Internal Revenue Service
DEPARTMENT OF THE TREASURY

LB&I Concept Unit

Unit Name	IRC Section 250 Deduction: Foreign-Derived Intangible Income (FDII)	
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Book	Foreign-Derived Intangible Income (FDII)
Chapter	IRC 250 Deduction: Foreign-Derived Intangible Income (FDII) and Global Intangible Low-Taxed Income (GILTI)

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General Overview

IRC Section 250 Deduction: Foreign-Derived Intangible Income (FDII)

The Tax Cuts and Jobs Act enacted section 250, which provides for a deduction with respect to Global Intangible Low-Taxed Income (GILTI) and Foreign-Derived Intangible Income (FDII). The deduction is only available to domestic corporations (except that the GILTI deduction is also available to individuals that make a section 962 election).

The section 250 deduction helps neutralize the role that tax considerations play when a domestic corporation chooses the location of intangible income attributable to foreign-market activity, that is, whether to earn such income through its controlled foreign corporations (CFCs) or through its U.S.-based operations.

For income earned by a domestic corporation through its CFCs, section 250 provides a deduction of 50%* of GILTI (including the section 78 gross-up).

For income earned by a domestic corporation through its U.S.-based operations, section 250 provides a deduction of 37.5%* of FDII.

The section 250 deduction is limited if a domestic corporation's taxable income (not taking into account the section 250 deduction) is less than the sum of its GILTI and FDII.

*The percentages are reduced to 37.5% (GILTI) and 21.875% (FDII) for taxable years beginning after December 31, 2025.

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General Overview (cont'd)

IRC Section 250 Deduction: Foreign-Derived Intangible Income (FDII)

Section 250 Deduction = **50% of (GILTI + Section 78 gross-up)** + **37.5% of FDII**

- Section 250 is effective for taxable years beginning after December 31, 2017.
- Proposed Section 250 Regulations were released in March 2019.
- Final Section 250 Regulations were published on July 15, 2020.

- The Final Section 250 Regulations apply to tax years beginning on or after January 1, 2021.
- For tax years beginning before January 1, 2021, taxpayers may:
  - Rely on the Proposed Regulations in their entirety (but taxpayers may rely on the special transition rule for documentation for all taxable years beginning before January 1, 2021); or
  - Apply the Final Regulations in their entirety (excluding certain substantiation requirements and once applied, must be applied for all subsequent years); or
  - Apply a reasonable interpretation of the statute.

Detailed Explanation of the Concept

IRC Section 250 Deduction: Foreign-Derived Intangible Income (FDII)
Facts of Concept

Analysis	Resources
The FDII deduction under section 250 comes down to two basic questions: ▪ What is the intangible income a domestic corporation is deemed to produce? ▪ What part of this intangible income is foreign derived? Taxpayers answer these questions by following these 4 steps: Step 1. Determine Deduction Eligible Income (DEI) Step 2. Calculate Deemed Intangible Income (DII) Step 3. Determine Foreign-Derived Deduction Eligible Income (FDDEI) Step 4. Calculate the FDII deduction under section 250 using the amounts determined in steps 1 through 3.	

Detailed Explanation of the Concept (cont'd)

IRC Section 250 Deduction: Foreign-Derived Intangible Income (FDII)
Step 1: Determine Deduction Eligible Income (DEI)

Analysis	Resources
DEI is the excess of a domestic corporation's gross income, without regard to certain excluded categories of income, over the deductions properly allocable to such gross income. Excluded Categories of Income: ▪ Amounts included in gross income under section 951(a)(1) (including section 78 gross up amounts); ▪ Global intangible low-taxed income under section 951A (including section 78 gross up amounts); ▪ Financial services income (as defined in section 904(d)(2)(D) and Treas. Reg. § 1.904-4(e)(1)(ii)); ▪ Dividends received from a CFC; ▪ Domestic oil and gas extraction income; and ▪ Foreign branch income (as defined in section 904(d)(2)(J)). Deductions Properly Allocable: ▪ The domestic corporation's deductions (including taxes) are then properly allocated to gross DEI to arrive at DEI.	▪ IRC 250(b)(3) ▪ Form 8993 (Dec. 2020) Part I, and accompanying Instructions

Detailed Explanation of the Concept (cont'd)

IRC Section 250 Deduction: Foreign-Derived Intangible Income (FDII)
Step 2: Calculate Deemed Intangible Income (DII)

Analysis	Resources
DII means the excess (if any) of the domestic corporation's DEI, over the corporation's Deemed Tangible Income Return (DTIR). DTIR is an estimation of the corporation's income attributable to its tangible assets and is defined as 10% of the corporation's Qualified Business Asset Investment (QBAI). QBAI is the domestic corporation's average aggregate adjusted basis, determined quarterly, in specified tangible property. Specified tangible property is any depreciable tangible property that is utilized in the production of gross DEI for the taxable year. DTIR = 10% * QBAI DII = DEI – DTIR	▪ IRC 250(b)(2) ▪ Form 8993 (Dec. 2020), Part I, and Accompanying Instructions

