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by George Callas and Mark Prater

George Callas

Mark Prater

George Callas is managing director of the government affairs and public policy group of Steptoe & Johnson LLP in Washington. He previously acted as House Ways and Means Committee chief tax counsel and senior tax counsel to former House Speaker Paul Ryan. Mark Prater is managing director of the tax policy services group of PwC's Washington National Tax Services practice. He previously served as chief tax counsel and deputy staff director for the Senate Finance Committee.

In this article, Callas and Prater consider whether the global intangible low-taxed income regime has lived up to its drafters' intention that the competitive effects of the shift to a new hybrid system be eased by the aggregate treatment of GILTI and associated foreign tax credits.

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On December 22, 2017, President Trump signed into law the Tax Cuts and Jobs Act, which contained the most significant changes to U.S. international tax policy since the addition of the anti-deferral regime known as subpart F in 1962, and perhaps since the inception of the federal income tax in 1913.

Under prior law, U.S. companies doing business overseas operated under a hybrid system. While the United States generally taxed companies on their worldwide income, taxpayers could defer taxation of active business foreign earnings until that income was repatriated to the U.S. parent as a dividend. That was different from the policy of most U.S. trading partners, which exempts foreign earnings repatriated from foreign subsidiaries. In lieu of an exemption, the United States allowed a foreign tax credit to provide relief against double taxation.

Policymakers recognized the shortcomings of the old system — for example, that it led to locking out investment in the United States because of the tax consequences of repatriating foreign earnings and the application of the comparatively high U.S. corporate rate. U.S. companies became attractive targets for tax-driven foreign takeovers or inversion transactions because of the uncompetitive, worst-in-class features of the U.S. tax system.

The TCJA's authors intended to create a new, more competitive hybrid system. Instead of worldwide taxation with deferral, outbound active business income that reflects normal returns now generally enjoys exemption treatment. To protect the U.S. tax base, Congress enacted new section 951A, creating the global intangible low-taxed income regime to capture high-return income, often earned from intangible assets that had migrated to low-tax jurisdictions. If derived from U.S. operations, the same kind of income receives a preferential rate under the foreign-derived intangible income regime. The GILTI and FDII rules were designed to complement each other in a manner that eliminates the tax bias for locating high-return income in low-tax jurisdictions. Specifically, Congress intended for those highly mobile assets — and the jobs and economic activity they create

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— to face a minimum tax rate of 13.125 percent, no matter where the activity occurred.[1]

Critically, the Senate Finance Committee, where the provision originated, intended for GILTI to kick in only if the income was otherwise low-taxed: If income "is located in a jurisdiction with a sufficiently high tax rate, the Committee believes there is limited base erosion concern."[2] In discussing its analogous provision, the House Ways and Means Committee said it does not believe the concentration of high returns abroad is itself a sufficient indication of erosion of the U.S. tax base. It added that when those returns are subject to a low effective tax rate, U.S. taxation is appropriate. "Conditioning the application of an anti-base erosion rule on low effective tax rates can be accomplished through . . . a reduced U.S. tax rate with a credit," it said.[3]

Moreover, the TCJA's conferees defined a sufficiently high tax rate, saying that "at foreign rates greater than or equal to 13.125 percent, there is no residual U.S. tax owed on GILTI, so that the combined foreign and U.S. tax rate on GILTI equals the foreign tax rate."[4] The TCJA drafters intended that as a bottom-line policy goal. The effects on the combined foreign and U.S. tax rate on GILTI were intended to target income bearing an effective rate lower than 13.125 percent.

In replacing the prior regime with the GILTI/FDII regime, the TCJA drafters wanted to ensure that the new system enhance, not diminish, the competitiveness of U.S. companies. That is why they were keenly focused on not undercutting the target worldwide effective rate of 13.125 percent. To achieve that goal, offshore income was to be treated in an aggregate manner. In other words, foreign income from multiple controlled foreign corporations would be combined as if it had all been earned by a single entity.

The Finance Committee said it believed that "calculating GILTI on an aggregate basis, instead of on a CFC-by-CFC basis, reflects the interconnected nature of a U.S. corporation's global operations and is a more accurate way of determining a U.S. corporation's global intangible income."[5] The Ways and Means Committee reached the same conclusion for its analog to GILTI, saying, "It is more appropriate to look at a multinational enterprise's foreign operations on an aggregate basis, rather than by entity or by country."[6]

The taxwriting committees discovered that reasoning after nearly seven years of work on international tax reform that started in earnest in 2011, with the release of a discussion draft by then-Ways and Means Committee Chair Dave Camp. Camp proposed replacing the system with an exemption for repatriated foreign earnings, combined with an anti-base-erosion rule to protect the U.S. tax base. His draft included three ways to prevent base erosion, commonly referred to as options A, B, and C.

After more than two years of stakeholder feedback, Camp decided to incorporate a modified version of option C into his comprehensive Tax Reform Act of 2014, which he released as a discussion draft in February of that year. Option C created a new category of subpart F income (called foreign base company intangible income) targeting profits derived from intangible assets and taxed that income currently at the full corporate rate for U.S.-derived income and at a reduced rate of 15 percent for foreign-derived income. Crucially, option C included a carrot in addition to the subpart F stick, providing the same 15 percent rate on foreign-derived income earned directly by U.S. taxpayers (for example, export income and foreign-source royalties), thus creating parity between U.S. and foreign ownership of intangible assets.

