

# GILTI TAX

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## INCLUSION, REPORTING, EXCEPTIONS

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# INTRODUCTION

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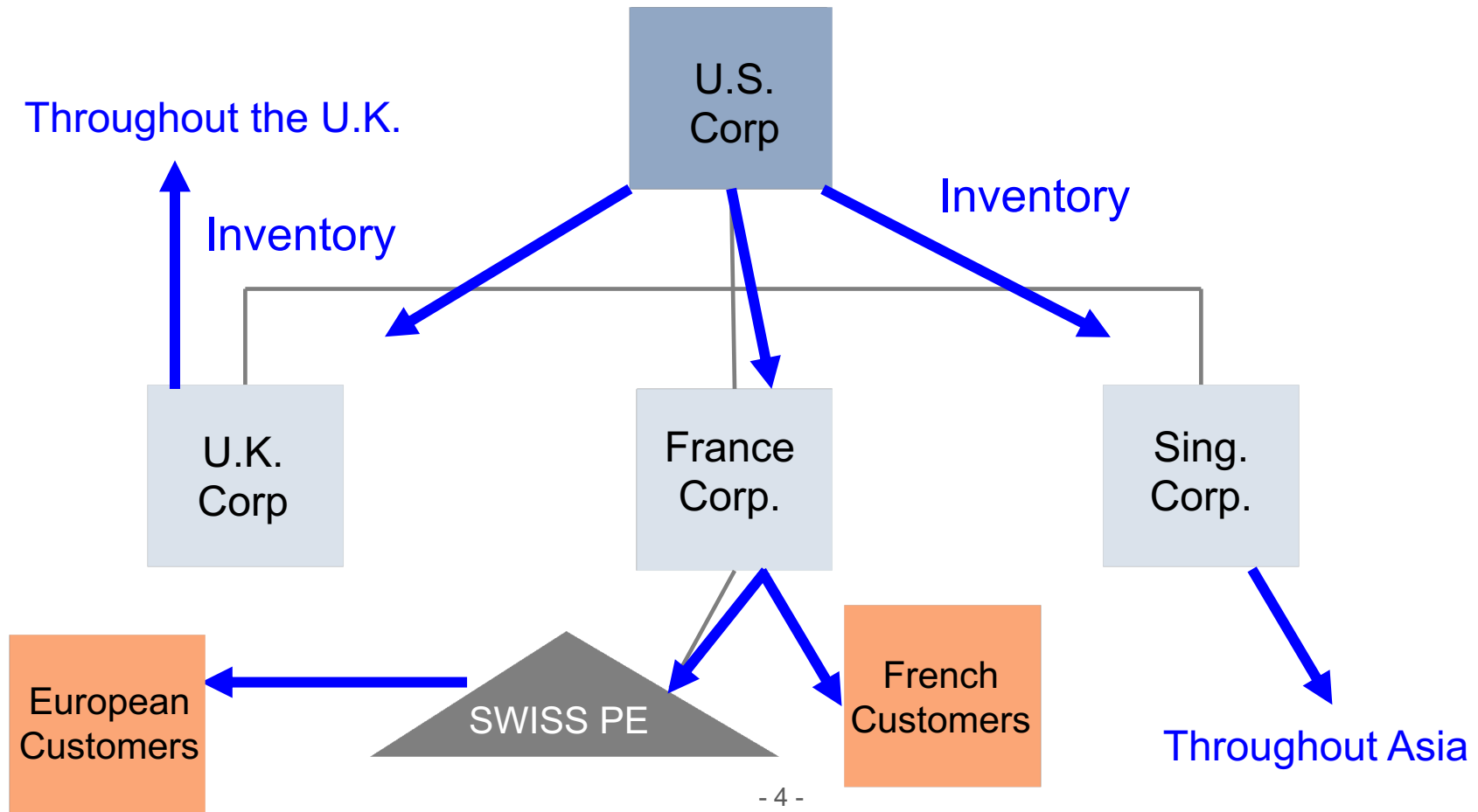
# Topics Covered

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- GILTI Rules for CFCs, followed by a Fact Pattern
- Final Regulations on GILTI High-tax Exception (H.T.E.)
- H.T.E. and §962 Relief for U.S. Individuals Owning CFCs
  - Fact Patterns
- Ownership of CFCs Through Domestic Partnerships
  - Treatment for GILTI
  - Proposed regulations to neutralize treatment for Subpart F
- Form 5471 Relief from Filing for foreign controlled CFCs

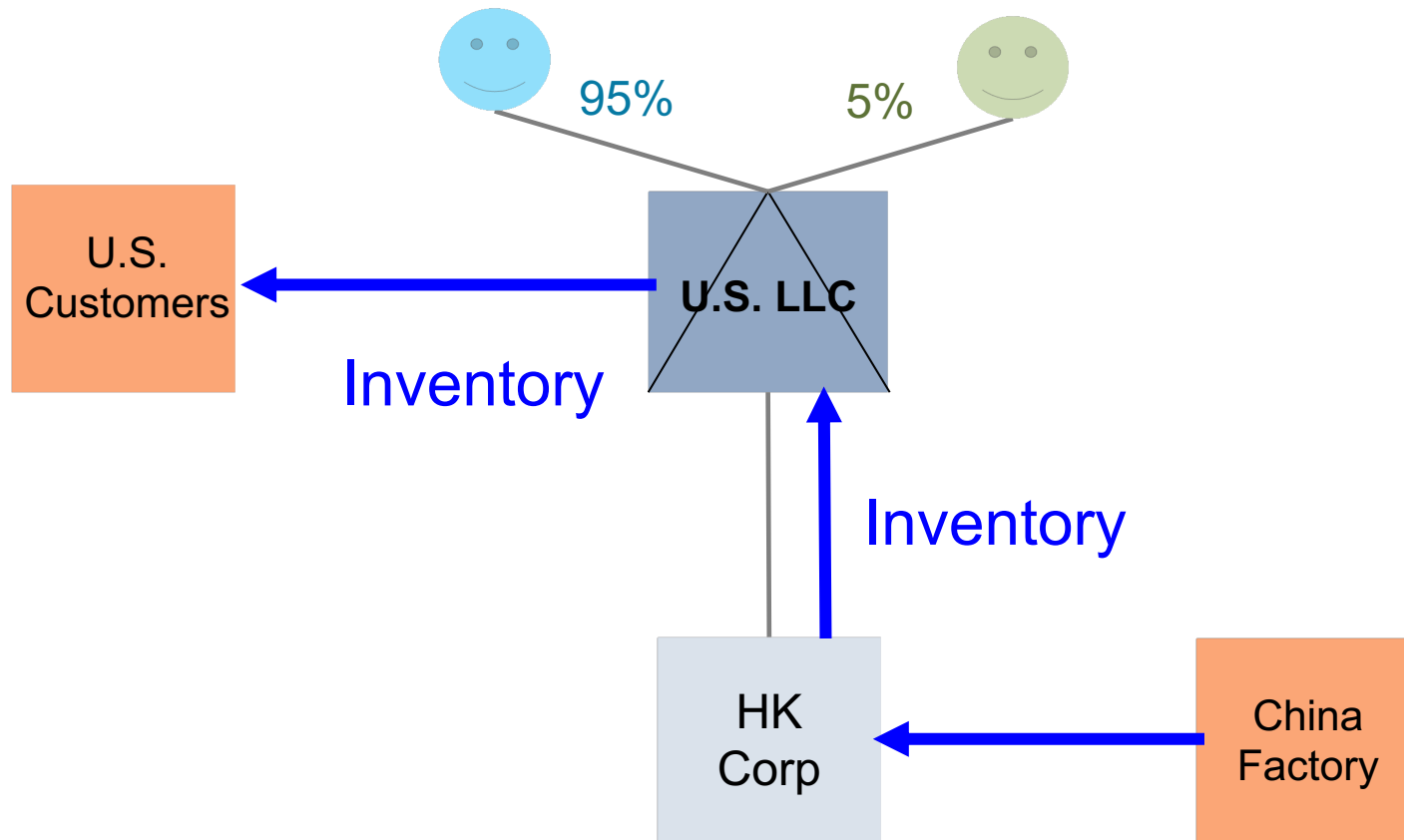
# Typical Fact Patterns

- U.S. C-Corp owns subsidiaries overseas that are local distributors of a product produced in the U.S.



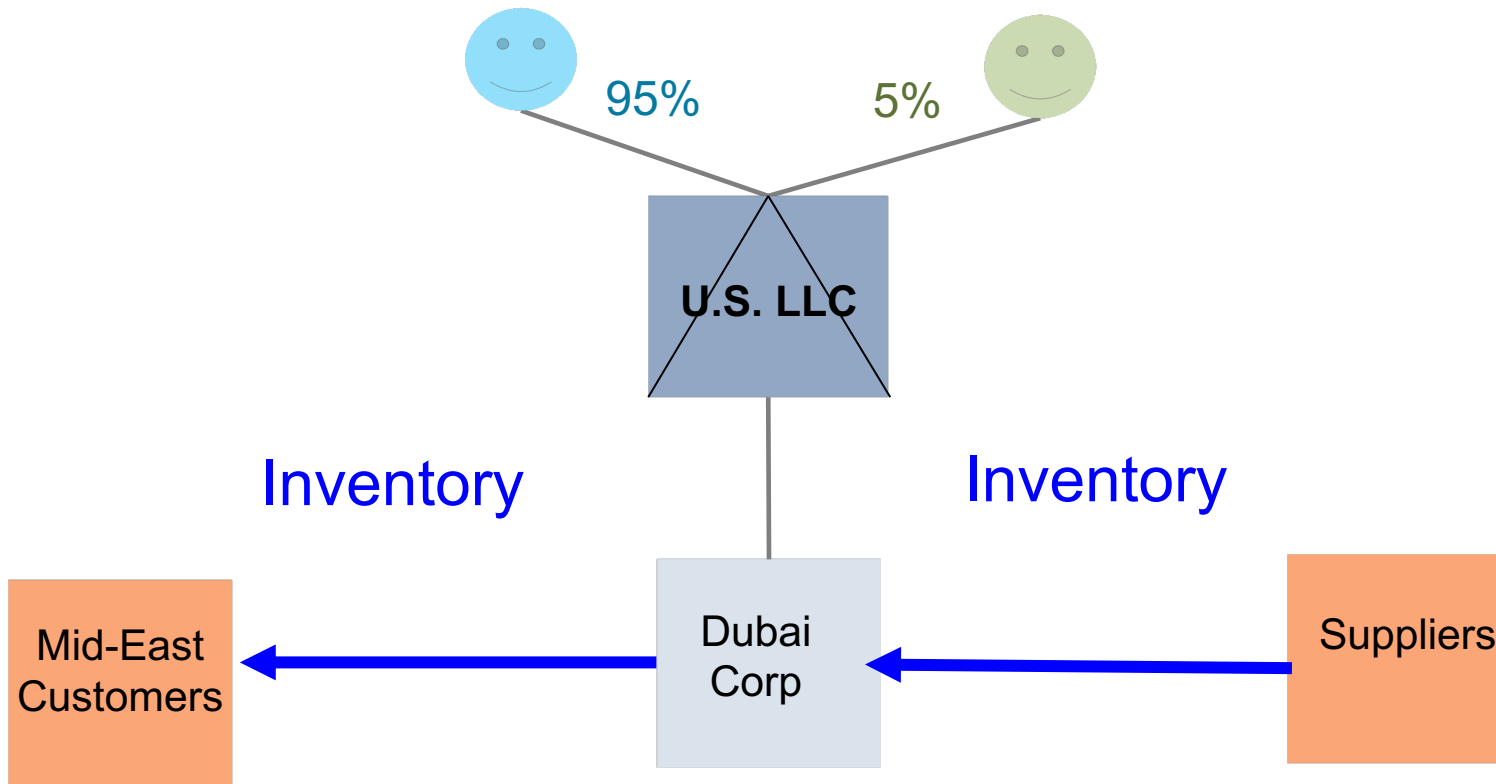
# Typical Fact Patterns

- U.S. LLC that has purchasing operations in Hong Kong for goods made in China and sold to LLC for distribution in U.S.



