to encourage the repatriation of foreign earnings.

Conversely, the new "FDII" regulations prescribe certain tax benefits to U.S. taxpayers that sell goods and services to foreign customers. As a result, this two-pronged approach of taxing certain overseas profits and implementation of tax benefits for certain U.S. exports was designed to impact the paradigm of global fiscal policy.

FDII Tax Rates

	12/31/2017 to 12/31/2025	1/1/2026 and beyond
Tax Rate	13.125%	16.406%

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How does it work?

In order to calculate the potential tax deduction, you need to calculate a few components of the calculation.

Technical Term		Common Term
Deduction-eligible income	=	Gross Income
Foreign-derived deduction eligible income	=	Foreign Income
QBAI	=	Adjusted Basis of Depreciable Tangible Property
QBAI Exemption	=	10% of QBAI (Adjusted Basis of Depreciable Tangible Property)
Deemed Intangible Income	=	Gross Income less QBAI exemption
FDII Income	=	Deemed Intangible Income x Percentage of Foreign Income to Total Income
FDII Deduction	=	Amount of Income Excluded from Corporate Tax The FDII exclusion rate is 37.5%

To illustrate the tax deduction, let's look at an example.

Example Data

Foreign Income	20,000,000
Gross Incomne	100,000,000
QBAI	2,000,000

Calculation

Step 1 Determine Deemed Intangible Income

Gross income	100,000,000
Less QBAI exemption (10%)	200,000
Deemed Intangible Income	99,800,000

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Step 2 Determine FDII Taxable Income

FDII Income	[99.8 million x (20 million / 100 million)]	19,960,000
FDII Deduction	[19.96 million x 37.5%]	(7,485,000)
FDII Taxable Income		12,475,000

Step 3 Determine Tax on FDII Tax Income

FDII Taxable Income	12,475,000
Corporate Tax Rate	21.0%
Corporate Tax on FDII Income	2,619,750

Tax Savings

FDII Income	19,960,000
Corporate Tax Rate	21.0%
Estimated Corporate Tax without FDII Tax Credit	4,191,600
Corporate Tax	4,191,600
Corporate Tax on FDII income per new FDII Regulations	2,619,750
Tax Savings under FDII Regulations	1,571,850

Check

FDII Income Excluded from Corporate Tax	7,485,000
Corporate Tax Rate	21.0%
Tax Savings under FDII Regulations	1,571,850