Detailed Explanation of the Concept (cont’d)

IRC Section 250 Deduction: Foreign-Derived Intangible Income (FDII)
Step 3: Determine Foreign Derived Deduction Eligible Income (FDDEI)

Analysis	Resources
FDDEI is any DEI which is derived in connection with: ▪ PROPERTY which is SOLD by the taxpayer to any person who is not a United States person, and which is for a foreign use; or ▪ SERVICES provided by the taxpayer to any person, or with respect to property, not located within the United States. FDDEI is a subset of DEI. Because DEI is a net income amount, it is important that FDDEI is likewise a net amount. A domestic corporation’s deductions must be properly allocated to gross FDDEI to arrive at FDDEI.	▪ IRC 250(b)(4) ▪ Form 8993 (Dec. 2020), Part II, and Accompanying Instructions

Detailed Explanation of the Concept (cont'd)

IRC Section 250 Deduction: Foreign-Derived Intangible Income (FDII)
Step 3: Determine Foreign Derived Deduction Eligible Income (FDDEI) (cont'd)

FDDEI Sales	**FDDEI Services**
FDDEI Sales include sales of property by the taxpayer: ▪ to a foreign person, and ▪ for a foreign use. Sales include any lease, license, exchange, or other disposition. Foreign use means any use, consumption, or disposition which is not within the U.S. FDDEI Sales do not include sales to another person (other than a related party) for further manufacture within the U.S., even if such other person subsequently uses the property for a foreign use. Related party transactions: Foreign use does not include sales to related parties unless the sale is followed by a sale or service to an unrelated foreign person, where such property is for foreign use.	FDDEI Services include services provided by the taxpayer: ▪ to any person not located in the U.S., or ▪ with respect to property not located in the U.S. FDDEI Services do not include services provided to another person located within the U.S., even if such other person uses the services in providing services that meet the FDDEI Services requirements. Related party transactions: Services provided to a related party must not be substantially similar to services provided by such related party to persons located in the U.S.
A transaction that includes elements of both sales and services is classified according to its overall predominate character.	

Detailed Explanation of the Concept (cont'd)

IRC Section 250 Deduction: Foreign-Derived Intangible Income (FDII)
Step 4: Calculate the FDII deduction under section 250

Analysis	Resources
Once the components in Steps 1 through 3 have been determined, a domestic corporation's FDII can be computed. This is accomplished by multiplying Deemed Intangible Income (DII Step 2) by the Foreign-Derived Ratio (FDR). The FDR is the ratio of the corporation's Foreign-Derived Deduction Eligible Income (FDDEI Step 3) over Deduction Eligible Income (DEI Step 1) for the year. $FDII = \underbrace{\frac{FDDEI}{DEI}}_{\textbf{FDR}} * \underbrace{(DEI - \underbrace{(10\% * QBAI)}_{\textbf{DTIR}})}_{\textbf{DII}}$ FDII is then multiplied by 37.5% (21.875% for taxable years beginning after 2025) to arrive at the FDII deduction under section 250. This amount is reported on a domestic corporation's Form 1120, Schedule C. Reminder: If the sum of FDII and GILTI exceeds taxable income, then FDII and GILTI will be limited. FDII will be reduced by the same ratio to total excess taxable income, as such FDII bears to the sum of FDII and GILTI. And GILTI will be reduced by the remainder of such excess.	▪ IRC 250(b)(1) ▪ Form 8993 (Dec. 2020) Part III, and accompanying Instructions

Detailed Explanation of the Concept (cont'd)

IRC Section 250 Deduction: Foreign-Derived Intangible Income (FDII)
Other Considerations: Foreign Tax Credits

Analysis	Resources
Foreign tax credits are not part of the FDII computation. But note: ▪ FDII eligible sales and services gross income which is also foreign source, is typically included in the general category of income for purposes of Form 1118. ▪ The FDII deduction amount allocated and apportioned to foreign source income is entered on Form 1118, Sch. A, col. 14(b). This amount may not tie to the FDII deduction reported on Form 8993 because some of the deduction may be allocated to FDII eligible income that is U.S. source for FTC purposes. Foreign Source Income for Form 1118 purposes is not the same as Foreign Derived Income for FDII. ▪ Foreign taxes relating to FDII sales or services are reported on Form 1118, Sch. B, Part I. ▪ It is possible for certain income to receive a deduction under section 250 as well as an FTC.	

Example of the Concept

IRC Section 250 Deduction: Foreign-Derived Intangible Income (FDII)
FDII – Example - Facts
▪ US Parent (USP) is a domestic corporation that manufactures and sells property to unrelated foreign and domestic customers. ▪ USP generates only deduction eligible income in its business (no exclusion items). ▪ USP has a quarterly average adjusted basis of $1,200 in specified tangible property (QBAI). ▪ USP sells $100 (gross) to U.S. customers (to which there are $20 of allocable deductions). ▪ USP sells $300 (gross) to foreign customers (to which there are $60 of allocable deductions). ▪ USP has gross income of $400 ($100+$300) and total deductions of $80 ($20 + $60).