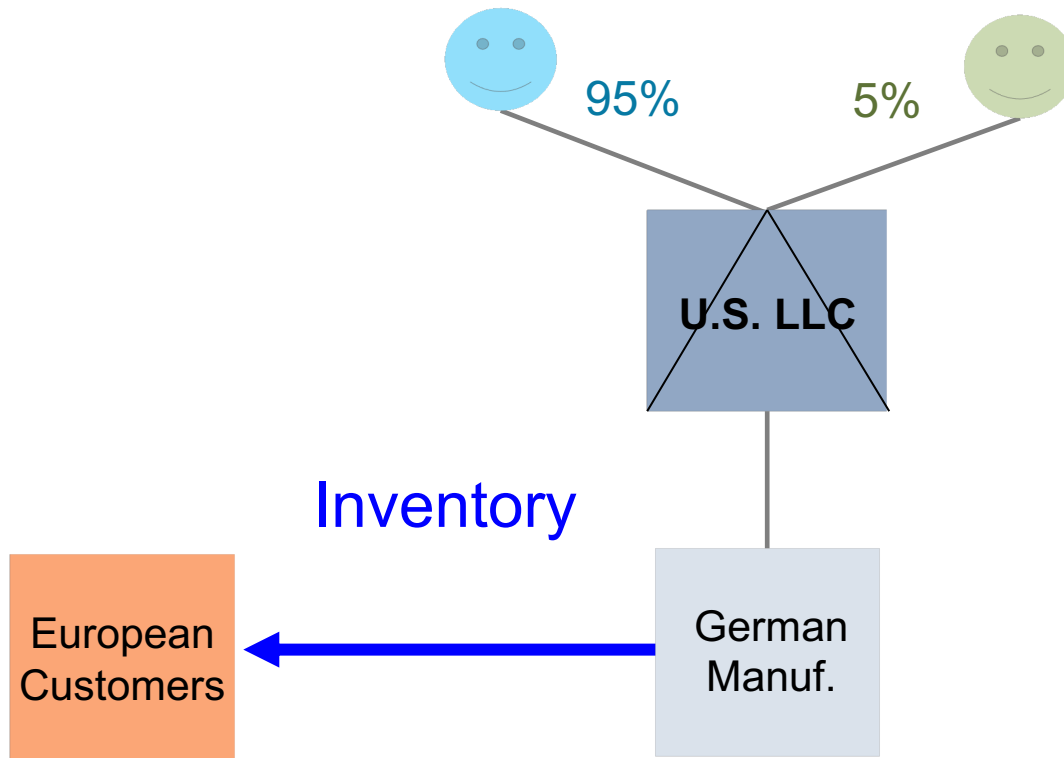
# Typical Fact Patterns

- U.S. LLC that has standalone business in Dubai



# Typical Fact Patterns

- U.S. LLC owned by 2 members with German standalone manufacturing subsidiary supplying European customers



# GILTI RULES

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# Global Intangible Low-Tax Income

- Applies only to U.S. Shareholders of CFCs
- Taxes foreign earnings that are not otherwise caught under U.S. taxation
- Allows 10% (arbitrary) return on qualified business asset investment (“Q.B.A.I.”)
- Q.B.A.I. = the CFCs average aggregate adjusted basis as of the close of each quarter of a taxable year in Q.B.A.
- Q.B.A. = depreciable (under S.L. method) tangible property used in a trade or business to produce tested income as of the end of each quarter

# GILTI Tested Income

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- Tested Income is the starting point for GILTI inclusion.
- Includes all gross income except:
  - E.C.I.
  - Subpart F Income
  - Income that escapes Subpart F character under high tax (18.9%) exception
  - Foreign oil and gas income
  - Dividend from related persons

# GILTI Inclusion

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## Net Tested Income – Net D.T.I.R.

- D.T.I.R. (Deemed Tangible Income Return) = 10% of the Q.B.A.I.
- Net D.T.I.R. = D.T.I.R. - Specified Interest Expense
- Specified Interest Expense = Tested interest expense minus tested interest income

## GILTI Inclusion – Cont'd

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- Tested interest expense and tested interest income is a CFC level determination
- Specified Interest Expense is a U.S. Shareholder level determination based on the pro rata share
- To calculate the GILTI inclusion, a U.S. Shareholder aggregates the pro rata share of D.T.I.R. of tested income CFCs and reduces the Specified Interest Expense
- The net D.T.I.R. is reduced from the aggregate net tested income

## Limitations on D.T.I.R.

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- Q.B.A.I. return is not available for CFCs with tested loss (Reg. §1.951A-3(b))
- If a CFC with tested loss has interest expense taken into account in calculating the net loss, the interest expense ends up reducing the available D.T.I.R. of a tested income CFC
- To mitigate the result, the final regulations reduce the amount of the interest expense of a tested loss CFC by the disallowed D.T.I.R. (Reg. §1.951A-4(b)(1))
- More of the D.T.I.R. will be available to reduce Tested Income

# Limitation of D.T.I.R. - Illustration

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Foreign Co 1

## Foreign Co 1

\$150 Tested Interest Income

\$400 Other Tested Income

\$150 Tested Interest expense

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\$400 Net Tested Income

\$2000 Q.B.A.I.

Potential D.T.I.R. \$200

Foreign Co 2

## Foreign Co 2

\$149 Gross Tested Income

\$150 Interest Expense

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(-1) Tested Loss

\$1000 Q.B.A.I.

Potential D.T.I.R. \$100

# GILTI Inclusion - Illustration

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- CFC determination:
  - Tested interest expense from Foreign Co 1 = \$150
  - Tested interest income from Foreign Co 1 = \$150
  - Tested interest expense from Foreign Co 2 = \$50 (\$150 - \$100)
  - Tested interest income from Foreign Co 2 = \$0
- U.S. Shareholder determination:
  - Total interest income \$150
  - Total interest expense \$200
  - Specified Interest Expense = \$50 (\$200 – \$150)
  - Net D.T.I.R. = \$200 – \$50 = \$150
- GILTI Inclusion = \$399 – 150 = \$249

# Deduction for GILTI

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- §250 deduction for GILTI is available to domestic corporations other than a R.I.C., R.E.I.T., or S-corporation
- Does not apply to individuals (though §962 can help)
- Applies to both GILTI and §78 deemed dividend
- 50% until 2025 (37.5% thereafter – but who knows?)
  - 10.5% rate on GILTI (13.125%)
- Foreign taxes:
  - 80% limitation and
  - inclusion percentage rule and
  - no carryforward



# AN EXAMPLE

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# Fact patterns

## Example – GILTI Inclusion with Multiple CFCs

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U.S. Corporate Shareholder (100%)	CFC 1	CFC 2	CFC 3
Gross Income	1,000.00	1,200.00	600
Properly allocable deductions (including interest expense)	300.00	700.00	900.00
Adjusted basis of Tangible and depreciable property at the end of each quarter of CFC Tax Year (S.L.M.)			
Q1	700.00	-	75.00
Q2	600.00	-	75.00
Q3	550.00	-	75.00
Q4	550.00	-	75.00
Interest expense	-	10.00	40.00

# Fact patterns

## Example – GILTI Inclusion with Multiple CFCs

CFC Level Calculations			
Step 1- CFC Tested Income (Loss)			
	CFC 1	CFC 2	CFC 3
Gross Income	1,000.00	1,200.00	600
Less: Exclusions			
1. ECI	-	-	-
2. Subpart F income	-	-	-
3. High Tax Income	-	-	-
4. Related Party Dividends	-	-	-
5. Gas and Exploration Income	-	-	-
Total Exclusions	-	-	-
Gross Income after Exclusions	1,000.00	1,200.00	600
Less: Properly Allocable Deductions	300.00	700.00	900.00
<b>CFC Tested Income (Loss)</b>	<b>700.00</b>	<b>500.00</b>	<b>(300.00)</b>

# Fact patterns

## Example – GILTI Inclusion with Multiple CFCs

CFC Level Calculations			
Step 2- Q.B.A.I. Calculation			
Adjusted basis of Tangible and depreciable property at the end of each quarter of CFC Tax Year (S.L.M.)	CFC 1	CFC 2	CFC 3
Q1	700.00	-	75.00
Q2	600.00	-	75.00
Q3	550.00	-	75.00
Q4	550.00	-	75.00
Sum of Adjusted Basis	2,400.00	-	300.00
Q.B.A.I.	600.00	-	75.00 /0*

\* A Tested Loss CFC has 0 Q.B.A.I. [Reg. §1.951A-3(b)]

# Fact patterns

## Example – GILTI Inclusion with Multiple CFCs

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CFC Level Calculations			
Step 3- Tested Interest Expense			
	CFC 1	CFC 2	CFC 3
QBAI	600.00	0.00	75.00
Interest Expense	-	10.00	40.00
Tested Interest Expense	-	10.00	32.50*

\* For a Tested Loss CFC, Tested Interest Expense is equal to the excess of the Interest Expense included in “properly allocable deductions” over 10% of Q.B.A.I. Reg. §1.951A-4(b)(1)(i) and (iv).

# Fact patterns

## Example – GILTI Inclusion with Multiple CFCs

CFC Level Calculations			
Step 1- CFC Tested Income (Loss)			
	CFC 1	CFC 2	CFC 3
CFC Tested Income (Loss)	700.00	500.00	(300.00)

Shareholder Level Calculations				
Step 1: Net CFC Tested Income = $\Sigma$ Pro-rata share of CFC Tested Income – $\Sigma$ Pro-rata share of CFC Tested Loss				Net CFC Tested Income
	CFC 1	CFC 2	CFC 3	
U.S. Shareholder's Ownership interest %	100%	100%	100%	
Pro rata CFC Tested Income (Loss)	700	500	(300)	900.00

# Fact patterns

## Example – GILTI Inclusion with Multiple CFCs

### CFC Level Calculations

#### Step 2 and 3 - QBAI and Tested Interest Expense Calculation

	CFC 1	CFC 2	CFC 3
Q.B.A.I.	600.00	-	75.00
Tested Interest Expense (CFC Level)	0.00	10.00	32.50

### Shareholder Level Calculations

#### Step 2:

**Net Deemed Tangible Income Return = 10% of  $\Sigma$  Pro-rata share of Q.B.A.I. –  $\Sigma$  Pro-rata share of Specified Interest Expense**

	CFC 1	CFC 2	CFC 3	$\Sigma$ Pro-rata share of Q.B.A.I.	10% of $\Sigma$ Pro-rata share of Q.B.A.I.	$\Sigma$ Pro-rata share of Specified Interest Expense
U.S. Shareholder's Ownership interest %	100%	100%	100%			
Q.B.A.I.	600	0	75			
Pro-rata share of Q.B.A.I.	600	0	0*	600	60	
Specified Interest Expense	0	10	32.5			42.50
Net D.T.I.R.	\$17.50					

