Q. What is foreign-derived intangible income and how is it taxed under the TCJA?

A. Foreign derived intangible income is income that comes from exporting products tied to intangible assets, such as patents, trademarks, and copyrights, held in the United States. The Tax Cuts and Jobs Act taxes this income at a reduced rate.

As part of the 2017 Tax Cuts and Jobs Act, Congress lowered the tax rate for US corporations' foreign-derived intangible income (FDII). Congress effectively reduced the tax rate on foreign-derived sales and service income to 13.125 percent, rather than the regular 21 percent, seeking to encourage US corporations to export more goods and services, and locate more intangible assets in the United States.

The FDII computation is complicated, but it is intended to approximate income from the sale of goods and services abroad attributable to US-based intangible assets such as patents, trademarks, and copyrights. As with the provisions of the new law related to global intangible low-taxed income, Congress approximated the income attributable to a US firm's intangible assets by the income that exceeds a 10 percent deemed return on its depreciable tangible property. The share of the excess income allocated to the sale of goods and services abroad is taxed at a reduced rate.

For example, suppose a US corporation earned $100 million, with tangible assets of $200 million. The firm would allocate the deemed intangible income, $80 million ($100 million of earnings−$20 million deemed return on its tangible assets), between foreign and domestic sales of goods and services. The United States would tax the share of the $80 million allocated to foreign sales at 13.125, rather than the regular 21 percent. In 2026, the rate on FDII will rise from 13.125 to 16.83 percent.

Further Reading

Gravelle, Jane G., and Donald J. Marples. 2018. "Issues in International Corporate Taxation: The 2017 Revision (P.L. 115-97)." CRS Report R45186. Washington, DC: Congressional Research Service.

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