# Are You Feeling GILTI, or Just BEAT? Some [Unintended?] Intersections of the New International Tax Rules

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## Get Out of the Pool!

Some Interactions Among Subpart F, Section 956, GILTI and PTI

## GILTI Is a Shareholder Item and Isn't a Type of Income

**You Can't Find it Just by Looking at A Single CFC, No Matter How Hard You Try**

- If you're used to working with subpart F and section 904 income "baskets," it's tempting to think of GILTI as a certain type of income (like royalties or interest or general or passive category income).
- But, GILTI is a quantitative idea, and almost any kind of income can be GILTI, or not be GILTI, depending on the context.
- This makes tax planning a lot trickier.

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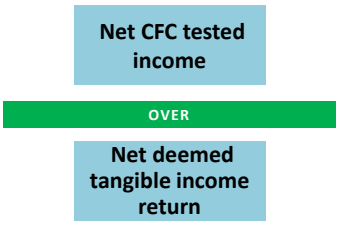
## Defined in Quantitative, Not Qualitative Terms

- "Global Intangible Low Taxed Income" ("GILTI") is defined *with reference to the relevant United States shareholder, as the excess of:*




- This has a flavor of trying to tax "intangible" income while not taxing returns on tangible assets, but that's not the way to think about this.

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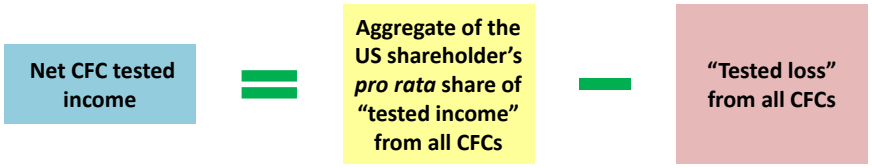
## Defined in Quantitative, Not Qualitative Terms *(cont'd)*




- "Tested income" is all income (reduced by "properly allocable" deductions) other than:
  - ECI
  - Subpart F income (and income under the "high-tax kickout")
  - Related party dividends
  - FOGEI
- "Tested loss" is created when a CFC's "properly allocable" deductions exceed the CFC's gross tested income

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## Defined in Quantitative, Not Qualitative Terms *(cont'd)*

- "Net deemed tangible income return" is:
  - (i) any tested income in an amount up to 10% of the U.S. tax basis on all "Qualified Business Asset Investments" ("QBAI"), minus
  - (ii) interest expense that doesn't give rise to tested income for the United States shareholder somewhere else.
- But note that this is measured at the level of the shareholder – so what matters is a United States shareholder's aggregate pro rata portions of QBAI of different CFCs.
  - QBAI is "specified tangible property" used in a trade or business for which a depreciation deduction is allowed.
  - "Specified tangible property" is any tangible property "used in the production of tested income."

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## Defined in Quantitative, Not Qualitative Terms

- Attributes do need to be allocated to CFCs.
  - For purposes of several Code sections, including sections 959 and 961, once GILTI is calculated by the United Shareholder, GILTI then is reattributed back to all CFCs that had positive tested income on a pro rata basis by reference to the aggregate tested income of each CFC taken into account by the United States shareholder.

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## FTCs and deductions

- Income taxes allocable to GILTI income are creditable, with a 20% haircut.
  - GILTI is now a separate basket with no carryforwards or carrybacks.
- Section 250
  - Allows a deduction equal to 50% of:
    - GILTI inclusions, and
    - Section 78 gross up amounts attributable to FTCs in respect of GITLI income.

