

## OBBBA Introduces New Carveouts from FDDEI

By Brian Jenn

Although most of the excitement generated by the reconciliation bill known as the “One Big Beautiful Bill Act” (OBBBA) arose from changes to the domestic provisions of the Code, taxpayers are also grappling with some changes to the international provisions of the Code. My most recent Note described the new regime under Code Sec. 951B, which backstops the repeal of downward attribution under Code Sec. 958(b) by applying a parallel U.S. tax system that will mainly impact foreign individual and foreign-based multinational groups. U.S. multinational groups, on the other hand, are grappling with changes to the foreign-derived intangible income (FDII) regime and global intangible low-taxed income (GILTI) regimes, which will henceforth be known as the foreign-derived deduction eligible income (FDDEI) and net CFC (Controlled Foreign Corporation) tested income (NCTI) regimes.

The most obvious changes to GILTI/NCTI and FDII/FDDEI were slight rate increases in both regimes, bringing the effective rate on GILTI/NCTI and FDII/FDDEI to 14% on a permanent (or at least sunset-free) basis, as well as the elimination of qualified business asset investment (QBAI) as a factor in the calculations under both regimes.<sup>1</sup> More subtly, there were changes to expense allocation rules affecting both regimes, eliminating the allocation of interest expense and research and experimentation expense to FDDEI and to the Code Sec. 951A category under Code Sec. 904. Finally, OBBBA introduced important new carveouts to the scope of income that qualifies for FDDEI. This Note will focus on those new carveouts, which raise some interpretational questions that should ultimately be addressed through regulations but which will require taxpayers to carefully consider positions in the meantime.



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### New FDDEI Exclusion for Intangible Property Sales

OBBBA introduced two new exclusions from the Code Sec. 250(b)(3) definition of “deduction eligible income” (DEI), which forms the basis for the calculation of FDDEI eligible for the Code Sec. 250 deduction. The first new exclusion (the “IP Exclusion”), contained in Code Sec. 250(b)(3)(A)(i)(VII)(aa)), is for “any income and gain from the sale or other disposition (including pursuant to

the deemed sale or other deemed disposition or a transaction subject to Code Sec. 367(d) of ... intangible property (as defined in Code Sec. 367(d)).”

The IP Exclusion applies to any transfer of intangible property that constitutes a sale or other disposition for U.S. federal income tax purposes, whether to a related party or an unrelated party. Thus, taxpayers will need to determine whether a transaction that is nominally a license of intangible property actually constitutes a sale or exchange of the intangible property for U.S. federal income tax purposes, which generally will be the case in the view of the Internal Revenue Service (IRS) when “all substantial rights” with respect to the property have been transferred.<sup>2</sup>

*One would hope that Treasury and the IRS exercise that authority as they have in the past, including carveouts for previously agreed transactions.*

It should be noted that although a true license transaction is generally considered a “sale” for purposes of Code Sec. 250, such treatment does not extend to the new IP Exclusion. Thus, apart from Code Sec. 367(d), royalty income should still qualify as DEI and be potentially eligible for the Code Sec. 250 deduction. In particular, although Code Sec. 250(b)(2)(E) provides that for purposes of Code Sec. 250(b) the term “sale” includes any lease, license, exchange, or other disposition, OBBBA added language to this paragraph explicitly providing that it does not apply for purposes of Code Sec. 250(b)(3)(A)(i)(VII), which includes the IP Exclusion.

As noted above, the deemed royalty resulting from a transaction subject to Code Sec. 367(d), including an outbound transfer described in Code Sec. 351 or an outbound transfer as part of a reorganization that is subject to Code Sec. 361, will fall within the IP Exclusion and will no longer qualify for the Code Sec. 250 deduction. This change makes being subject to the Code Sec. 367(d) regime, which in many routine cases of post-acquisition integration can be unavoidable, even more punitive than it was pre-OBBBA. With this change, a deemed Code Sec. 367(d) royalty may reduce tested income subject to a 14% rate (which may have no tax effect at all if there are excess foreign tax credits (FTCs) in the Code Sec. 951A category) but be included in income at a 21% rate, without

reducing foreign tax liability. The legislative history of OBBBA does not provide any clear indication of the purpose of this change, although it may be intended to discourage outbidding of intangible property or to prevent a Code Sec. 250 deduction for income from intangible property that results from research and experimentation (R&E) that may have qualified for a current deduction.

