

DON'T BE GILTI: PLANNING FOR PROPOSED CHANGES TO THE U.S. MINIMUM TAX REGIME

On May 28, 2021, the Treasury Department released its general explanation of tax proposals included in the Biden Administration's fiscal year 2022 budget submission to Congress, commonly known as the [Green Book](#). The Green Book provides additional details on the proposed changes to the calculation of global intangible low-taxed income (GILTI) for U.S. corporations, as well as the calculation of the GILTI foreign tax credit (FTC) – both of which would be calculated on a country-by-country basis instead of on a global aggregate basis as under the existing rules.

OVERVIEW OF EXISTING GILTI RULES

Under the existing rules, U.S. shareholders of controlled foreign corporations (CFCs) are taxed on their pro rata share of "net CFC tested income," regardless of whether the income is repatriated. U.S. shareholders can reduce their share of CFC tested income by a 10% deemed return on their "qualified business asset investment" (QBAI). U.S. C corporations can also claim a 50% deduction against GILTI inclusions (the "Section 250 deduction"), thus subjecting GILTI to a U.S. effective tax rate of 10.5%. (The effective rate is scheduled to increase to 13.125% beginning in 2026.)

The GILTI rules also allow for an FTC of up to 80% of the CFC's deemed paid foreign income taxes for U.S. C corporations, subject to expense allocations under Internal Revenue Code Section 861 and the FTC limitation under Section 904. The 80% limitation results in an automatic loss of 20% of the amount of foreign income taxes available for credit (also referred to as a 20% "haircut"). Any foreign taxes not utilized as a credit in the current tax year are forfeited and not permitted to be carried over.

GREEN BOOK PROPOSALS

The Green Book proposes several substantial changes to the existing international tax regimes. One of the most notable, which applies to the GILTI calculation as well as the calculation of GILTI FTCs, is the country-by-country approach.

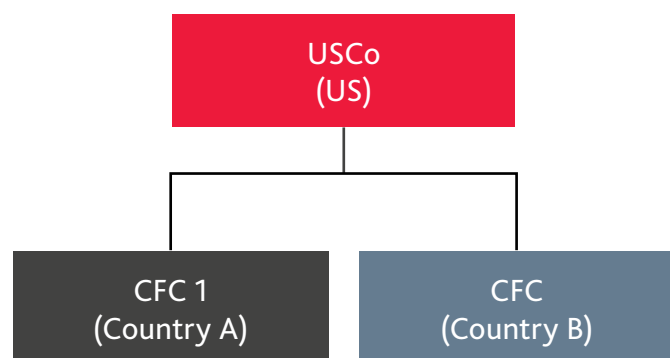
Under existing rules, both GILTI and the GILTI FTC are calculated on a global aggregate basis (i.e., foreign income taxes paid relating to GILTI in all foreign jurisdictions are added together and are part of one combined FTC calculation). This blended approach allows excess foreign income taxes paid in high-tax jurisdictions to be used to offset residual U.S. taxes on income earned in low-tax jurisdictions. However, under the Green Book, which raises concerns about global blending, both GILTI and the corresponding FTC calculations would be calculated on a country-by-country basis. Additionally, since FTC calculations are done on an income by basket basis (e.g., GILTI, passive, general, foreign branch, etc.), the same global blending concerns also prompted the Administration to propose applying the country-by-country approach to foreign branch income, which is anticipated to significantly increase the complexity of FTC limitation calculations.

In addition to requiring the country-by-country approach, the Green Book proposals would:

- ▶ Eliminate the 10% QBAI deduction; and
- ▶ Reduce the Section 250 deduction to 25%, thereby increasing the U.S. effective tax rate on GILTI to 21% (when also considering the proposed increase in the statutory corporate tax rate to 28%).

CURRENT AND PROPOSED GILTI FTC RULES¹

Below are simplified examples of how the GILTI and GILTI FTC calculations are generally applied under the existing rules, and a high-level overview of how the GILTI and GILTI FTC calculations are anticipated to be applied under the Green Book proposals, pending further guidance.



CFC 1 has tested income of 100, foreign taxes of 10, and QBAI of 100. CFC 2 has tested income of 10, foreign taxes of 3, and QBAI of 10.

EXISTING RULES - AGGREGATE APPROACH

Net Tested Income	110
Less 10% of QBAI	(11)
GILTI Inclusion (90%)	99
Plus Foreign Tax Gross Up (13 taxes X 90% inclusion)	12
Less Section 250 Deduction (50%)	(55)
Net GILTI Inclusion	55
U.S. Liability (21%)	12
Estimated FTC (13 taxes X 80% permitted)	10
Residual U.S. Tax	2

PROPOSED RULES² - COUNTRY-BY-COUNTRY APPROACH

	Country A	Country B
Net Tested Income	100	10
GILTI Inclusion (100%)	100	10
Plus Foreign Tax Gross Up	10	3
Less Section 250 Deduction (25%)	(28)	(3)
Net GILTI Inclusion	82	10
U.S. Liability (28%)	23	3
Est. FTC (10 taxes X 80% permitted)	8	2
Residual U.S. Tax	15	1
Total Residual U. S. Tax (Country A + Country B)		16