\* In case of a Tested Loss CFC, U.S. Shareholder's Pro-rata share of QBAI is 0. [Reg. §1.951A-3(b)]

# Fact patterns

## Example – GILTI Inclusion with Multiple CFCs

### **Shareholder Level Calculations**

**Step 3:**

**GILTI Inclusion = Net CFC Tested Income – Net D.T.I.R.**

**= \$900 – \$17.50**

**= \$882.50**



# Fact patterns

## Example – GILTI Inclusion with Multiple CFCs

- GILTI Inclusion w.r.t each CFC
  - When a U.S. person is a U.S. shareholder of more than one CFC, GILTI Inclusion should be allocated among the CFCs to determine the following items:
    - Previously Taxed Income under §959
    - Stock basis adjustments under §961
    - Determination of the FTC amount

# Fact patterns

## Example – GILTI Inclusion with Multiple CFCs

- In case of a tested loss CFC, the GILTI inclusion amount is 0 [Reg. §1.951A-5(b)(2)(i)(A)]
- In case of a tested income CFC, the GILTI Inclusion amount is determined according to the following formula: [Reg. §1.951A-5(b)(2)(i)(A)]

U.S. Shareholder's GILTI Inclusion Amount

X

U.S. Shareholder's Pro rata share of TI of CFC for which GILTI Inclusion is being determined

Aggregate of Tested Income of all CFCs\*

\*Tested loss of a Tested Loss CFC is ignored

# Fact patterns

## Example – GILTI Inclusion with Multiple CFCs

Allocation of U.S. Shareholder's GILTI Inclusion among CFCs						
		CFC 1	CFC 2	CFC 3		Code section and Regulation
Tested Income (Loss)		700.00	500.00	(300.00)		
Aggregate Tested Income of Tested Income CFCs					1,200.00	
U.S. Shareholder's GILTI Inclusion					882.50	
GILTI Inclusion w.r.t. each CFC		514.79	367.71	-		Reg. §1.951A-5(b)(2)(i)

$$\text{GILTI Inclusion w.r.t. CFC1} = 882.50 \times \frac{700}{1,200} = \$514.79$$

$$\text{GILTI Inclusion w.r.t. CFC2} = 882.50 \times \frac{500}{1,200} = \$367.71$$

# Fact patterns

## Example – GILTI Inclusion with Multiple CFCs

- **Impact of GILTI Inclusion on Foreign Tax Credit**

- A U.S. corporate shareholder is entitled to claim a credit of only 80% of the foreign taxes paid by a CFC

Foreign Tax Credit = 80% x Inclusion Percentage x Foreign Taxes

Inclusion % =

U.S. shareholder's GILTI Inclusion

Σ U.S. shareholder's pro rata share of TI of each Tested Income CFC

# Fact patterns

## Example – GILTI Inclusion with Multiple CFCs

Inclusion Percentage for FTC under §960(d)						Code section and Regulation
		CFC 1	CFC 2	CFC 3		
Tested Income (Loss)		700.00	500.00	(300.00)		
Aggregate Tested Income of Tested Income CFCs					1,200.00	
U.S. Shareholder's GILTI Inclusion					882.50	
Inclusion Percentage					<b>0.74</b>	§960(d); Reg. §1.960-2(c)(2)
Foreign Taxes properly attributable to Tested Income		100	80	0	180	Reg. §§1.960-2(c)(3), 1.960-1(d)(3)(ii)
FTC capped at	80%					§960(d)
FTC against GILTI Tax					105.90	§960(d); Reg. 1.960-2(c)(1)

# Fact patterns

## Example – GILTI Inclusion with Multiple CFCs

U.S. Shareholder's GILTI Tax Computation		
GILTI Inclusion		\$882.50
Gross up under §78	$0.74 \times 180^*$	\$133.20
GILTI Inclusion after Gross up		\$1,015.70
\$250 Deduction	50%	\$507.85
GILTI Inclusion after §250 Deduction		\$507.85
GILTI Tax	21%	\$106.65
FTC Available		\$105.90
GILTI Tax Payable		\$0.75
Excess FTC cannot be c/f		0

\*If a domestic corporation chooses to have the benefits of foreign tax credit for any taxable year, an amount equal to the taxes deemed to be paid by such corporation under §960(d) (**determined without regard to the phrase “80 percent of” in subsection (d)(1) thereof**) for such taxable year shall be treated as a dividend received by such domestic corporation from the foreign corporation.

# Fact patterns

## Example – GILTI Inclusion with Multiple CFCs

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- **Adjustments to Earnings and Profits in case of a Tested Loss CFC**
  - A CFC's subpart F income is limited to its current earnings and profits.
  - In case of a Tested Loss CFC, earnings and profits are increased by the amount of tested loss. [§951A(c)(2)(B)(ii); Reg. §1.951A-6(b).]
  - CFC 3 is a tested loss CFC therefore its E&P will be increased by \$300 (Tested Loss). Subpart F income, if any, will be recognized to the extent of Subpart F earnings.
  - This rule does not affect the GILTI calculation, but it does affect the calculation of Subpart F income.

# HIGH TAX EXCEPTION

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# High Tax Exclusion from GILTI – the “Tested Unit”

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- §951A(c)(2)(A)(i)(III) excludes from GILTI tested income any gross income excluded from Subpart F by reason of §954(b)(4)
- Reg. §1.951A-2(c)(1)(iii), clarifies that the high tax exception of §954(b)(4) applies for GILTI purposes provided that:
  - An **election** is made under Reg. §1.951A-2(c)(7) (“H.T.E.” or the “Election”) and
  - The taxable rate condition is met (higher than 90% the rate of tax in §11; for the moment, that’s >18.9%)
- These Regulations were issued on July 23, 2020; apply to a CFC’s taxable years beginning on or after that date
  - May be applied retroactively to 2018 provided consistency requirements are met
- Annual election

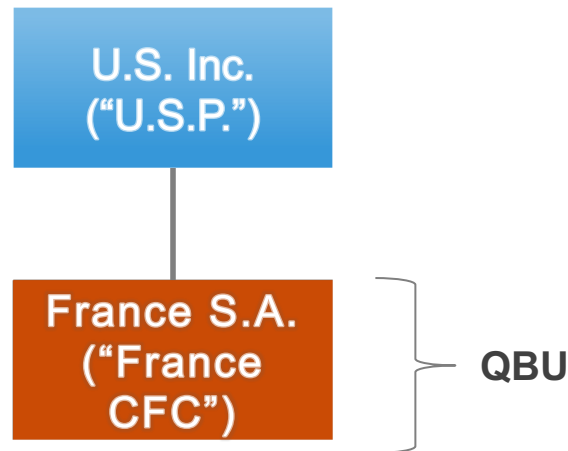
# Determining Effective Rate

- To determine whether the taxable rate condition is met, a Tested Unit approach is applied
  - A trade or business with separate books and records is considered a Tested Unit
  - All tested units of a CFC located or resident in the same country must be combined as a single Tested Unit
  - One Tested Unit may be eligible for the H.T.E. while another, within the same CFC, isn't – the Election is made for each CFC owned by a taxpayer, and a single election must be made for all CFCs that are members of a "CFC Group"

# Does a rose by any other name smell as sweet? Cf. Proposed Regs

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Proposed Regulations (REG-101828-19) (6/21/19)

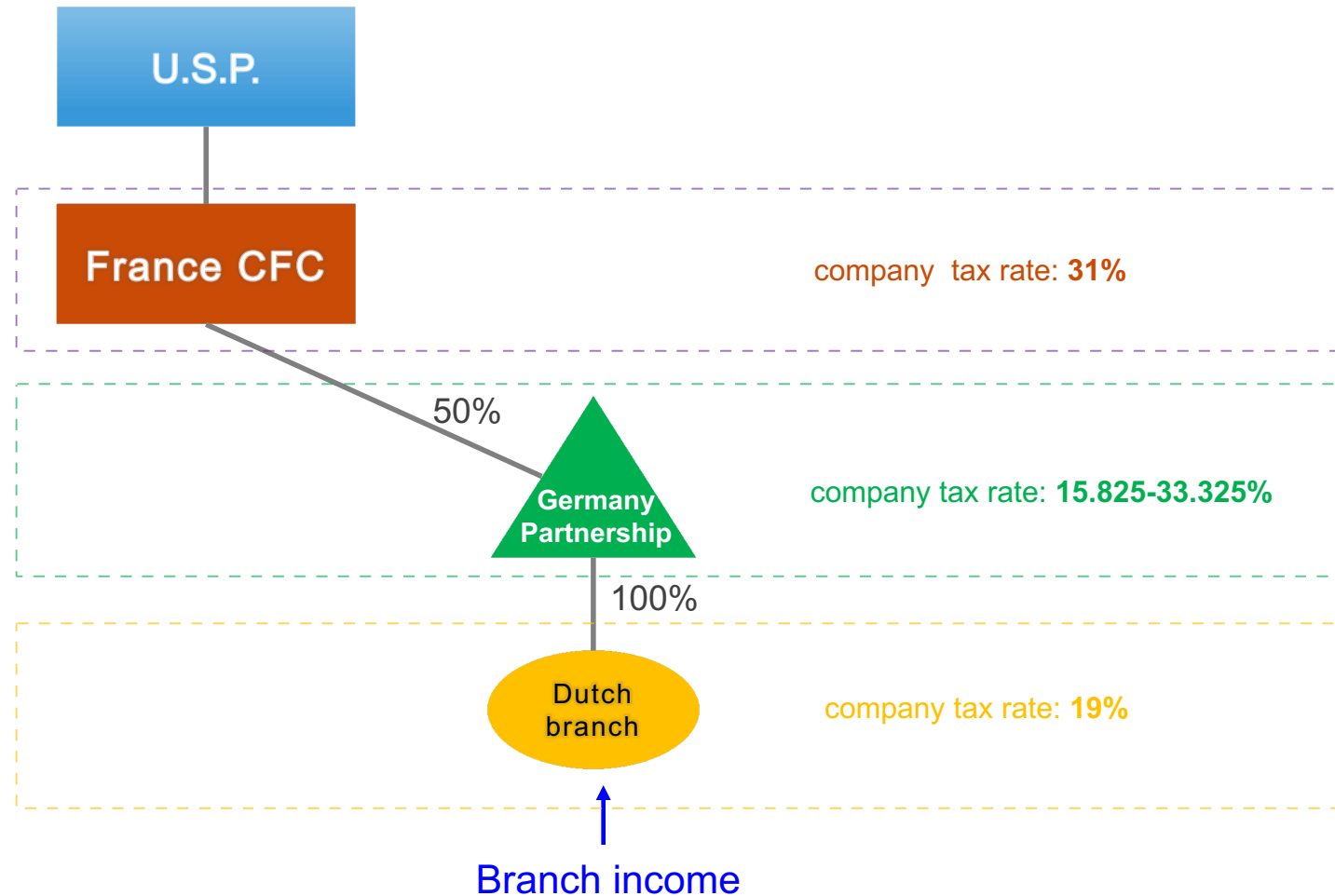


Prop. Reg. §1.951A-2(c)(6)(ii)(A)(1):

A single tentative gross tested income item with respect to a controlled foreign corporation for a CFC inclusion year is the aggregate of all items of gross income attributable to a single [QBU] of the [CFC] . . . that would be gross tested income . . . and that would be in a single tested income group as defined in §1.960-1(d)(2)(ii)(C).

