WINSTON & STRAWN LLP

CLIENT ALERT

The GILTI Regime

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The Tax Reform Act provides new Code Section 951A, which requires each U.S. Shareholder of a controlled foreign corporation ("CFC") to currently include in its income its global intangible low-taxed income ("GILTI") in the applicable tax year.[1] GILTI is the excess of the U.S. Shareholder's "net tested income" over its "net deemed tangible income return."[2] Such residual amount is deemed intangible income subject to tax. A U.S. Shareholder that includes GILTI in its income is allowed to increase its basis in the CFC stock and such GILTI amounts are treated as "previously taxed income" for subpart F purposes. In addition, new Code Section 250 provides a deduction that reduces effective tax rates on GILTI for U.S. Shareholders of eligible C corporations.[3]

These new rules are effective for tax years of CFCs beginning after December 31, 2017, and for tax years of U.S. Shareholders in which or with which such tax years of the CFC ends. According to the Joint Committee on Taxation, the GILTI regime will increase revenues by $112.4 billion over 10 years.

Calculation

The first step in determining the GILTI amount is to calculate the net tested income. Net tested income is the aggregate net income or loss of each relevant CFC other than effectively connected income, subpart F income, income excluded from su part F income under the high tax exception, dividends received from related persons, and certain oil and gas income.[4]

The second step is to calculate the net deemed tangible income return, which is 10% of the excess of the CFC's qualified business asset investment ("QBAI") over the net amount of interest expense taken into account in determining net tested income.[5] QBAI is the average adjusted basis of "specified tangible property" that is used in the CFC's trade or business and using a straight-line depreciation method.[6]

The final step is to calculate the GILTI amount that is the excess (if any) of the U.S. Shareholder's net tested income over the aggregate net deemed tangible income return.

GILTI Deduction

Section 250 provides a deduction for eligible C corporations with respect to income amounts included under the GILTI regime, which reduces the effective tax rate imposed on GILTI. For tax years 2018 through 2025, the allowable deduction is equal to 50% of the GILTI inclusion amount plus any deemed dividend under Section 78 to the extent such amount is attributable to GILTI.[7] At the new 21% corporate tax rates, this produces an effective tax rate of 10.5% on any GILTI inclusion (before taking into account any foreign tax credits). For tax years 2026 and later, the deduction is reduced to 37.5% of the GILTI inclusion plus any related Section 78 amount, producing an effective tax rate of 13.125%.[8] The amount of the GILTI deduction is subject to limitation if the sum of such GILTI and foreign derived intangible income ("FDII") exceeds its taxable income.[9]

Foreign Derived Intangible Income

The flipside of the GILTI regime is FDII. Under the new tax law, Section 250 provides a deduction for excess returns earned directly by a U.S. corporation from foreign sales or services. The FDII amount is the amount of the corporation's "deemed intangible income" attributable to sales of property to foreign persons for use outside the U.S. or the performance of services for foreign persons or with respect to property outside the U.S.[10] Deemed intangible income is its gross income that is not attributable to a CFC, foreign branch, or domestic oil and gas income reduced by related deductions[11] and an amount equal to 10% of the aggregate adjusted bases of its U.S. depreciable assets.[12]

The Section 250 deduction to U.S. corporations is 37.5% of FDII inclusion amounts, creating an effective tax rate on such income of 13.125%.[13] These rates apply to tax years 2018 through 2025. Beginning in 2026, this deduction is reduced to 21.875% with an effective tax rate of 16.406%.[14] This deduction is not available for S corporations, RICs, or REITs.

GILTI Tax Credit

Eligible C corporations are also entitled to a tax credit for 80% of foreign taxes paid by their CFCs attributable to the GILTI amount.[15] The amount of foreign taxes attributable to the GILTI amount is calculated by multiplying the U.S. Shareholder's "inclusion percentage" by the total foreign income taxes paid by such CFCs that are attributable to tested income.[16] The inclusion percentage is the ratio of such U.S. Shareholder's GILTI amount divided by the relevant aggregate amount of tested income.[17]

$$\text{GILTI Tax Credit} = 80\% \times \frac{\text{GILTI} \times \text{Tested Foreign Income Tax}}{\text{Tested Income}}$$

The GILTI tax credits are segregated into a separate foreign tax credit basket with no carryforward or carryback available for any excess credits. Because the calculation is done by first aggregating all foreign taxes attributable to tested income, foreign taxes paid by one CFC may be available to offset GILTI inclusions from another CFC. However, taxes with respect to any income excluded from tested income are not eligible for cross-crediting. Thus, in certain circumstances, these rules may interact to subject eligible C corporations to U.S. tax, even where the effective worldwide rate exceeds the highest applicable U.S. rate.

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[1] IRC § 951A(a).

[2] IRC § 951A(b)(1).

[3] IRC § 250(a)(1).

[4] IRC § 951A(c).

[5] IRC § 951A(b)(2).

[6] IRC § 951A(d).

[7] IRC § 250(a)(1)(B).

[8] IRC § 250(a)(3)(B).

[9] IRC § 250(a)(2).

[10] IRC § 250(b)(4).

[11] IRC § 250(b)(3).

[12] IRC § 250(b)(2)(B).

[13] IRC § 250(a)(1)(A).

[14] IRC § 250(a)(3)(A).

[15] IRC § 960(d)(1).

[16] Id.

[17] IRC § 960(d)(2).

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