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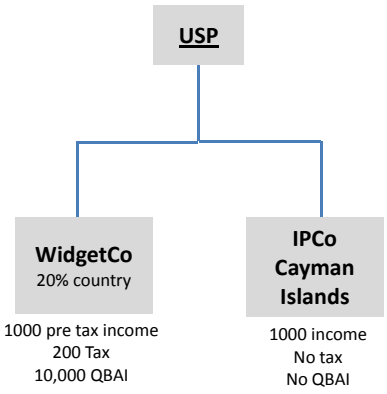
# Example One




- What is USP's GILTI inclusion?
  - *Not* 1000 from the Cayman Islands, although that would have been the result if IPCo had been an only child. Instead:


  - Net CFC tested incomed = 1800 (1000 from IPCo and 800 from WidgetCo)
  - Net deemed tangible income return = 1000
  - GILTI inclusion = 800 (Not taking into account section 78, discussed later)
  - Note that the income taxes paid by WidgetCo, in addition to being creditable, freed up capacity to provide "cover" to IPCo.

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# Example One *(cont'd)*

- How is GILTI allocated back down?
  - On a pro rata basis by reference to WidgetCo's and IPCo's positive net tested income
    - WidgetCo gets 800/1800 of the GILTI.
      - 800*800/1800 = 355.56
    - IPCo gets 800*1000/1800 = 444.44
  - What credits does USP get?
    - 80% * "inclusion percentage" * "tested foreign income taxes"
      - Inclusion percentage = GILTI/tested income (for USP)= 800/1800
      - Tested foreign income taxes = taxes "properly attributable to the tested income [of the relevant CFC] taken into account by such domestic corporation under section 951A."
        - » So, tested income includes WidgetCo's income, and it was "taken into account" under section 951A, even though it wouldn't have given rise to a GILTI inclusion without IPCo.
    - 80%*800/1800 * 200 = 71.11 FTCs allowable to USP.
  - GILTI = 800, minus the deduction of 400 allowed under section 250= 400 of taxable income. Then 400*21%= 84 of tax liability..
  - 84 minus 71.11= 12.89 of residual tax liability for USP (assuming no additional expense allocation).

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## Example One *(cont'd)*

- How are section 78 gross up amounts treated?
  - They are included in income (i) *without* the 20% haircut (basically treated as a dividend to which the section 245A DRD does not apply, and (ii) *with* the benefit of the section 250 deduction.
    - 800/1800*200=88.89, and 88.89/2 = 44.45 of additional net income
  - Is this extra amount treated as GILTI for purposes of section 904?
  - **These slides assume that section 78 gross ups are not in the GILTI basket**, but the point may not be clear.
    - If yes, the income could use up GILTI FTCs that might otherwise be lost.
  - Legislative history described the gross up amount as an "increase in GILTI for purposes of section 78."
  - Section 250 refers to the gross up and the GITLI inclusion as two separate items.

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## Examples Two & Three

| Example Two | Example Three |
|---|---|
| • Same as Example One, except that WidgetCo's QBAI is 20,000<br>– Net deemed tangible income return is 2000, and USP has no GILTI in respect of its investment in IPCo. | • Same as Example One, except that WidgetCo makes only 1.00 of after-tax income, rather than 1000<br>• QBAI "cover" of 1000 remains, so GILTI inclusion is only 1 (1001 minus 1000). |

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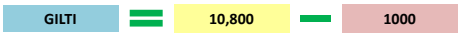
## Example Four (Is section 956 really such a hot new cool way to bring home credits?)

- Same as Example One, except that:
  - (i) USP thinks that WidgetCo will have some creditable taxes to bring up, so it puts in place a section 956 loan, and
  - (ii) IPCo has a banner year and makes 10,000
- Result:




  - Of that amount, 800/10,800 is allocable to WidgetCo.
    - 9800 * 800/10,800 = 725.93
    - So, of WidgetCo's 800 of taxable income, 725.93 is PTI
    - Of WidgetCo's 200 of credits, 196 were brought up under the GILTI regime and haircut (200 *9800/10000=196). The section 956 inclusion might bring up the remaining 4.
- So WidgetCo has 74.07 (800-725.93) of E&P that's not PTI, and 4 of taxes. With a section 78 gross up, that gives you a tax rate of 5.4% (4/78.07)

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## Example Four *(cont'd)*

- To implement a section 956 strategy, USP then has to:
  - Take a view on how much PTI will be created for WidgetCo based on what IPCo might do
  - Take a view on WidgetCo's ETR after FTCs are brought up under section 951A(a)
  - Manage section 956 by reference to an average of quarter-end balances.
  - Incur interest expense (which may or not be deductible under BEAT) and add to WidgetCo's tested income.
- More wrinkles
  - What if IPCo issued new equity to someone during the taxable year?
  - What if WidgetCo or IPCo had issued debt that was recharacterized as equity for US. tax purposes?