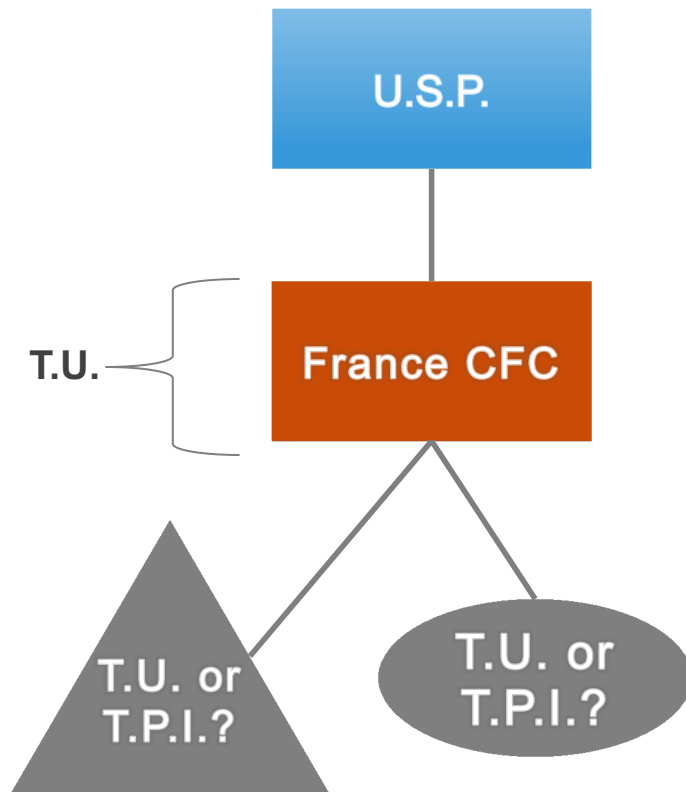
QBU = A separate and clearly identified unit of a trade or business of a taxpayer which maintains separate books and records

## Tested Unit – identifying the T.U.'s



# How is a “T.U.” different?

Final Regulations – T.D. 9902 (7/20/2020):



Tested Unit includes:

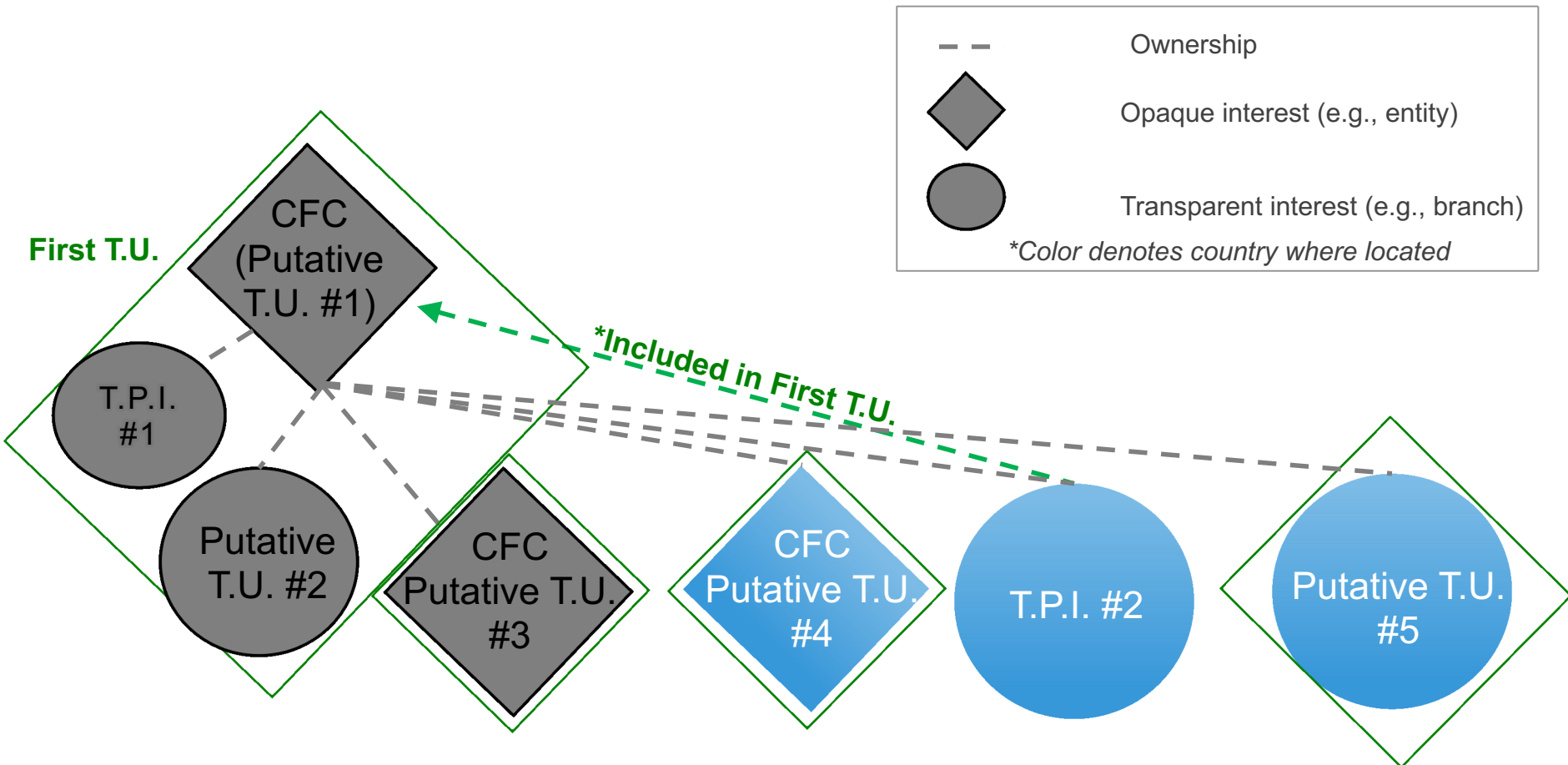
1. CFC as defined in §957
  2. An interest in a pass-thru entity that is:
    - (i) tax resident of any (third) foreign country, or
    - (ii) not fiscally transparent under laws of CFC (or T.U.) owner's country of residence
  3. A branch that:
    - (i) gives rise to a taxable presence in the country where its activities occur, or
    - (ii) Is subject to an exclusion, exemption, preferential rate in country of its (CFC or T.U.) owner
- If taxable solely in the jurisdiction of its owner (for example, under a Treaty's permanent establishment provisions) a branch is referred to as a transparent interest (T.P.I.)

# Tested Unit – special rules

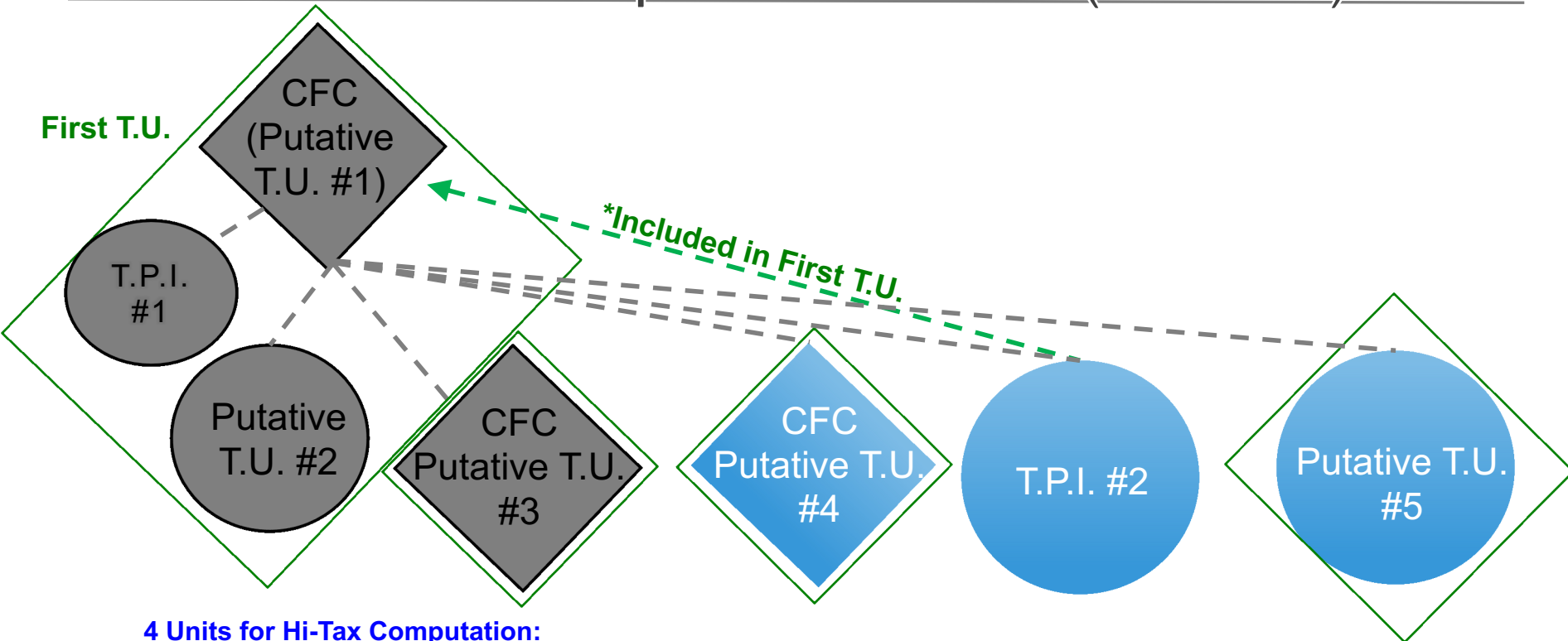
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- **Rule #1:** T.U.'s in a vertical chain owned by the same CFC are aggregated if tax resident in the same foreign country.
  - It appears that CFCs owned by other CFCs are not aggregated
- **Rule #2:** Where items appear on multiple T.U.'s books, if T.U.'s are not aggregated, an item is attributable to the lowest-tier T.U. to which may be attributable (and is eliminated from the other T.U.'s books and records).
  - Where a taxpayer fails to maintain separate books and records for a T.U. or T.P.I. reflecting its gross income, disregarded payments, and any other items required for purposes of the T.U. calculation, the Regulations provide that such books “must be determined”. This gives the I.R.S. the opportunity to determine the books and records in a way that may not be consistent with the high-tax position adopted by taxpayer. Therefore, making sure H.T.E. positions are documented and supported based on properly maintained books and records for all the claimed foreign T.U.'s is strongly recommended.
- Examples of allocation of gross income, disregarded payments and other items under Reg. §1.951A-2(c)(8) are worth working through carefully.

