

# Transformative Shifts in International Taxation

As global commerce flourishes in the new digital era, countries worldwide are keen on developing international tax laws to dissuade profit-shifting and tax avoidance by multinational enterprises, while simultaneously keeping their markets competitive. As the U.S. continues to adapt its international tax regime to an everchanging global landscape, 2025 brought numerous changes that will dramatically reshape the international tax arena. With the passage of the OBBB and several significant rulings and treaties, businesses must quickly adapt their tax strategies in a landscape that grows more complex by the year.

## U.S. Tax Treaty Updates: Spotlight on Belarus Suspension

The U.S. Department of the Treasury and the Republic of Belarus mutually agreed to suspend part of the income tax treaty established in 1973 between the two countries, effective December 17, 2024, through December 31, 2026. Due to the suspension, interest on credits, loans, and other forms of indebtedness connected with the financing of trade between the two countries may be subject to taxation in both the U.S. and the Republic of Belarus. Withholding agents should take extra care when applying the applicable tax rate for these income types, as both withholding and other forms of taxation are covered by the suspension.

## Proposed PTEP Regulations Gain Clarity

The U.S. Department of the Treasury released lengthy proposed regulations (REG-105479-18) that address numerous matters relating to previously taxed earnings and profits (PTEP) of foreign corporations for U.S. shareholders. The rules governing IRC §959 and IRC §961 are designed to prevent double taxation of earnings from foreign corporations owned by U.S. shareholders. Generally, IRC §959 allows U.S. shareholders to exclude PTEP from current year income, and IRC §961 allows shareholders to adjust their basis in stock of foreign corporations for income that was previously taxable on their U.S. return.

For years, the government has acknowledged that clarity was desperately needed on these code sections as the rules for tracking basis quickly grew complex, especially following the passage of the TCJA, which introduced new provisions for recognizing foreign income from controlled foreign corporations. The long-awaited proposed regulations are intended to clarify and resolve basis tracking issues for controlled foreign corporations. These regulations are expected to apply to tax years beginning on or after the date that the final regulations are enacted.



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## Transfer Pricing in a Digital Age: *Facebook, Inc. v. Commissioner*

In May of 2025, the landmark case of *Facebook, Inc. v. Commissioner* set a precedent for how the IRS scrutinizes transfer pricing agreements involving intangible assets shared by a subsidiary in a low-tax jurisdiction and a U.S. entity. The dispute revolved around Facebook's 2010 cost-sharing agreement with its Irish subsidiary for intangible assets that were used and developed by both entities. Under the general rules of the cost-sharing agreement, the Irish subsidiary was required to pay income to the U.S. entity for its use of the various Facebook platforms. However, costs for maintaining and developing the platforms would be split between the two entities. The pricing compensation and costs paid were governed by IRC §482 and Treasury Regulations §1.482-1 through §1.482-8, which require the use of the best available method to yield the most reliable arm's length transaction. A central point of contention between the IRS and Facebook was over which method produced the most reliable arm's length transaction. The IRS further scrutinized some of the inputs and projections Facebook used to determine its pricing valuations.

Ultimately, the tax court ruled that Facebook undervalued its pricing structure with the method it chose for determining the arm's length value of compensation paid by the Irish subsidiary to the U.S., as well as for expenses allocated between the entities. The court provided adjusted amounts for the arm's length calculations for both income and costs between the entities, resulting in higher U.S. tax liabilities for Facebook, Inc.

The outcome of this case highlights the necessity for companies sharing the cost of intangible assets with foreign subsidiaries or controlling entities to carefully review the terms of their transfer pricing agreements to determine whether they are utilizing the best method for arm's length transactions. It is likely that the IRS will conduct further audits into transfer-pricing agreements

for companies sharing intangible assets in the future, thus businesses should proactively review these agreements to maintain compliance as the entities evolve.

## The OBBB Affect in International Taxation

In the world of international taxation, the OBBB represents a sweeping overhaul in U.S. policy. Strategic tax planning is a necessity now more than ever for businesses to properly calculate the impacts of these changes in relation to tax returns with international components. While most changes mandated by the bill become effective for taxable years beginning after December 31, 2025, there are a few key changes that take effect earlier which could impact 2025 tax returns, including:

### Changes to income included in DEI

The OBBB modifies the method for calculating deduction-eligible income (DEI), which is used to calculate foreign-derived deduction-eligible income (FDDEI, formerly FDII). The DEI definition has been amended to include a new subclause to the list of items that are excluded from determining DEI. In particular, the subclause added excludes any income and gain from the sale or other disposition of intangible property and any other property that is subject to depreciation or amortization. Meaning, this type of income is no longer eligible for a FDDEI deduction. The impact of this amendment will vary depending on the type of income that corporations have on a year-to-year basis. This amendment will apply to any sales or dispositions occurring after June 16, 2025.

### Disallowance of a foreign tax credit related to distributions of previously taxed NCTI

Under the bill, shareholders are not permitted to claim a foreign tax credit for 10% of any foreign income taxes paid or accrued in connection to the previously taxed net controlled foreign corporation (CFC) tested income taken as a distribution by the shareholder. This new rule applies to any distributions made after June 28, 2025, potentially impacting the foreign tax credits available to offset tax due on the net CFC tested income for shareholders of controlled foreign corporations.

### Updated tax year requirements for specified foreign corporations

IRC §898(c) has been amended to provide that specified foreign corporations, which are CFCs where a U.S. person owns more than 50% of the total voting power or value

of stock, are no longer allowed to have a year that is one month earlier than the majority of U.S. shareholders tax year. Now, corporations must have the same tax year as the majority of U.S. shareholders. Specified foreign corporations subject to this change will begin transitioning after November 30, 2025, and will receive transition guidance from the U.S. Secretary of State.