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## Example Five

- Same as Example One, except that WidgetCo loses 1
- No QBAI cover (footnote 1536 of the Senate Report says assets used in the "production of tested loss" are not QBAI).
  - How does one know which assets are used in the production of tested loss, other than by looking at the overall net result in a particular CFC?
  - Does it matter if WidgetCo has a profitable business and a loss business, and the loss business lost $1 more than the profitable business earned?
- 999.00 of GILTI income with no tax credits
- Deduction of 499.5, so taxable income of 499.5 * 21% = 94 of liability (assuming no expense allocation).

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## Example Six

- Same as Example One, except that (i) WidgetCo loses 600 and (ii) IPCo has 100 of tax liability (for after tax income of 900)
- GILTI = 300 (Net CFC Tested income = 900-600, and there's no QBAI cover).
- FTC Inclusion Percentage = 300/900 = 33%, so 33*80%=26.4 FTC allowable
- GILTI tax = 300-150 (section 250 deduction) =150. 150*21%=31.5. 31.5-26.4=5.1 of residual tax liability. What happens to IPCo's remaining 67 of income taxes?
  - Is it possible to bring them up through section 956?
  - If so, then presumably the taxes come up with no haircut and not subject to the GILTI limitations.

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## Example Six *(cont'd)*

- What if WidgetCo and IPCo were DREs under a single CFC parent?
  - Inclusion percentage would be 100% and all 100 of taxes would be allowed (subject to haircut)
  - Would the assets be QBAI? They were still used in the production of a "loss", but not a "tested loss" since that is measured at the level of the CFC and not at the level of the branch.
  - If the inclusion percentage is now 100%, then all of the FTCs would be under the GILTI basket and subject to those rules, which might be a bad thing in some circumstances.
- What if WidgetCo is a reverse hybrid under IPCo?
  - IPCo's taxes reduced to 40, and only 33% of that comes up = 13.2
  - Arguably inconsistent with policy, since foreign and U.S. tax bases are the same.
  - Loss surrender/Consolidation

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## Losses reduce GILTI and decrease inclusion percentages, but what do E&P deficits do?

- Imagine CFC A merges into CFC B at the end of Year 1, and both are direct, wholly owned subs of USP.
- CFC A has an E&P deficit of (1000) at the time of the merger.
- In Year 2, CFC B (a financial services company with no tangible assets to speak of) earns 1000 of income after tax.
  - CFC B now has 1000 of GILTI income and 0 E&P.
  - Presumably USP has a PTI account of 1000.
    - But section 959(a) refers to distributions out of "previously taxed earnings and profits."
      - Does CFC B have a 1000 of E&P for these purposes to distribute?
      - This may not matter, since the payment presumably is excluded from income and grinds basis either way.

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## Losses reduce GILTI and decrease inclusion percentages, but what do E&P deficits do? *(cont'd)*

- But what if CFC B makes a payment to a sister CFC C at the end of Year 2 in respect of an instrument that is treated as debt in CFC B's jurisdiction and as equity for U.S. federal income tax purposes?
- If the payment is treated as PTI out of earnings and profits, then is it a hybrid dividend under section 245A(e)?
- Is it then subpart F income, or PTI, or both?
- Or is this just a payment that grinds basis and isn't income?

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## Is it so bad to be GILTI?

