Tax readiness: A fresh look at stewardship expenses

July 30, 2019

In brief

The comprehensive federal tax reform legislation enacted in late 2017 (the Act) and subsequently issued guidance significantly affect the ability of taxpayers to claim foreign tax credits (FTCs). The ability to claim FTCs is closely tied to how certain expenses — including selling, general, and administrative (SG&A) and stewardship — are allocated and apportioned among different categories of income. Similar rules may also affect foreign-derived intangible income (FDII) benefits. PwC on July 24 hosted a webcast featuring specialists who discussed these issues. This Insight highlights those discussions.

The next Tax Readiness webcast — Accounting methods (and beyond): tax planning and compliance under tax reform — is scheduled for August 6, 2019, from 2:00 PM - 3:00 PM (EDT).

In detail

Stewardship expense allocation and apportionment

Generally, stewardship expenses are expenses incurred by one company for oversight functions performed for the company’s own benefit as an investor in a related company.

Given that dividends, and deemed dividends, from controlled foreign corporations (CFCs) may be income in more than one Section 904 basket, foreign stewardship expenses of the US shareholder could be allocated in part to the global intangible low-taxed income (GILTI) basket (and to the general or passive basket if there is subpart F income). Foreign stewardship arguably also is allocable to foreign earnings eligible for the Section 245A deduction.

Determining the amount of apportionable expenses is important for properly managing GILTI exposure and FDII deductions. Companies should consider conducting an integrated SG&A or HQ study, which would help provide companies a more accurate determination of their stewardship and expense allocations (under Section 861) and a refresh of their transfer pricing (Reg. sec. 1.482-9) studies, especially in light of the reduction in US tax rate following tax reform. Data from a comprehensive SG&A study can be used for multiple analyses, including US outbound Section 482 charges, Section 904 basketing of foreign-source income (e.g., GILTI), and FDII.

Observation: When asked during the July 24 webcast what method their company uses when analyzing SG&A expenses, respondents were divided among interviews (36%); surveys (24%); and apportionment ratios (40%).

Once foreign stewardship expenses have been identified (e.g., via an integrated SG&A study), the Section 861 rules generally require such expenses to be allocated based on foreign
dividends received or to be received, and then apportioned between Section 904(d) baskets using a ‘permissible method.’ Under existing guidance, there appear to be several reasonable apportionment methods for companies to employ regarding foreign stewardship expenses; however, taxpayers should be mindful of the fact that Treasury has yet to issue final regulations.

**Observation:** The provisions of the Act are highly interactive, and changes to the expense apportionment amounts are likely to affect other tax attributes. Taxpayers should consider modeling when analyzing the impact of the Act’s provisions.

**Observation:** When participants in the July 24 webcast were asked what analysis their company has performed in connection with SG&A expenses, 25% said they have conducted an aligned transfer pricing and FTC expense allocation analysis post-Act enactment; 19% said they have only undertaken a pre-Act-enactment transfer pricing management services analysis; 17% said they have only undertaken a pre-Act-enactment stewardship analysis; and 39% said they have not undertaken an analysis.

**The takeaway**

For most companies, calculation of stewardship expenses is an important consideration because of GILTI, FDII, and the ability to claim FTCs in general.

When determining the amount of stewardship expenses, interviews inherently are more accurate than surveys or apportionment. Overall, companies should take an integrated approach that identifies the appropriate amount of stewardship expenses and provides more accurate expense allocations for FTC and FDII purposes.

Finally, companies should be mindful of the interactivity of tax code provisions and of consistency in positions taken.