# Tested Unit – special rules



# Tested Unit – special rules (cont'd)



## 4 Units for Hi-Tax Computation:

- a)  $\Sigma \{T.U. \#1 + T.U. \#2 + T.P.I. \#1 + T.P.I. \#2\}$
- b) T.U. #3
- c) T.U. #4
- d) T.U. #5

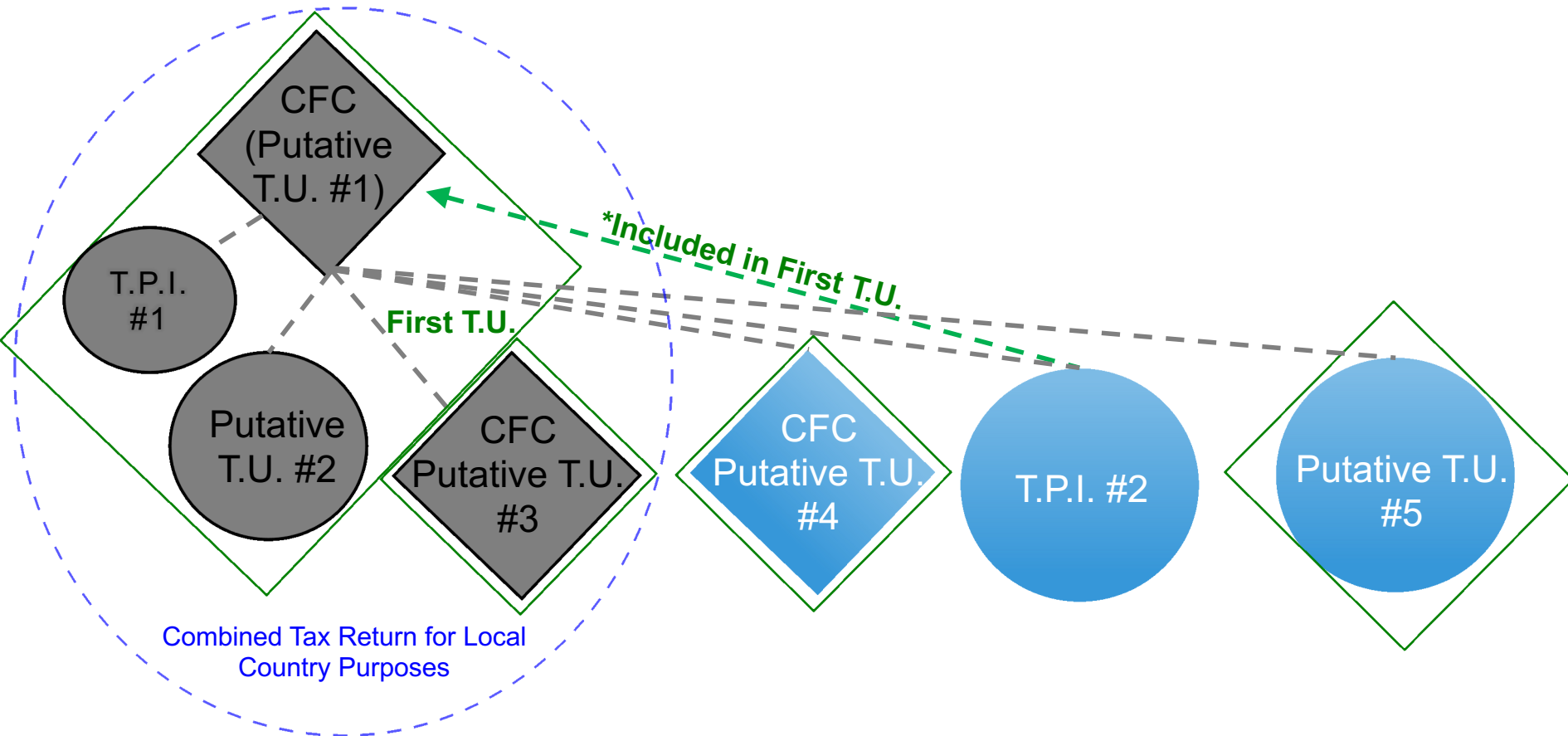


# Additional rules

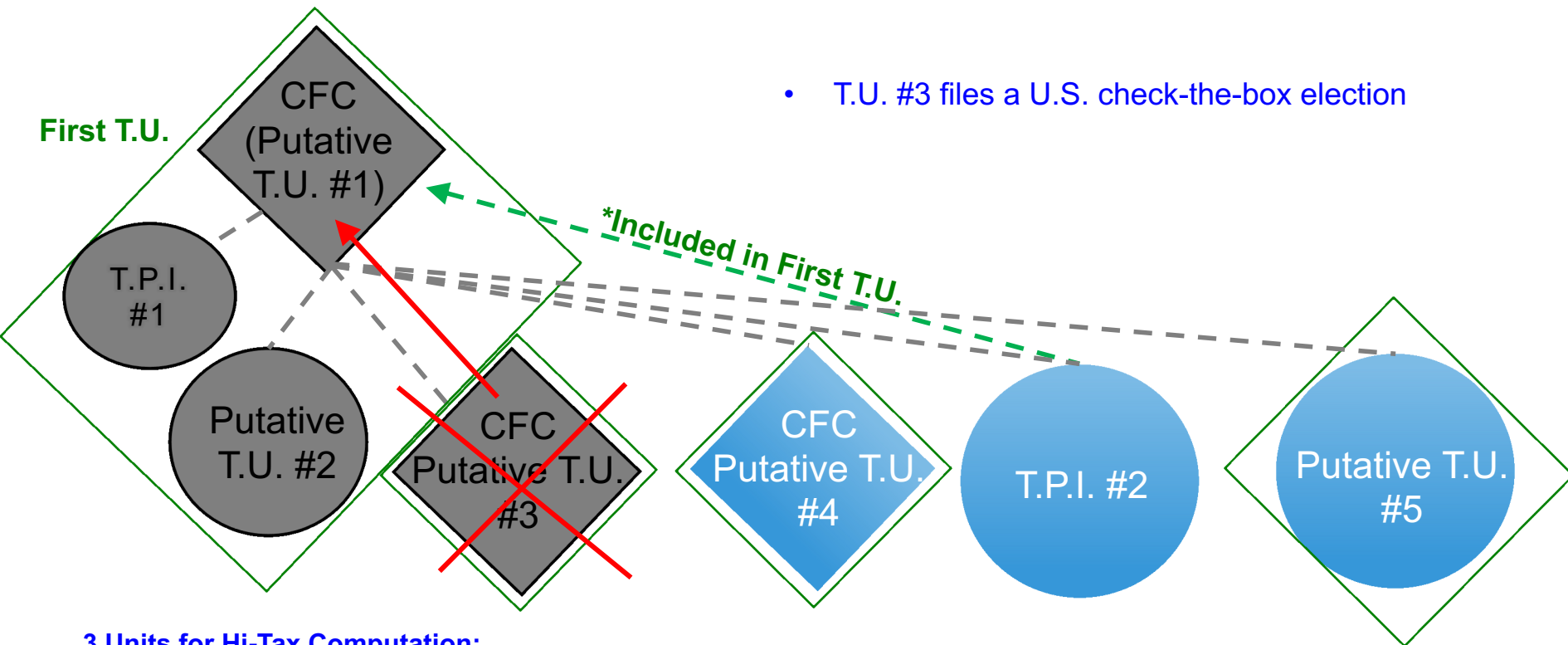
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- Gross income is determined under U.S. tax principles and adjusted for Disregarded Payments
- Consistency rules – Subpart F
- CFC Group rule
- Mechanics of Election by Controlling U.S. Shareholders
  - The election is binding on all U.S. Shareholders of the CFC
  - All-or-nothing election, i.e., must be made for all income of all Tested Units under common control that are considered high-taxed
  - The election is made on an annual basis on a tax return or amended tax return
  - Notice Required to Minority Shareholders

# T.U. Questions



## T.U. Questions (cont'd)



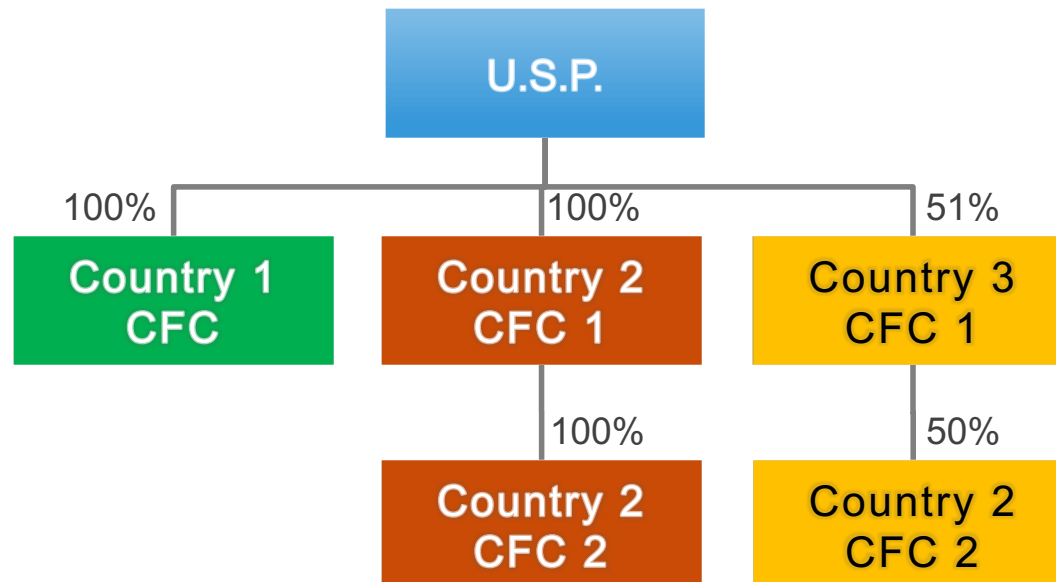
- T.U. #3 files a U.S. check-the-box election

### 3 Units for Hi-Tax Computation:

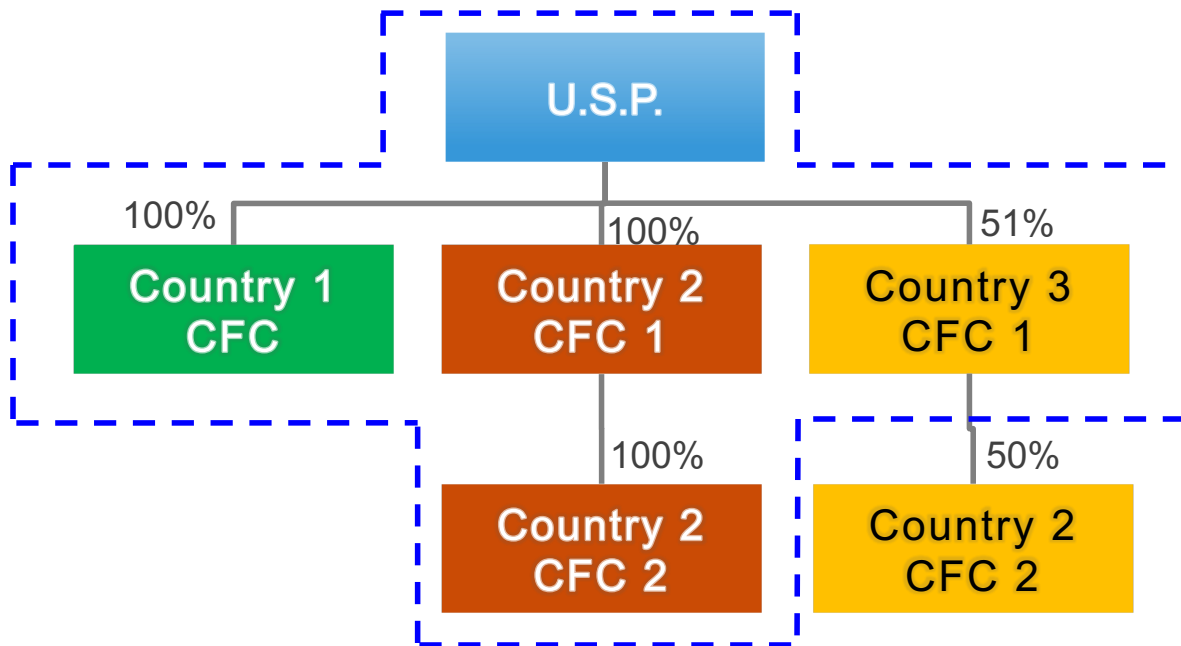
- $\Sigma \{ \text{T.U. \#1} + \text{T.U. \#2} + \text{T.U. \#3} + \text{T.P.I. \#1} + \text{T.P.I. \#2} \}$
  - T.U. #4
  - T.U. #5
- i.e., limited planning opportunity?*