- If USP lends money to its wholly-owned CFC, then it has interest income.
  - The interest deduction may reduce GILTI, or not, depending on whether the effects of the deduction are fully offset by the loss of QBAI cover.
  - Maybe the interest income is in the GILTI basket?
  - Taxed at 21%.
- But instead, what if USP makes an equity contribution to CFC?
  - GITLI income taxed at 10.5% -- with credits (albeit subject to a haircut).
- What if USP borrows in the U.S. to fund a Cayman entity that makes loans to its internal CFC affiliated group?
  - U.S. deductions, GITLI income at the CFC taxed at 10.5%, and deductions in the ultimate borrowing jurisdictions.
- If the Cayman Islands had the infrastructure to support it, the "stick" of GILTI would give U.S. multinationals every reason to relocate their businesses there.

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# Get With the BEAT!

## Scope of Section 59A(e)(3)'s Aggregation Rule

- Section 59A applies to an "applicable taxpayer"
- Section 59A(e)(1) defines an applicable taxpayer, with respect to any taxable year, as a taxpayer that is,
  - A corporation other than a RIC, a REIT, or an S corporation,
  - With average annual gross receipts for the 3-taxable-year period ending with the preceding taxable year of at least $500 million, and
  - A base erosion percentage (defined in section 59A(c)(4)) for the taxable year of at least 3 percent (or 2 percent for certain taxpayers)

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## Scope of Section 59A(e)(3)'s Aggregation Rule

- Section 59A(e)(3) provides that all persons treated as a single employer under section 52(a) are treated as 1 person for purposes of sections 59A(c)(4) and 59A(e), except that in applying section 1563 for purposes of section 52, foreign corporations are included.
- What is the scope of this aggregation rule?
  - Is it relevant only for purposes of the gross receipts and base erosion percentage tests of Section 59A(e)(1)(B) and (C)?
  - Or is it relevant for all purposes of Section 59A, including for determining whether any base erosion payments are made and an applicable taxpayer's BEAT liability?

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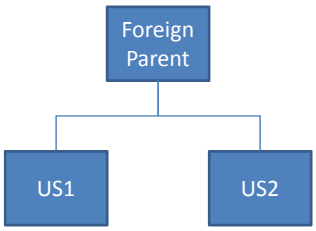
## Scope of Section 59A(e)(3)'s Aggregation Rule




| Year 1 | US1 | US2 |
|---|---|---|
| Gross Income | $1000x | $800x |
| Interest Paid to FP | $0x | <$300x> |
| BEAT Depreciation | $0x | <$150x> |
| Non-BEAT Deductions | <$1800x> | $0x |
| NOL deduction | $0x | $0x |
| Taxable Income | <$800x> | $350x |

- Are US1 and US2 treated as a single applicable taxpayer to determine the BEAT liability for Year 1?
- If FP had ECI gross receipts, would the aggregation rule disregard the interest paid by US2 to FP?

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## Statutory Scheme – Aggregation Generally

- Section 59A(e)(3) contains an aggregation rule that applies for purposes of defining who is an applicable taxpayer (that is, for purposes of the gross receipts and BEP tests)
- Section 59A(e)(2)(B) provides that in determining gross receipts, rules similar to those contained in section 448(c)(3)(B), (C) and (D) apply
  - Interestingly, the aggregation rule of section 448(c)(2), which is identical to that of section 59A(e)(3), is not cross-referenced
  - Nevertheless, because the same aggregation of gross receipts applies for purposes of both sections, regulations issued under section 448(c)(2) should suggest some answers
  - These rules are described next

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## Statutory Scheme – Gross Receipts

- Section 448 aggregation rules:
  - Ignore intercompany receipts; this of course is a rule that must be imported into section 59A in order for it to work at all. Reg. 1.448-1T(f)(2)(ii)
  - Gross receipts from the sale of capital assets are limited to gains. Again, seems necessary. Reg. 1.448-1T(f)(2)(iv)
  - Gross receipts of tax-exempt entities are counted only if they are unrelated business income. Reg. 1.448-1T(f)(2)(i)
- Note the similarity between the tax-exempt entity rule in the domestic context and the exclusion of all but ECI of a foreign corporation under section 59A(e)(2)(A)