## New FDDEI Exclusion for Sales of Cost Recovery Property

The second of the new exclusions from DEI under OBBBA applies to sales of property that is subject to a cost recovery allowance (the “Cost Recovery Property Exclusion”). In particular, under new Code Sec. 250(b)(3)(A)(i)(VII)(bb)), DEI now excludes “any income and gain from the sale or other disposition (including pursuant to the deemed sale or other deemed disposition or a transaction subject to Code Sec. 367(d)) of ... any other property [other than intangible property] of a type that is subject to depreciation, amortization, or depletion by the seller ....”

Like the IP Exclusion, the Cost Recovery Property Exclusion applies only to transfers of property that constitute a sale or other disposition of the property. This presumably would include gain recognized under Code Sec. 367(a) on an outbound transfer of cost recovery property in a transaction described in Code Sec. 351 or 361. The Cost Recovery Property Exclusion should not apply to rental income from leasing a property to a foreign person or to the use of depreciable property to provide services to a foreign person. Nonetheless, combined with the IP Exclusion, the Cost Recover Property Exclusion will significantly increase the cost of certain routine transactions, including the outbound transfer of a foreign branch or a sale of assets to an unrelated foreign purchaser.

The Cost Recovery Property Exclusion rather curiously refers to property “of a type that is subject to” cost recovery allowances, introducing some uncertainty regarding the scope of the exclusion. In particular, taxpayers that make and sell property that is subject to depreciation in the hands of the user may question whether, if they also use and depreciate the same property in their own business, the property that they sell might be “of a type” that is subject to a cost recovery allowance. Consider, for example, an equipment manufacturer that both sells the equipment to some customers and uses the same equipment to provide services for other customers.

Fortunately, there are good reasons to believe that the property that is sold to customers should not fall within the Cost Recovery Property Exclusion. Although there is no legislative history that would indicate the purpose of the exclusion, it seems likely that it is intended to prevent a perceived double benefit, where a taxpayer may claim depreciation deductions that reduce property basis and—in some cases—lead to gain that otherwise would qualify for a Code Sec. 250 deduction when the property is transferred to a foreign person. This purpose does not require excluding gain on inventory sales from FDDEI. In fact, doing so would arbitrarily disadvantage certain taxpayers based on their business model and would appear contrary to the (apparently) broader purpose of the FDDEI regime to put income from sales by U.S. persons to foreign persons on par with comparable sales by CFCs.

Additionally, Treasury and the IRS have previously interpreted statutory “of a type” language in a favorable manner, specific to a particular item of property, in the context of QBAI. Under Code Sec. 951A(d)(1), QBAI is defined as property ... “of a type with respect to which a deduction is allowable under Code Sec. 167.” Reg. §1.951A-3 applies this definition on the basis of specific items of property and even contains special provisions subdividing property (as partially QBAI and partially non-QBAI) in cases where the property generates income that is gross tested income and income that is not gross tested income (*i.e.*, dual use property). A similarly

granular approach in interpreting the Cost Recovery Property Exclusion would lead to the conclusion that income from the sale of inventory property should never be subject to the Cost Recovery Property Exclusion and should always fall within DEI.

## Retroactive Effective Dates and Regulatory Authority

Unlike most other OBBBA tax provisions, both the IP Exclusion and the Cost Recovery Property Exclusion are effective retroactively, applying to sales or other dispositions occurring after June 16, 2025. Some taxpayers who had binding third-party agreements to sell assets to a foreign purchaser as of June 16, 2025, but who had not completed the sale by that day, are facing higher rates on their asset sales than they had contemplated. In this regard, however, it is notable that OBBBA specifically provides Treasury and the IRS authority to remove certain transactions from the scope of the IP Exclusion and the Cost Recovery Property Exclusion. One would hope that Treasury and the IRS exercise that authority as they have in the past, including carveouts for previously agreed transactions. More generally, one would hope that Treasury also would use the authority to create exceptions from the new Exclusions for commonplace business transactions, including the outbound transfer of foreign branches with routine intangibles.

### ENDNOTES

- <sup>1</sup> The 14% effective rate on GILTI takes into account the foreign tax credit haircut under Code Sec. 960(d), which was decreased from 20% to 10%.
- <sup>2</sup> See, e.g., Rev. Proc. 83-59, 1983-2 CB 575 (indicating that order to receive a favorable Code Sec. 351(a) ruling from the Service on a transfer

of patent rights, the applicant must represent that the transfer qualifies under Code Sec. 1235, which provides an “all substantial rights” test for determining whether a transfer of patent rights qualifies as a sale of a capital asset, such that the transferor’s income/gain qualifies for

capital gain treatment, and that for transfers of trademarks, the applicant must represent that the trademark transfer satisfies the requirements of Code Sec. 1253, which provides a similar test for determining whether a transfer of trademark rights gives rise to capital gain).

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