## T.U. Questions (cont'd)

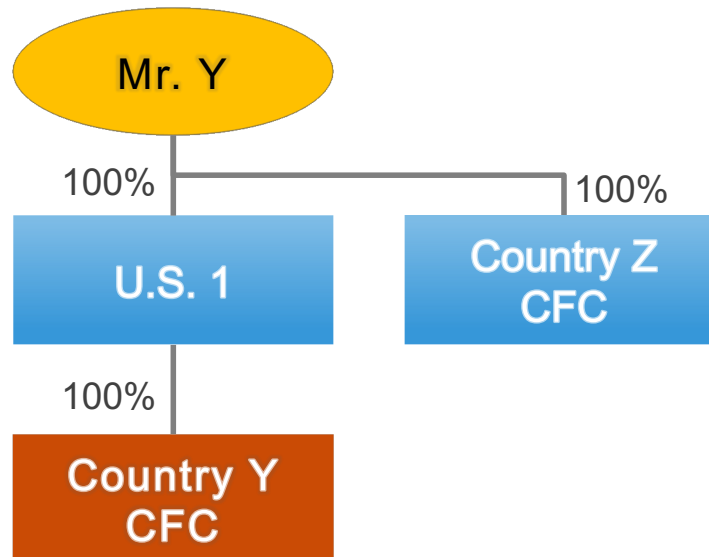
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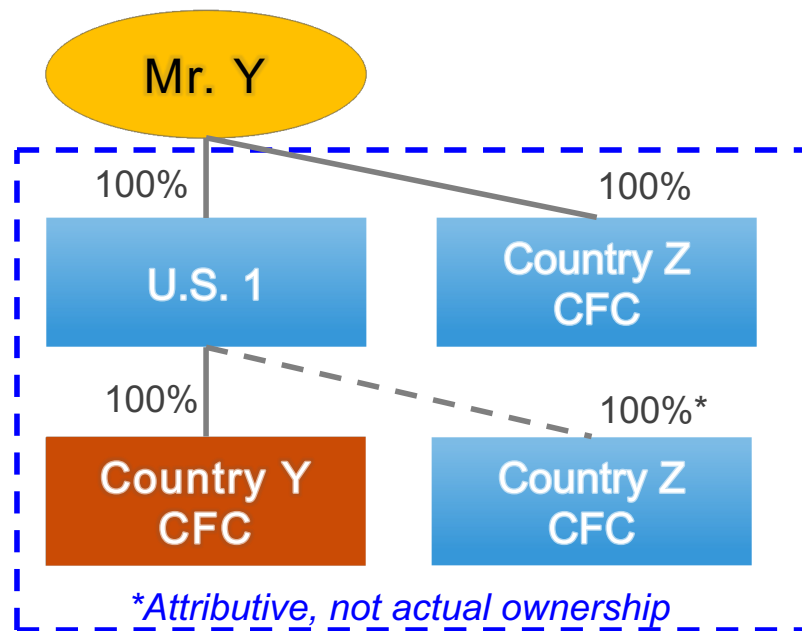
## T.U. Questions (cont'd)



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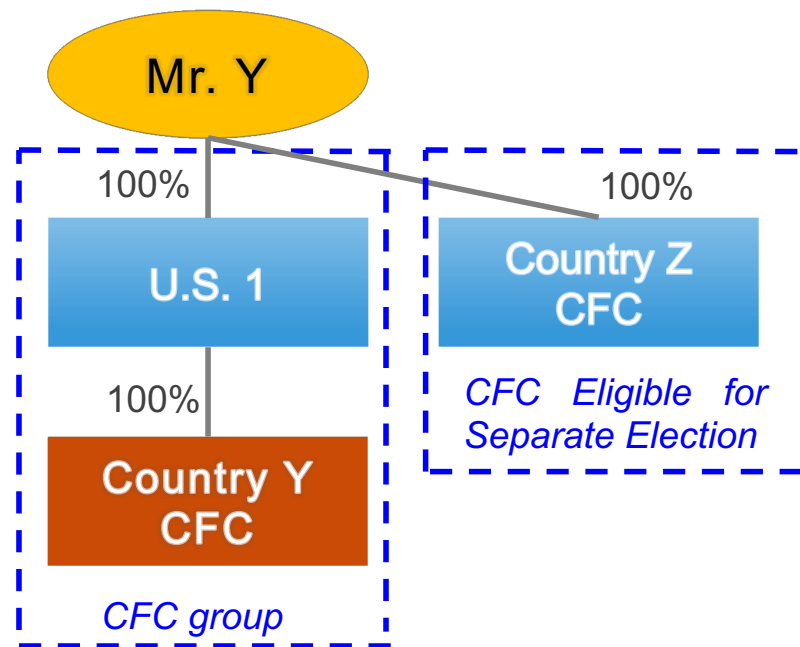


## Questions (cont'd)



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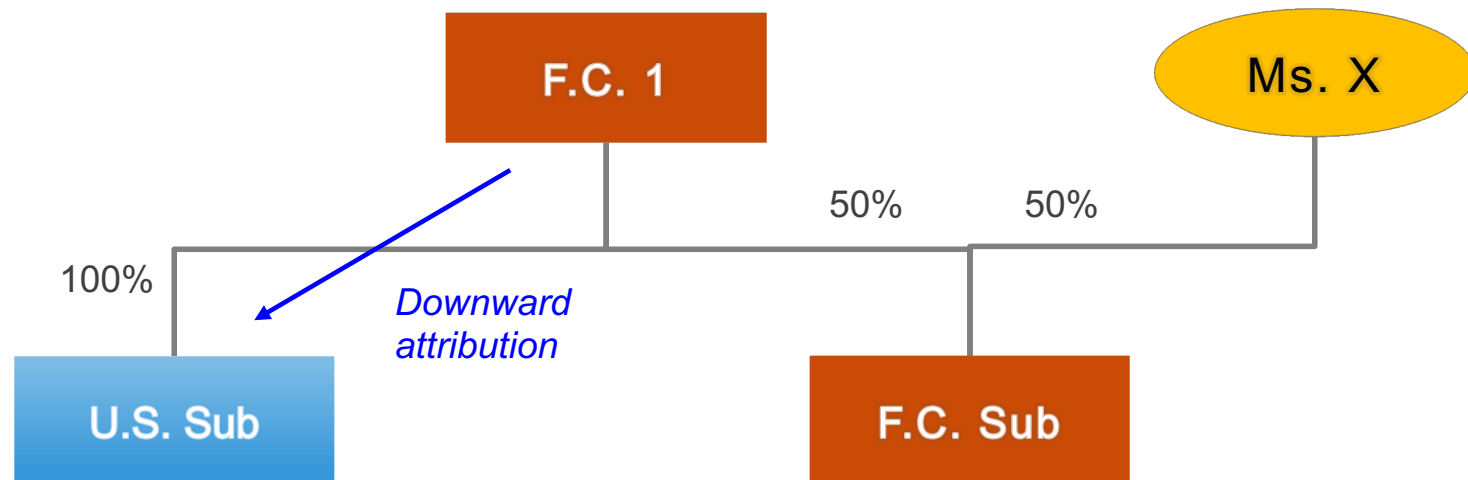
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## Questions (cont'd)

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## Some additional considerations

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- FTCs from the high-taxed CFC are not available
  - Examples
- Corporate U.S. shareholder may repatriate earnings tax free under §245A
- Q.B.A.I. from the high-taxed CFC isn't included in the D.T.I.R. calculation
- Individual U.S. shareholder would repatriate earnings at 37% tax, or 20% if the CFC is eligible for treaty benefits

# How is the Election made?

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## **The Controlling Domestic Shareholder Must:**

- File a statement under Reg. §1.964-1(c)(3)(ii), which includes identifying information for both the CFC and each Controlling Domestic Shareholder approving the Election, identifying other U.S. domestic shareholders notified of action taken, and other required details.
  - Unless there is one sole 100% U.S. owner, the Controlling Domestic Shareholders all are required to attach a statement describing the action taken to their U.S. tax or information returns.
- Provide notice to other U.S. domestic shareholders in the CFC, though failure to do so (apparently) does not invalidate the Election.
- Provide any additional information required by applicable administrative pronouncements.
- Additional requirements apply if the Election is made with retroactive effect on an amended return, filed within 24 months of the unextended due date.

## Proposed Regulations (REG-127732-19)

- Proposed regulations harmonize Subpart F and GILTI hi-tax rules and make significant innovations:
  - Single set of rules for Subpart F and GILTI under §1.954-1 (with the GILTI hi-tax rules to be withdrawn).
  - Negative E.T.R. computation results in deemed high-tax treatment (and inability to utilize F.T.C.'s).
  - New de minimis rule for T.U.'s: 1% of CFC's income or \$250k, combined with an antiabuse rule.
  - General antiabuse rule – where an “applicable instrument” is issued or acquired or a reverse hybrid is used with a significant purpose of avoiding GILTI or Subpart F rules.
  - Coordination rule regarding Subpart F's E&P Limitation.

# **§962 RELIEF FOR U.S. INDIVIDUALS OWNING CFCS**

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# Hypothetical Investment by U.S. Corp

- Subpart F and GILTI provisions applies equally to U.S. individuals and U.S. corporations
- Two major differences exist between the tax treatment of U.S. corporations and U.S. individuals under Subpart F
  - Disparity in tax rates
    - Individuals are taxed at rates up to 37% plus 3.8% N.I.I.T.
    - Corporation are taxed at a flat 21%
  - Indirect foreign tax credits
    - Corporations may claim a foreign tax credit for income taxes paid by a CFC at the time the operations of the CFC generate Subpart F Income
    - Individuals are not entitled to claim a foreign tax credit for foreign income taxes paid by a CFC

# Disparities of Treatment

U.S. CO



U.S. PERSON



## FACTS

- CFC taxable income      \$100
  - CFC income tax            15
  - Net income after tax      \$ 85
- 
- All income is Subpart F Income
  - No dividends are paid

50%

50%



CFC

# Disparities of Treatment

## U.S. Co Tax

- Share of Subpart F Income      \$42.50
- Share of foreign  
income taxes                      7.50
- Subpart F Income + Gross Up \$50.00
- Tentative Tax (at 21%)            10.50
- Less FTC                              (7.50)
- Net U.S. tax paid                   \$2.50
- Total taxes paid on  
share of pre-tax income           \$10.00

## U.S. Individual Tax\*

- Share of Subpart F Income      \$42.50
- U.S. income tax (at 37%)        \$15.75
- U.S. N.I.I.T. (at 3.8%)           1.62
- Total U.S. tax                        \$17.37
- Total taxes paid on  
share of pre-tax income\*\*       \$24.87

\* See below for tax when actual dividend is paid

\*\* \$7.50 + \$17.47 = \$24.87



## §962

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- §962 generally allows an individual who is a U.S. Shareholder to be treated as a domestic C-corporation for the purpose of computing tax on Subpart F Income
  - The amount will equal the tax imposed under §11 (relating to corporations), rather than under §1 (relating to individuals), and
  - The individual may obtain an indirect foreign tax credit for the shareholder's foreign taxes paid or accrued by the CFC with respect to the Subpart F Income allocable to the individual