## International Tax Changes Effective for Tax Years Beginning in 2026:

### Foreign Tax Credit

The OBBB introduces significant changes in the ways that the foreign tax credit (FTC) is calculated. The FTC generally allows taxpayers to take a dollar-for-dollar reduction in taxes for taxes paid to foreign governments on income that is being taxed in the U.S.

For shareholders of controlled foreign corporations, several key updates apply:

- **NCTI must be reduced by the allowed NCTI deduction:** Any deduction allowed under IRC §250(a)(1)(B), commonly known as GILTI but will be referred to as NCTI for tax years beginning in 2026, must be allocated and apportioned when determining the net CFC tested income. This net income is then used to calculate taxable income and the FTC limitation. The deduction allowed under IRC §250(a)(1)(B) is generally 40% of the net CFC tested income (as amended by the OBBB).
- **Exclusion of interest and R&D expenditures:** Interest and research and development (R&D) expenses are no longer allocated when determining the net CFC tested income for the calculation of taxable income and the FTC limitation.
- **Only directly allocable expenses permitted:** Other deductions related to the net CFC tested income may be considered for FTC limitation purposes, only if the expenses are directly allocable to that income. Any amounts or deductions which are not mentioned will only be allocated or apportioned if the income is sourced within the U.S.

For businesses in inventory production, the following rules apply:

- **Updated sourcing rules for inventory:** IRC §904(b) has been amended to add a new paragraph clarifying the sourcing rules for inventory produced in the U.S.

and sold through foreign branches. This applies to U.S. persons who maintain a foreign office and sell U.S.-produced inventory to customers outside of the U.S. Under the new rules, these sales will be treated as foreign sales for FTC purposes. However, the amount treated as foreign sales should not exceed 50% of the total income from selling the specified inventory.

Under the GILTI (now NCTI) rules, U.S. shareholders who own more than 10% of the value or voting power of a U.S. CFC are required to include specific amounts from their pro-rata share of the foreign corporation's income in their U.S. taxable income.

### GILTI (Now NCTI): Deduction Rate Changes

One of the most notable changes to the Global Intangible Low-Taxed Income (GILTI) is renaming it to Net CFC Tested Income (NCTI). Under the GILTI (now NCTI) rules, U.S. shareholders who own more than 10% of the value or voting power of a U.S. CFC are required to include specific amounts from their pro-rata share of the foreign corporation's income in their U.S. taxable income. This requirement applies when a series of tests determines that the foreign jurisdiction has taxed the income at below average rates. Previously, NCTI income was calculated as the excess of a shareholder's net CFC tested income over the shareholder's net deemed tangible income return for the taxable year. However, the new bill redefines the NCTI calculation to equal the net CFC tested income, removing any consideration of the net deemed tangible income return. This change not only simplifies the calculation for both the NCTI deduction and income inclusions, but it also has the potential to significantly impact the amounts reported on 2026 tax returns.

Key adjustments to NCTI are:

- **Deduction rate change:** Starting in 2026, the deduction rate decreases from 50% (originally enacted in 2017) to 40%.
- **Increased FTC for foreign taxes paid:** The credit for foreign taxes deemed paid will increase from 80% to 90% of the product of the domestic corporation's

inclusion percentage multiplied by the aggregate tested foreign income taxes paid or accrued by CFCs.

### FDII Redefined: Introducing FDDEI

The rules for the Foreign Derived Intangible Income (FDII) deduction, now referred to as Foreign Derived Deduction Eligible Income (FDDEI), have been modified. The deduction grants domestic corporations a reduced tax rate on qualifying income generated from sales made in foreign markets. For tax years before 2026, the FDII (now FDDEI) deduction was equal to 37.5% of the estimated amount of the corporation's foreign derived intangible sales. However, beginning in taxable years after December 31, 2025, the deduction will be equal to 33.34% of qualifying FDDEI, with the new calculation simplified by eliminating the previous complex formula. The deduction is no longer limited to sales exceeding 10% of the adjusted basis of the corporation's tangible business property. This change opens the door for domestic corporations who were previously ineligible for the FDDEI deduction due to not surpassing the business property barrier. In addition, interest and R&D expenses will no longer need to be subtracted when calculating the deduction eligible income.

### Other International Tax Changes

- **BEAT Rate:** The tax rate for the base-erosion and anti-abuse tax (BEAT) permanently increases to 10.5%, rather than increasing to 12% as previously scheduled for 2026.
- **IRC §954(c)(6)(C):** The look-thru rules for income received from related CFCs, originally set to expire after December 31, 2025, will remain in effect permanently providing ongoing clarity on the future of these laws.
- **Refined Downward Attribution Rules:** Amendments to IRC §958(b) clarify that rules for partnerships, estates, trusts, and corporations under IRC §318(a) (3) do not apply to consider stock owned by non-U.S. persons as held by U.S. persons. The addition of a new section called IRC §951B, further outlines the amounts includable in gross income for foreign controlled U.S. shareholders.
- **Redefined CFC Income Inclusion:** IRC §951(a) has been rewritten to more specifically define which shareholders must include CFC income on their tax returns, with the taxable year aligning with that of the CFC.



## Strategic International Tax Planning Amid Change

With several moving parts in the international landscape, businesses must remain proactive and adaptive. Now is the time to review transfer pricing agreements, re-examine ownership and tax structures, and model how the OBDD changes will impact your business.