The 2014 version of option C adopted a formula intended to approximate the portion of foreign earnings attributable to the presence of intangible assets, defining foreign base company intangible income generally as CFC income in

[1]Congress originally intended to target income bearing an effective rate of less than 12.5 percent, or the Irish statutory rate. While both the House and Senate versions of the TCJA reduced the U.S. corporate rate to 20 percent, the conference agreement allowed that to drift up to 21 percent. Congress chose not to adjust the deduction under proposed section 250 to keep the maximum GILTI and FDII effective rates at 12.5 percent, instead allowing it to drift in proportion to the statutory corporate rate.

[2]S. Prt. 115-20, at 370.

[3]H.R. Rep. No. 115-409, at 390.

[4]H.R. Conf. Rep. No. 115-446, at 626-627.

[5]S. Prt. 115-20, at 371.

[6]H.R. Rep. No. 115-409, at 389.

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excess of a routine return of 10 percent of qualified business asset investment. Being a category of subpart F income, however, it applied CFC-by-CFC. That restrictive application raised major concerns about the effect on the competitiveness of U.S. companies vis-à-vis foreign companies, which in turn contributed to a halt in momentum for tax reform.

Meanwhile, in late 2013, Harry Grubert of the Treasury Office of Tax Analysis and Rosanne Altshuler of Rutgers University examined several international tax reform options, including one they referred to as an "overall" basis. They described the overall approach as 15 percent tax on active foreign income with a credit for a company's overall effective foreign rate up to the 15 percent threshold. They calculated a company's effective foreign rate by taking the ratio of total foreign taxes to total foreign earnings and profits net of dividends received. Grubert and Altshuler found that the overall aggregate minimum tax "appears to be successful in targeting the companies that have the greatest opportunities for shifting income." They concluded that while a per-country limitation goes farther in capturing tax haven income, the overall, or aggregate, approach "is a substantial move in that direction and is much simpler."

When the taxwriting committees continued their work on international tax reform in 2015, including a bipartisan working group headed by Sens. Rob Portman, R-Ohio, and Charles E. Schumer, D-N.Y., and a (never-published) international tax reform discussion draft by Ways and Means Chair Paul Ryan,[7] many saw the Grubert-Altshuler analysis of the aggregate approach as a way forward other than the CFC-by-CFC approach of option C. Both chambers decided to include an aggregate approach to reducing profit shifting in their versions of the TCJA, and option C's "carrot and stick" eventually evolved into the FDII (carrot) and GILTI (stick) regimes that were developed by the Finance Committee and became the base text for what became law.

Congress could not have been clearer: GILTI was designed to be determined on an aggregate basis. Both the House and Senate reached that conclusion after years of deliberation and with the specific intent of abandoning the CFC-by-CFC approach of option C. Congress allowed taxpayers to average low-tax income with higher-tax income for computing the FTC. The drafters of the TCJA, in moving to current inclusion of all GILTI, directly balanced that important measure to combat profit shifting with the notion that U.S. companies could manage that change by aggregating both income bearing different levels of foreign tax and their FTCs. In fact, for GILTI, Congress specifically chose to allow averaging across entities rather than across years — as evidenced by the absence of an FTC carryover, with its unintended harsh effects. These two major structural features of GILTI — current inclusion and FTC aggregation — were symbiotic in serving the TCJA's drafters' goal of a competitive rate on outbound income.[8]

That history could inform discussions regarding pending TCJA guidance involving the availability and determination of FTCs, including the proposed high-tax exception to GILTI and potential changes to the expense allocation rules. Officials charged with drafting TCJA guidance have undertaken herculean efforts to meet the aggressive effective dates in the legislation. Regarding section 951A guidance, a laser-like focus on the congressional expression of intent is warranted to show that guidance drafters will carefully consider that authority.

In a related and now rapidly progressing development, the OECD is revisiting long-standing rules and norms of international taxation. Some of the discussions have focused on whether to propose a GILTI-inspired set of rules on a country-by-country or entity-by-entity basis. The TCJA and GILTI drafters decided that an entity-by-entity approach would be too onerous, and a country-by-country approach would be

[7] Ryan became House speaker October 29, 2015, at which point he ceased to be Ways and Means Committee chair, and the committee put aside its work on the international tax reform discussion draft.

[8] In fact, adopting the aggregate approach required moving GILTI out of the traditional section 954 definition of foreign base company income and into a new section 951A, because section 954 is built on an entity-by-entity approach. In so doing, Congress did not generally intend for taxpayers to lose options they would have been able to use had GILTI remained within section 954 (such as the high-tax exception and the section 962 election).

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even more so (for example, because of the check-the-box rules), and thus would caution U.S. negotiators against signing on to a proposal that rejects one of Congress's clearly preferred design features.

U.S. officials drafting guidance and negotiating with the OECD as it embarks on its discussions should consider the consequences of the legislative design of the TCJA. The new hybrid system is a substitute for the century-old bedrock principle of deferral. On one hand, income generated from normal returns receives exemption treatment. On the other hand, Congress intended GILTI to operate as an anti-base-erosion measure directed at high returns located in low-tax jurisdictions.

As part of that consideration of the consequences of the new hybrid system, we urge policymakers to focus on a fundamental design feature of GILTI. That is, GILTI was structured as an aggregate measure and did not contemplate the dilution of FTCs allocable to that aggregate income by entity or by country. The TCJA drafters meant the competitive effects of the shift to a new hybrid system to be eased by the aggregate treatment of GILTI and associated FTCs. ■

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