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## Statutory Scheme – BEP

- As in the case of gross receipts, in determining the BEP, group members are aggregated
- Very confusing drafting here:
  - The general aggregation rule of section 59A(e)(3) says to aggregate "for purposes of this subsection," which includes the BEP factor with a cross-reference to (c)(4)
  - But the same rule says "for purposes of this subsection ***and*** subsection (c)(4)"
  - Note that the definition of BEP in (c)(4) begins "For purposes of paragraph (1)(B)." But that paragraph is only about calculating the BEP of any NOL
- All this has led some to question whether the operative rules of (c)(4) incorporate an aggregation rule that seems intended only for determining who is an applicable taxpayer

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## Statutory Scheme – Separate Company Calculation

- Once the Applicable Taxpayer definition is met, each member of the group is separately liable to the BEAT and performs its own separate company calculation of the tax
  - Section 59A(a) provides: "There is hereby imposed on *each* applicable taxpayer . . . "
- So, if you are a small corporation that is part of a large group, you are subject to the BEAT on your own

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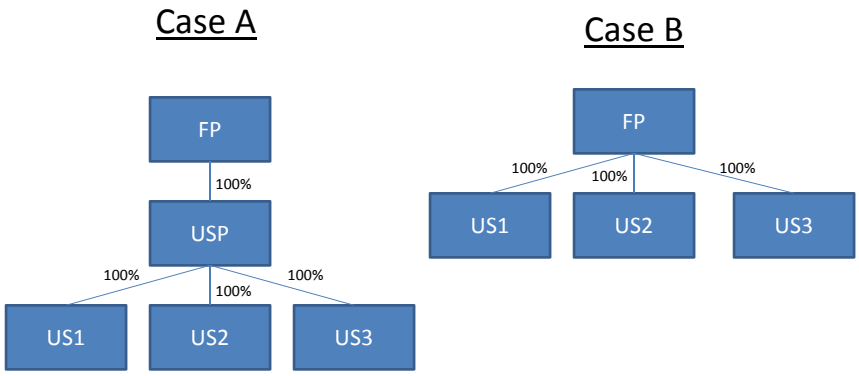
## Two Structures

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## Comparison of Cases A and B

- In Case A, there is a large US group, whereas in Case B there are only small stand-alone US taxpayers
- In Case A, there is only one source of base erosion payments, USP, whereas in Case B there are three separate sources
- It follows that the operative rules will apply differently in the two cases unless the statute is interpreted to require aggregation for purposes of the operative rules

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## Comparison of Cases A and B32

- There are numerous differences in the tax treatment of foreign-owned US consolidated groups and separate US subsidiaries
- Assuming that the BEAT amounts differ in Cases A and B, should we assume that the aggregation rules apply in the same way to Case A and Case B? Is there a possibility that aggregation should not be required in Case B?
  - Note that in Case B, the only common ownership is through FP, which cannot have a BEP
  - If FP also has no counted gross receipts (ECI), is there any reason to aggregate?

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## How is "Modified Taxable Income" Calculated? – NOLs

- Modified taxable income means the *taxable income* of the taxpayer *computed under this chapter for the taxable year*, determined without regard to—
  - Any base erosion tax benefit with respect to any base erosion payment, or
  - The base erosion percentage of *any net operating loss deduction allowed under section 172 for the taxable year.*
- Unclear whether the "base erosion percentage" of a NOL deduction is the percentage for the tax year in which the NOL was incurred or the year in which the NOL deduction is claimed
  - The former would exempt pre-TCJA losses, but the latter could result in different percentages applying to a NOL that is deducted over multiple tax years.
- More importantly, can the starting point for determining a taxpayer's modified taxable income be a negative amount?

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## How is "Modified Taxable Income" Calculated?

- Section 63(a) generally defines "taxable income" to mean gross income minus the deductions allowed by Chapter 1 of the Code (other than the standard deduction).
- Current section 172(a) allows a deduction for a taxable year equal to the lesser of—
  - The aggregate of the NOL carryovers and carrybacks to such year, or
  - 80% percent of taxable income computed without regard to the NOL deduction otherwise allowable in such year.
- However, current section 172(a)'s 80 percent limitation applies only to losses arising in tax years beginning after December 31, 2017.
- Former section 172(a) allowed a deduction for a taxable year equal to the aggregate of the NOL carryovers and carrybacks to such year.
  - Section 172(b) determines the NOL carryforward to another tax year.