## §962

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- When an actual dividend is paid by the CFC, it is treated as a dividend from a foreign corporation
  - The tax rate on the actual dividend is capped at either 20% or 37%, depending on whether the dividend is a qualified dividend
  - It is P.T.I. to the extent of the U.S. tax previously paid, which in the example is \$2.50

Actual dividend received	\$42.50
Less: P.T.I.	<u>(2.50)</u>
Net dividend income	<u>\$40.00</u>
Tax on Nonqualified Dividend @37% + N.I.I.T.	\$16.32*
U.S. income tax paid previously	\$ <u>2.50</u>
Total U.S. inc. tax + N.I.I.T. on §962 + actual dividend	\$ 18.82

\*U.S. tax on Qualified Dividend at 20% + N.I.I.T. = \$9.52

\*Total U.S. tax on §962 + Qualified Dividend @20% + N.I.I.T. = 12.02

# FACT PATTERNS

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Comparing High Tax Exclusion with §962 Election

## Fact patterns – H.T.E.

### Ex. 1 – cross crediting between high and low taxes

**Example 1. -- U.S. Corporate Shareholder and ability to cross credit in the context of an Hi-Tax Election**

			Alternative 1		Alternative 2	
			HT Election is made		HT Election is not made	
			Tested Unit 1 (High Tax)	Tested Unit 2 (Low Tax)	Tested Unit 1 (High Tax)	Tested Unit 2 (Low Tax)
	Gross Tentative Tested Income		100	100	100	100
	U.S. \$ amount of foreign taxes paid or accrued		25	8.5	25	8.5
	Net Tentative Tested Income		75	91.5	75	91.5
	Effective foreign Tax Rate		25%	8.5%	20%	7.83%
	Eligible for HTE election?		Yes, and the election is made	No	Yes, but the election is not made	No
	Tested Income for GILTI Computation		NA	100	100	100
	QBAI		NA	20	20	20
	Deemed Tangible Income Return	10%	NA	2	2	2
	GILTI Inclusion before Section 250 Deduction		NA	98	98	98
	GILTI Deduction	50%	NA	49	49	49
	Net income subject to GILTI Tax		0	49	49	49
	GILTI Tax	21%	0	10.29	10.29	10.29
	FTC available	80%	0	6.8	20	6.8
	Net U.S. Tax liability - Additional Tax outflow		0	3.49	0	3.49
	Excess FTC available				9.71	
	Cross Credit of foreign taxes paid on the high-taxed income against the GILTI tax liability on the low-taxed tested income - up to \$9.71					3.49
	Net U.S. Tax liability - Additional Tax outflow		0	3.49	0	0
	Unused FTC (cannot be c/f)		\$20.00	0	\$6.22	

# Fact patterns – H.T.E.

## Collateral Effects of H.T.E.

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- **Effect of High Tax Election in Subsequent distributions by CFC**
  - Subsequent distributions are not given automatic tax free-treatment
  - Distributions are not P.T.I. under §959
  - May be eligible under §245A to claim a 100% dividend received deduction if certain conditions are satisfied:
    - Specific Holding Period Requirement
    - Only the foreign source portion of the dividends are eligible for the deduction
    - Hybrid dividends are not eligible for the §245A D.R.D.

## Fact patterns - HTE

### Ex. 2 – Individual Shareholder – §962

	Tax rate		No Election	HT Election	§962	Code sections and Regulations
<b>GILTI Inclusion in Current Year</b>			882.50	882.5	882.50	§962 includes the GILTI Inclusion Amount – Reg §1.962-1(b)(1)(i)(A)(2)
§78 Gross up			NA	0	250.00	Reg §1.962-1(b)(1)(i)(A)(3); §78
GILTI Inclusion after Gross Up			NA	0	1,132.50	
GILTI Deduction	50%		NA	0	566.25	Reg. §1.962-1(b)(1)(i)(B)(3)
Net GILTI Inclusion			882.50	0	566.25	
GILTI Tax	21%	37%	326.53	0	118.91	§962
Foreign Tax Credit	80%		200.00	0.00	200.00	
Net GILTI Tax Payable			326.53	0	0.00	
Foreign Tax Credit Lost			200.00	200.00	81.08	
<b>Distribution in Year 2</b>						
Gross Distribution			632.50	632.50	632.50	
Foreign Withholding Tax	15%		94.88*	94.88	94.88	
Net Distribution after foreign WHT			537.62	537.62	537.62	
U.S. Taxes paid on GILTI Inclusion			NA	NA	0.00	
Distribution subject to U.S. Federal income tax			0 (P.T.I.)	632.50	632.50	
U.S. Federal Income Tax - Treaty Country	20%		NA	126.50	126.50	
Foreign Tax Credit			NA	94.88	94.88	
Tax Payable on Dividends			NA	31.62	31.62	
Net Investment Income Tax	3.80%		24.04	24.04	24.04	Reg. §1.1411-10(c)(1)(i)(A)(1)
Total Cash after GILTI Tax, Foreign WHT, and N.I.I.T.			187.05	481.96	481.96	
*§960(c) - FTC Limitation under §904			94.88*			

# ATTRIBUTION RULES

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# CFC and the U.S. Shareholder

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- CFC – more than 50% owned by U.S. Shareholders
- U.S. Shareholder – 10% ownership under both §958(a) and §958(b) counts
  - Compare with income inclusion under §951(a) and 951A (a) where only §958(a) ownership counts
- §958(a) ownership - direct and indirect ownership through foreign entities
- §958(b) ownership - constructive ownership



# Constructive Ownership

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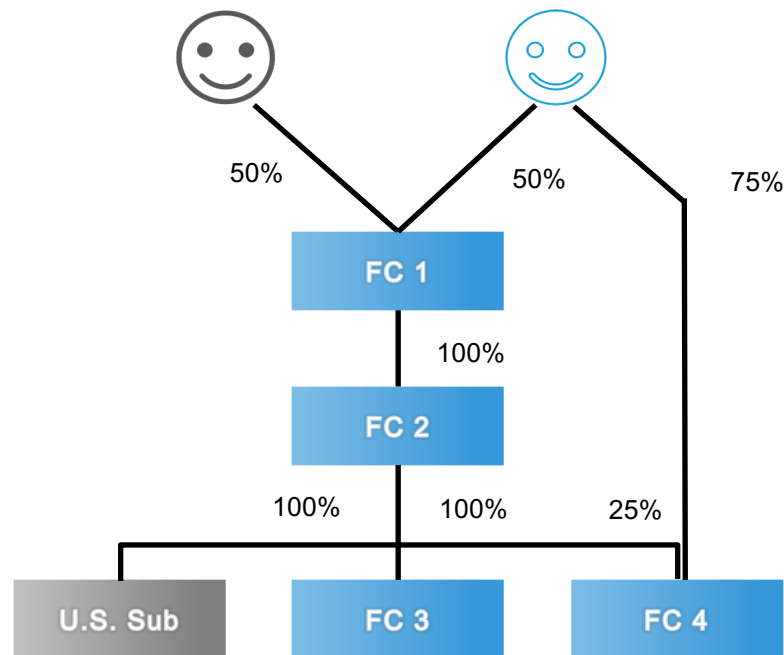
- Applies §318(a) attribution rules, as modified by §958(b):
  - Family attribution, only from U.S. family members (no sibling attribution)
  - Upward attribution from entities:
    - Attribution to shareholders from corporations, once 10% of the value is owned (reduced from 50% required under §318(a)(2)(C))
    - Attribution to partners from partnerships, with no threshold
  - “Mega attribution” to partners and shareholders from entities: once a corporation or a partnership own more than 50% of the vote in a lower-tier foreign corporation, it is deemed to own all of the vote in that lower-tier foreign corporation

# Constructive Ownership – Cont'd

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- Downward attribution:
  - Attribution to corporations from shareholders, of all stocks owned by shareholders, once 50% or more of the value is owned directly or indirectly
  - Attribution to partnership from partners, no threshold
- §958(b)(4) limited downward attribution so that it would not result in U.S. person treated as owning shares of a nonresident; this rule was repealed in the 2017 T.C.J.A. effective for tax years of foreign corporations beginning before 1.1.2018
- Operating rules relating to downward attribution:
  - Stock constructively owned by reason of downward attribution is not considered as owned for purposes of reattribution to shareholder (no sideways attribution)
  - Attribution not to result in a corporation treated as owning its own stock
  - A subsidiary cannot be deemed to control its parent or its parent's shareholder

# Effect of Repeal of §958(b)(4) - Example



U.S. Individual



Nonresident alien

# OWNERSHIP THROUGH DOMESTIC PASS- THROUGH ENTITIES

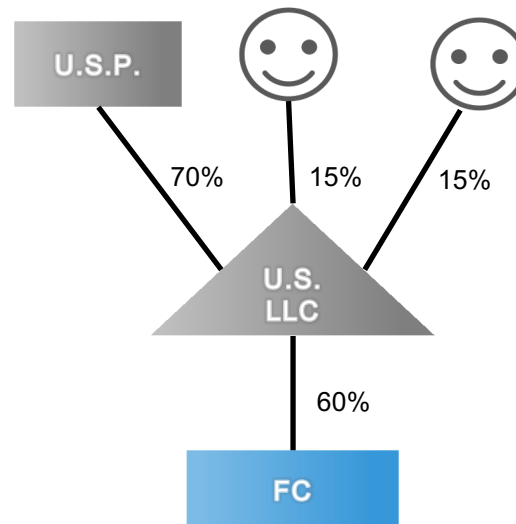
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# Ownership Through Domestic Partnerships/LLCs

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- Before 2017 T.C.J.A.
  - An entity or an aggregate?
  - Historically, I.R.S. took the view that a domestic partnership should be treated as an entity for Subpart F purposes
  - In contract, foreign partnerships, viewed as aggregate of partners
- Following 2017 T.C.J.A.
  - Proposed Regulations under G.I.L.T.I. provided for a hybrid approach: an aggregate of its partners for partners who were U.S. Shareholders and as an entity for partners who were not U.S. Shareholders
  - Final Regulations under G.I.L.T.I. and Proposed §958 Regulations (to equalize treatment for Subpart F income purposes) continue with a hybrid approach, but differently
- General Rule: aggregate approach = a domestic partnership is not treated as owning stock of a foreign corporation within the meaning of §958(a), and instead is treated in the same manner as a foreign partnership under §958(a)(2)
- Exception: for purposes of determining whether any U.S. person is a U.S. Shareholder (under §951(b), i.e., including constructive ownership), a controlling domestic shareholder or whether any foreign corporation is a CFC, a domestic partnership is treated as owning stock within the meaning of §958(a)

# Ownership By Domestic Partnership



 U.S. Individual

# FORM 5471 AND AVAILABLE RELIEF

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For Foreign Controlled CFCs

# Form 5471 Reporting Obligations

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- Applies to all U.S. Shareholders of CFCs
  - Constructive U.S. Shareholders
  - U.S. Shareholders of CFCs that are “foreign controlled,” meaning those that are treated as CFCs due to downward attribution from foreign persons
- Most categories of filers are required on annual basis
- Requires reporting of information relating to the CFC, irrespective of the need to include income from the CFC for the year
- May be required of a U.S. person who is not a U.S. Shareholder in the year of disposition reducing interest (including constructive) to below the 10% threshold