Example of the Concept (cont'd)

IRC Section 250 Deduction: Foreign-Derived Intangible Income (FDII)

FDII Example – Step 1: Determine DEI

STEP 1

DEI = Gross Income – Exclusions – Allocable Deductions

Gross Income (Form 1120, Line 11)	$400	
Less subpart F Inclusions	0	Specifically Excluded categories of income
Less GILTI	0	
Less Financial Services Income	0	
Less CFC Dividends	0	
Less Domestic Oil and Gas Extraction Income	0	
Less Foreign Branch Income	0	
Gross Income Less Exclusions	400	
Less deductions (incl. taxes) properly allocable to DEI	(80)	
DEI	**$320**	

Example of the Concept (cont’d)

IRC Section 250 Deduction: Foreign-Derived Intangible Income (FDII)

FDII Example – Step 2: Calculate DII

STEP 2

DII = DEI – DTIR

DTIR = 10% x QBAI:

QBAI	$1,200
Multiplied by 10%	x 10%
DTIR	$120

DII:

DEI	$320
Less DTIR	($120)
DII	$200

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Example of the Concept (cont’d)

IRC Section 250 Deduction: Foreign-Derived Intangible Income (FDII)

FDII Example – Step 3: Determine FDDEI

STEP 3

FDDEI = The Portion of DEI from Foreign-Derived Sales and Services

Qualifying sales to foreign customers	$300
Less allocable deductions	($60)
FDDEI	**$240**

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Example of the Concept (cont’d)

IRC Section 250 Deduction: Foreign-Derived Intangible Income (FDII)

FDII – Example – Step 4: Calculate the FDII deduction under Section 250

STEP 4

FDII Deduction under section 250 = FDII x 37.5%

FDII = DII x FDR

FDR = FDDEI / DEI = $240 / $320 = 75%

DII	$200
Multiplied by FDR	x 75%
FDII	$150
Multiplied by 37.5%	x 37.5%
FDII deduction under section 250	$56.25

$$\text{Effective tax rate} = \frac{(\$150 - \$56.25)}{\$150} \times 0.21 = 13.125\%$$

Index of Referenced Resources

IRC Section 250 Deduction: Foreign-Derived Intangible Income (FDII)
IRC 250
Proposed Treas. Reg. Sec. 1.250
Final Treas. Reg. Sec. 1.250 (TD 9901)
Form 1118 - *Foreign Tax Credit - Corporations*
Form 8993 - *Section 250 Deduction for Foreign-Derived Intangible Income (FDII) and Global Intangible Low-Taxed Income (GILTI)*
Form 8993 Instructions

Training and Additional Resources

IRC Section 250 Deduction: Foreign-Derived Intangible Income (FDII)	
Type of Resource	**Description(s)**
Saba Meeting Sessions	▪ *IRC Section 250 Foreign-Derived Intangible Income (FDII)* - 2020 In-Depth Training Saba Meeting
Reference Materials – Treaties	▪ Proposed Treas. Reg. Sec.1.250 (3/16/2019) ▪ Final Treas. Reg. Sec. 1.250 (7/15/2020) (TD 9901) ▪ *BNA Tax Management Portfolios* 6360-1st - Export Tax Incentives, III. Foreign Derived Intangible Income (FDII)

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Glossary of Terms and Acronyms

Term/Acronym	Definition
CFC	Controlled Foreign Corporation
DEI	Deduction Eligible Income is generally the eligible pool of income that potentially qualifies as FDII. *DEI = Gross Income – Exclusions – Allocable Deductions*
DII	Deemed Intangible Income is profit in excess of DTIR, if any, and is considered earned from intangible assets. *DII = DEI – DTIR*
DTIR	Deemed Tangible Income Return is ten percent of QBAI and is used to estimate tangible profit. *DTIR = 10% x QBAI*
FDDEI	Foreign-Derived Deduction Eligible Income is the portion of DEI from certain foreign sales and services.
FDII	Foreign-Derived Intangible Income can be defined as deemed excess domestic returns (deemed to be attributable to intangibles) that are considered foreign-derived. *FDII = DII x FDR*
FDII Deduction under Section 250	Section 250 Deduction with respect to FDII = 37.5% x FDII (results in 13.125% effective tax rate)
FDR	Foreign-Derived Ratio is the quotient of FDDEI over DEI, which is ultimately multiplied by DII to determine FDII. The FDR cannot exceed one (1) as part of this calculation. *FDR = FDDEI / DEI*
GILTI	Global Intangible Low-Taxed Income
QBAI	Qualified Business Asset Investment represents the taxpayer’s tangible business assets that produce DEI. *QBAI = Quarterly Average Adjusted Basis in Specified Tangible Property*
Specified Tangible Property	Specified Tangible Property is any depreciable, tangible property used in the production of gross DEI.

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Index of Related Practice Units

Associated UIL(s)	Related Practice Unit
	None at this time.