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## How is "Modified Taxable Income" Calculated?

| | Regular Taxable Income | Modified Taxable Income |
|---|---|---|
| Gross Income | $1000x | $1000x |
| Interest Paid to Related CFCs | <$100x> | $0x |
| Depreciation on Property Purchased from Related CFCs | <$200x> | $0x |
| Non-BEAT deductions | <$700x> | <$700x> |
| Deduction for Pre-TCJA NOL carryforward | <$500x> | <$350x>* |
| | <$500x> | <$50x> |

* Assumes application of the current year 30% base erosion percentage.

- Section 172(b) would provide for a $500x NOL carryforward to another tax year.
- Is that amount reduced because the NOL carryforward is used to offset the BEAT addbacks?
- Or is a separate BEAT NOL carryforward determined for use in other tax years?

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# It's All About the Rate!


## Selected Tax Rate Comparisons – Nominal and Effective

| | Fed./Prov. Statutory Tax Rates Combined (OECD) | | | |
|---|---|---|---|---|
| Country | 2000 | 2018 | 2000-18 Pct. Pt . Chg. | 2014 ETR of CFCs (FTC/Cur. E&P) * |
| **Selected Trading Partners** | | | | |
| Canada | 42.43% | 26.80% | -15.63% | **14.55%** |
| Germany | 51.61% | 29.83% | -21.78% | **18.46%** |
| Japan | 40.87% | 29.74% | -11.13% | **23.28%** |
| United States | 39.34% | 25.84% | -13.50% | -- |
| **Selected Low-Tax Countries** | | | | |
| Ireland | 24% | 12.50% | -11.50% | **3.10%** |
| Netherlands | 35% | 25% | -10.00% | **7.50%** |
| Switzerland** | 24.93% | 21.15% | -3.78% | **7.74%** |
| United Kingdom | 30% | 19% | -11.00% | **7.71%** |

OECD Tax Database - Table II.1 dataset (6-18-18) * Author calculations based on 2014 IRS Statistics of Income for profitable CFCs. ** Does not take account of companies eligible for special tax status, proposed to be repealed, or proposed tax reforms and rate reductions.

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**Mitigating Double Taxation with Exemption and Foreign Tax Credit – §960**

- Section 960 conditions – Post-TCJA
  - Domestic corporation is United States shareholder in controlled foreign corporation (CFC)
  - CFC has Subpart F income or GILTI
  - Foreign income taxes attributable to Subpart F income or GILTI "tested income"
- Section 960 conditions from prior law:
  - Earnings are determined under US rules; use post-1986 pools
  - Earnings are for the whole year; "nimble dividend" rule applies

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**Mitigating Double Taxation with Exemption and Foreign Tax Credit – §960 GILTI 80% FTC haircut**

- New §960(d) provides limited deemed paid credit for taxes "properly attributable" to GILTI
  - Amount of GILTI 960 credits allowed capped at *80%* of GILTI foreign taxes (does not include §901/§903 withholding taxes) – §960(d)(1)
    - There is residual US tax until effective foreign tax rate is at least 13.125% (before domestic expense allocation)
  - Section 78 gross-up inclusion equal to *100%* of FTCs even though only 80% can be taken as a credit

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## Mitigating Double Taxation with Exemption and Foreign Tax Credit – §960 GILTI Mechanic

- Section 960(d) Deemed Paid Credit -
  - 80% of: Inclusion Percentage X Aggregate Tested Foreign Income Taxes
- Inclusion Percentage =

  $$\frac{\text{GILTI Inclusion Amount}}{\text{Aggregate Tested Income}}$$
- Tested Foreign Income Taxes
  - Foreign income taxes that are "properly attributable to" CFC's Tested Income (i.e., no taxes attributable to entities with Tested Losses)
- Denominator of the inclusion percentage does not include any offset for tested losses. Thus, taxes paid by CFCs with tested income are further haircut by the inclusion percentage to the extent any tested income (in denominator) is offset by a CFC with a tested loss (reducing numerator)