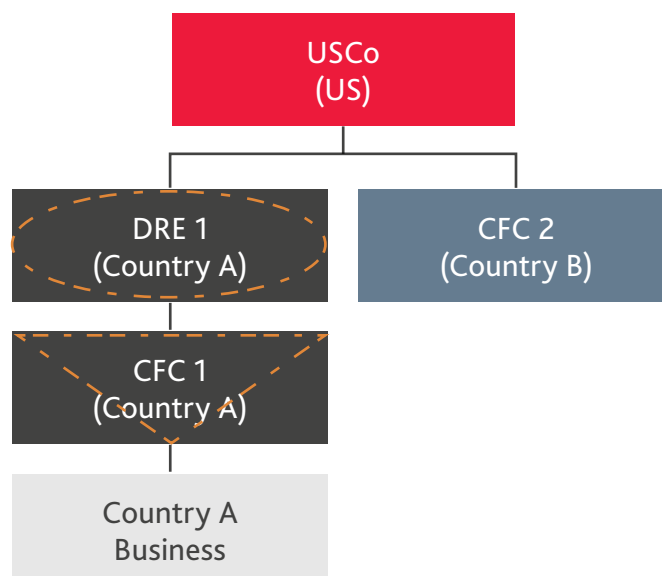
In the above examples, a country-by-country approach to both the GILTI and GILTI FTC calculations results in residual U.S. tax of approximately 16, compared to residual U.S. tax of only 2 when an aggregate approach is applied. As illustrated, the changes in the calculations proposed in the Green Book could result in additional U.S. tax expense.

WHAT CAN TAXPAYERS DO NOW?

Although it remains to be seen whether, and in what form, the proposals in the Green Book will be implemented, multinational companies should begin assessing the impacts of the proposals on their global operations now.

To potentially lessen the impact of the proposed changes to the GILTI and GILTI FTC calculations, multinational companies can consider whether there is an opportunity to “convert” the income of their CFCs from tested income under GILTI to Subpart F income that would fall within the general basket when calculating the FTC. Although the Green Book proposes a country-by-country approach with respect to the GILTI and foreign branch baskets, there is no immediate indication that such approach would be applied to the general basket.

Additionally, certain group structures may potentially mitigate the effect of the 20% haircut of foreign income taxes available to offset a GILTI inclusion under Section 960. An example of one such structure is illustrated to the right.



DRE 1 incurs 10 of foreign taxes. CFC 1 has tested income of 100 and 0 of foreign taxes. CFC 2 has tested income of 10 and 3 of foreign taxes.

PROPOSED RULES – COUNTRY-BY-COUNTRY APPROACH

	Country A	Country B
Net Tested Income	100	10
GILTI Inclusion (100%)	100	10
Plus Foreign Tax Gross Up	10	3
Less Section 250 Deduction (25%)	(28)	(3)
Net GILTI Inclusion	82	10
U.S. Liability (28%)	23	3
Est. FTC (10 taxes X 80% permitted)	8	2
Residual U.S. Tax	15	1
Total Residual U. S. Tax (Country A + Country B)		14

In this example, DRE 1 is considered under U.S. tax rules to be the “technical taxpayer” of the 10 of foreign taxes owed to Country A³. Further, because DRE 1 is a disregarded entity, the foreign taxes are considered to be paid by USCo and, as such, the 20% haircut does not apply. As a result, the full 10 of Country A taxes is available to partially offset the U.S. tax generated on the GILTI inclusion⁴. Combined with the Country B taxes for CFC 2, which are subject to the 20% haircut, USCo can claim a total FTC of 12, as opposed to an FTC of only 10 under the country-by-country approach in the previous example.

HOW BDO CAN HELP

BDO can help multinational companies assess the potential impact of the proposed changes to the GILTI and GILTI FTC calculations on their global operations. Specifically, BDO can model the changes, as well as consider various scenarios to potentially mitigate the impacts before legislation is enacted. For more information on these or other tax proposals that may affect you or your business, contact BDO.

Endnotes

- ¹ The examples are for illustrative purposes only and assume that neither the GILTI high-tax exclusion, if in effect, nor the Section 250 taxable income limitation apply. The calculations also do not address expense allocations under Section 861 or the FTC limitation under Section 904, both of which could decrease the amount of FTC permitted to be utilized.
- ² A detailed summary of all the proposed changes to the GILTI calculation under the Green Book is outside of the scope of this article. For a more in-depth look, please see BDO's article on the [Green Book proposals](#).
- ³ Pursuant to Section 901.
- ⁴ Generally subject to Section 909 suspension; however, the amount is released to the extent of the GILTI inclusion percentage. The amount is also in the GILTI basket pursuant to Treas. Reg. § 1.904-6.

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