# Reporting Relief

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- Relief is available for U.S. Shareholders of “foreign controlled” CFCs
- Relief incorporated into the Form’s instructions
- Three freebies:
  - Category 1 and Category 5 filers are exempt from filing if no U.S. shareholder (including the filer) owns interest in the CFC under §958(a)
  - Category 1 and Category 5 filers are exempt from filing if the filer is an Unrelated Constructive §958(b) U.S. Shareholder
  - Category 1, 4 or 5 filers are exempt from filing if:
    - The filer does not own a direct or indirect interest in the CFC and
    - The filer is required to file only because of constructive ownership from nonresident alien (individual)

## Safe Harbor Relief Under Rev. Proc. 2019-40

- A determination by a U.S. person that a foreign corporation is not a CFC will be accepted if:
  - the U.S. person does not have actual knowledge or statements received that the entity is a CFC
  - There is no reliable publicly available information sufficient to determine that the entity is a CFC, and
  - If the U.S. person directly owns an interest in a foreign entity (top-tier entity), the U.S. person must engage in further due diligence with that top tier entity and inquire if it may be a CFC, if it owns directly or indirectly stock in another foreign corporation, or in a domestic entity
  - If a U.S. person directly or indirectly owns (§958(a)) stock in a foreign corporation, and an unrelated foreign person also directly or indirectly owns (§958(a)) stock in the foreign corporation, the U.S. person's failure to inquire of the foreign person whether that foreign person owns directly, indirectly or constructively stock of, or an interest in, a domestic entity will not preclude reliance on the safe harbor
- The safe harbor only applies to foreign controlled CFCs

# Safe Harbor Relief for Using Alternative Information

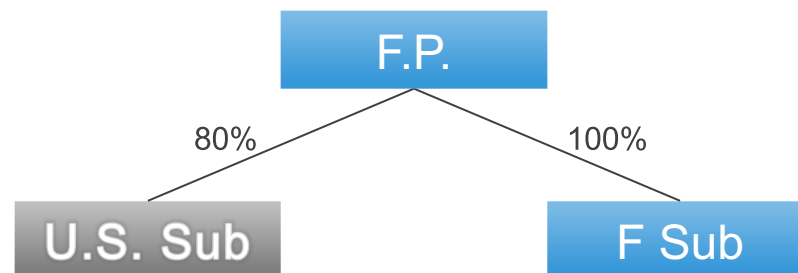
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- An Unrelated §958(a) U.S. Shareholder and Unrelated Constructive U.S. Shareholder that are not relieved from filing, but have no readily available information, may use alternative information if:
  - The CFC is foreign controlled, and
  - There is no Related §958(a) U.S Shareholder.
- Rev. Proc. 2019-40 provides penalty relief for failure to file a under the safe harbor and for accuracy related penalties for amounts based on alternative information

# Relief Examples I

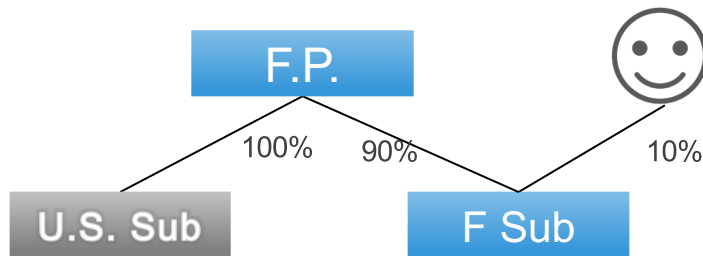
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- U.S. Sub is a Related Constructive U.S. Shareholder
- No §958(a) shareholder
- F Sub is a CFC only due to downward attribution from a foreign person
- U.S. Sub may benefit from a “free pass”



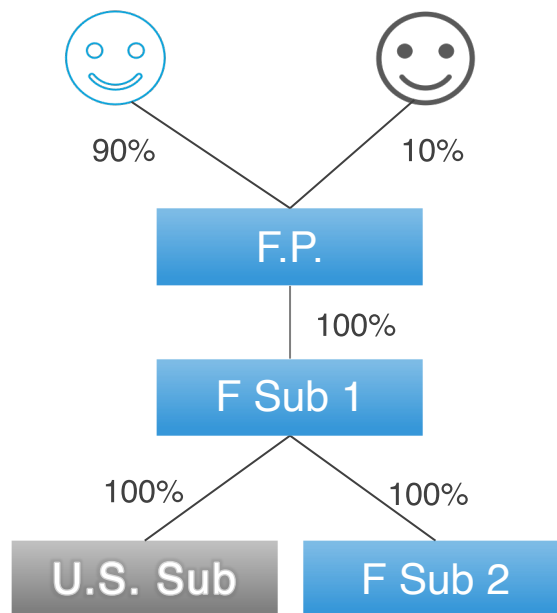
# Relief Examples II

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- U.S. Sub is a Related Constructive U.S. Shareholder
- U.S. Individual is an Unrelated §958(a) U.S. Shareholder
- F Sub is a CFC only due to downward attribution from a foreign person
- We have a §958(a) shareholder so no “free pass”
- Safe Harbors of Rev. Proc. 2019-40:
  - If no knowledge and no publicly available information
  - U.S.I. directly owns 10% interest in the CFC so it must engage in further due diligence and ask it if it could be a CFC
  - U.S. Sub does not own direct interest in a foreign entity and thus isn't required to further inquire

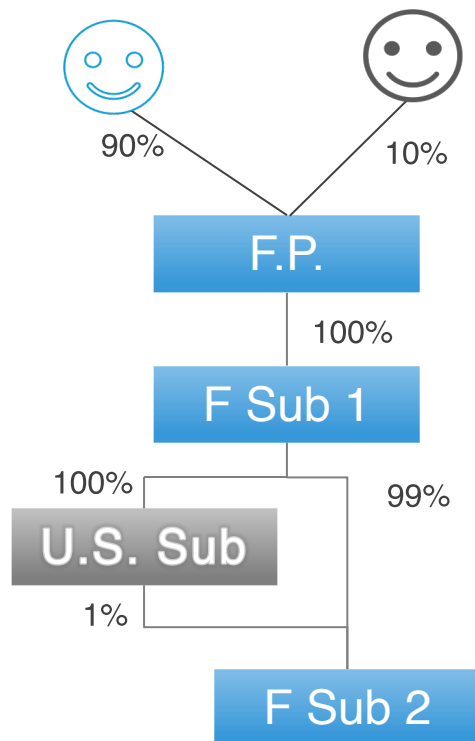
# Relief Examples III



😊 U.S. Individual  
😊 Nonresident alien

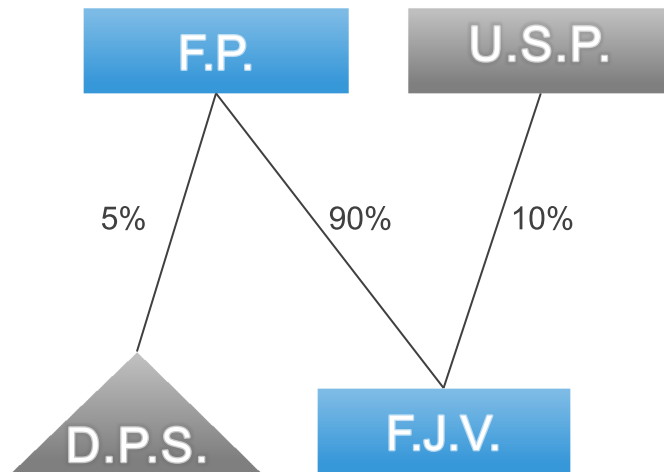
- F Sub 2 is a CFC only due to downward attribution from a foreign person
- U.S. Individuals is an Unrelated §958(a) U.S. Shareholder
- U.S. Sub is a Constructive Related U.S. Shareholder
- There is a §958(a) shareholder and attribution is not from a “nonresident alien”
- No “free pass” reliefs
- For Safe Harbor:
  - U.S. Individual must inquire because directly owns interest in a foreign entity
  - U.S. Sub doesn’t have to inquire
  - If filing required, alternative info relief available only to U.S.I.

# Relief Examples IV



- F Sub 2 is a CFC due to downward attribution from a foreign person
- U.S. Individuals is an Unrelated §958(a) U.S. shareholder
- U.S. Sub is a Related §958(a) U.S. shareholder
- No free passes
- Safe Harbor:
  - Both U.S. Sub and U.S.I. must inquire further because both own direct interest in a foreign entity
  - If filing obligation applies, the alternative information relief is not available (because U.S. Sub is related §958(a))

# Relief Examples V



- F.J.V. will be a CFC due to downward attribution from a foreign person (10% threshold only for §965)
- D.P.S. is a Related Constructive U.S. Shareholder
- U.S.P. is Unrelated §958(a) U.S. Shareholder
- No free passes
- Safe Harbor:
  - U.S.P. must inquire further with F.J.V. Not inquiring with F.P. doesn't preclude reliance
  - D.SP. Doesn't have to inquire further
  - If filing obligation, U.S.P. may use alternative information



# PROPOSED REGULATIONS – §163(j) ELECTION FOR CFCs

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# Notice of Proposed Rulemaking

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In August, the I.R.S. issued final §163(j) Regulations, T.D. 9905, and concurrently issued a Notice of Proposed Rulemaking (REG-106089-18) relating to application of the §163(j) limitation to CFCs, for purposes of determining how much interest expense should be taken into account under Reg. §1.163(j)-7 in determining Tested Income (“Proposed Regulations”).

- The Proposed Regulations would apply the §163(j) limitation to CFCs in the same manner as applicable to a domestic corporation, for purposes of determining Subpart F, GILTI Tested income, and E.C.I., subject to modifications.
- They observe that if §163(j) rules developed in the domestic context are applied to CFCs without modification, inappropriate increases to the U.S. Shareholder’s GILTI income may arise on the basis of intercompany debt between CFCs (deductions disallowed without corresponding income reduced); hence, a unitary election may be made for all the C.F.C.’s in the controlled group.
- A CFC group includes entities in which the group owns 80% of vote or value; in the case of a married couple or a domestic consolidated group, §318 attribution applies so that the total interests may reach 80%.
- As the Regulations are in proposed form, a reasonable position may be had to apply them before they are published as final.

## Further reading and forms

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- Andreas Apostolides & Neha Rastogi, “Final G.I.L.T.I. High-Tax Regulations and the Tested Unit: Would a Rose by Any Other Name Smell as Sweet?” in *Insights*, Vol. 7, No. 5, discussing several of the concepts contained in this presentation – at <http://www.ruchelaw.com/publications/final-gilti-high-tax-regulations-and-the-tested-unit-would-a-rose-by-any-other-name-smell-as-sweet>
- Galia Antebi & Nina Krauthamer, “New Partnership International Information Return Schedules” in *Insights*, Vol. 7, No. 5, discussing new I.R.S. schedules providing partners with partnership return schedules and instructions to address the reporting of income from international transactions, including for G.I.L.T.I. purposes – at <http://www.ruchelaw.com/publications/new-partnership-international-information-return-schedules>
- For Forms used to make the Hi-Tax Election, see 3 attached documents in Word included in the email together with this presentation, which include: (i) a joint consent form signed by the Controlling Domestic Shareholders; (ii) a notice from the Controlling Domestic Shareholder to other Domestic Shareholders, and (iii) a Statement to be filed together with the Controlling Domestic Shareholder (or Shareholders’) U.S. Federal income tax return for the year that includes the CFC’s inclusion year

# Important Notice

This presentation is not intended to be legal advice. Reading these materials does not create an attorney-client relationship. The outcome of each case stands on its own merits.