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## Mitigating Double Taxation with Exemption and Foreign Tax Credit – §960 GILTI Limitation Category

- GILTI FTCs are segregated into a separate FTC basket *with no carryforward or carryback available for any excess credits.* §904(c)
- Unclear from statute whether §78 gross up is in GILTI FTC basket. Legislative history suggests that it belongs in GILTI. IRS official expressed same view.
- Elephant in the Room - Domestic expenses allocable to GILTI are allocated to GILTI for FTC limitation purposes.
  - Under pre-TCJA law's deduction allocation rules, deductions "definitely related" to gross income are generally allocated to that gross income, and other deductions are generally ratably allocated and apportioned.
  - Interest deductions are generally allocated and apportioned on the basis of assets, rather than income. R&D deductions broadly allocable under watered-down rules. S,G&A is a big number. See Treas. Reg. §1.861-8(g), examples 19 and 20.

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**Mitigating Double Taxation with Exemption and Foreign Tax Credit – Income Assigned to Limitation Categories**

- Section 904(d)(1) Separate Categories
  - GILTI (except passive) and no carryovers (§904(c) last sentence) – □
  - Foreign branch income, can carryover □
  - Passive with high-tax kick out, can carryover □
  - General category, can carryover □ □

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**Mitigating Double Taxation with Exemption and Foreign Tax Credit – Playing With Limitation Categories**

- Subpart F income is excluded from GILTI and is fully taxed. High-taxed income excluded from Sub F under §954(b)(4) also is not GILTI.
  - Treas. Reg. §1.954-1(d)(1) allows the high-tax exception from Subpart F income to be elected on a CFC by CFC basis. See below – should §954(b)(4) be elective?
  - NYSBA Tax Section Report notes that exclusion from GILTI will apply to a CFC whether or not such an election is made (under the Subpart F exclusion if no election is made or under the exclusion for high-taxed Subpart F income for which the election is made).
- A CFC's net deemed tangible income return (NDTIR) will qualify for 245A DRD if it is not Subpart F income, but FTCs will be lost. If income would be NDTIR and FTCs can be utilized, may *not want* to elect 954(b)(4) for high-taxed Sub F.
- *Non*-Subpart F high-taxed operating income may be included in GILTI, risking loss of FTCs. May *want* to cause high-taxed operating income to be Subpart F income (not hard) and *not elect* 954(b)(4) exclusion.

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## Expenses and Foreign Tax Credits

FTC Variations

| Category of foreign Income | Credit allowed | Separate Limit or Cross-credit | Expenses allocated | Max FTC Limit |
|---|---|---|---|---|
| Passive (high tax kick-out) | 100% | SL | Yes | 21% |
| Subpart F | 100% | CC | Yes | 21% |
| GILTI | 80% | SL | Yes | 10.50% |
| 245A Exempt | 0% | NA | Yes | 0% |
| Foreign branch | 100% | SL | Yes | 21% |
| General category income | | | | |
| General | 100% | CC | Yes | 21% |
| FDII | 100% | CC | Yes | 13.125% |

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## Section 962

- §962 mechanism :
  - US individual (estate or trust) may elect to be taxed at the corporate rate on 951(a) amounts. Individual gets a 960 deemed-paid FTC as though she were a US corporation (§962(a)(2)).
  - When actual distributions are made to the US individual, she is taxed again as an individual to the extent the distribution exceeds the amount of tax paid at the time of the 962 election.
  - §962 expressly applies to GILTI through §951(A)(f)(1). Will §250 deduction be allowed to the "deemed" domestic corporation?
  - A taxpayer might make §962 election to achieve deferral of second level US tax. Will future distributions qualify for qualified dividend income (QDI) classification?
    - IRS litigating position under prior law is that QDI is not allowed by reason of §962 election.
  - Is theory of §962 to allow domestic corporate equivalence only for FTC, but not other domestic corporate attributes?
  - Example below sidesteps §250 issue by assuming 100% Subpart F income. Under facts assumed, §962 not worthwhile without QDI.

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## BEAT – FTC Disallowance

- The BEAT is an alternative minimum tax that applies if the tax under BEAT exceeds the regular tax.
- BEAT = Modified taxable income x 10%* > [Regular tax liability – (only) credits in excess of R&D credits and 80% applicable credits (LIHC, renew. elect. prod., energy ITC)]
  - In other words, non-R&D and 20% of applicable credits, but not FTCs and other credits, are used to reduce the regular tax liability hurdle.
  - The BEAT can be positive largely or even exclusively because of FTCs, resulting in partial disallowance.
- Modified taxable income = Taxable income + base erosion tax benefits + base erosion % of NOL deduction. Domestic NOLS or high percentage of high foreign tax income, among other circumstances, can trigger FTC loss.

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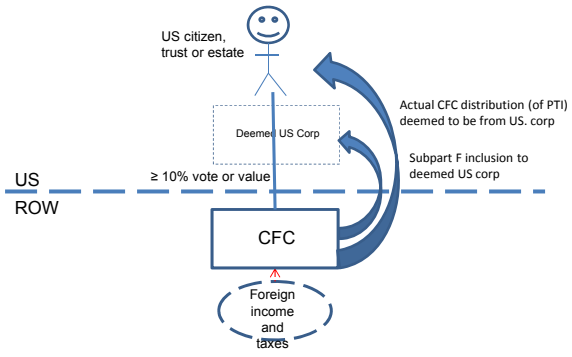
## Mitigating Double Taxation with Exemption and Foreign Tax Credit – §962

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## Section 962: All Subpart F (No GILTI, no §250 deduction) Example

| | | | |
|---|---|---|---|
| | **Assumptions** | | |
| | Tax rates | | |
| 1 | U.S. corporate tax rate (2018) | | 21% |
| 2 | Individual tax rate - Highest married bracket (2018) | | 37% |
| | | | of income over $500,000 plus $149,298 |
| 3 | Individual tax rate - Capital gain (2018) | | 20.00% |
| 4 | Individual tax rate - NIIT (2018) | | 3.80% |
| 5 | Foreign corporate tax rate | | 20% |
| | CFC | | |
| 6 | Pretax earnings and profits | | $1,000,000 |
| 7 | Foreign income taxes | | $200,000 |
| 8 | Earnings and profits | | $800,000 |
| 9 | Subpart F income | | $800,000 |

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## Section 962: All Subpart F (No GILTI, no §250 deduction) Example

| | | | |
|---|---|---|---|
| | **Individual shareholder - electing 962** | | |
| | Step 1: Deemed corporate tax | | |
| 10 | Income under section 951(a) from CFC | | $800,000 |
| 11 | Gross-up under sections 960(a)(1) and 78 | | $200,000 |
| 12 | Taxable income under section 11 | | $1,000,000 |
| 13 | Total foreign taxes | | $200,000 |
| 14 | Tentative U.S. tax - corporate rate | | $210,000 |
| 15 | Foreign tax credit | | $200,000 |
| 16 | US "deemed" corporate tax (excess FTC) | | $10,000 |
| | Step 2: On actual distribution | | |
| 17 | Actual Distribution of CFC's E&P | | $800,000 |
| 18 | US tax under 962(a) | | $10,000 |
| 19 | 962(d) taxable amount | | $790,000 |

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## Section 962: All Subpart F (No GILTI, no §250 deduction) Example

| | | §1(j) Regular tax + 1411 | §1(h)(11) QDI + §1411 |
|---|---|---|---|
| 20 | 962(d) tax | $286,618 | $188,020 |
| 21 | 962(a) tax | $10,000 | $10,000 |
| 22 | Tax under 962 | $296,618 | $198,020 |
| | | | |
| | **Individual shareholder - No 962 election** | | |
| 23 | Income under section 951(a) from CFC | $800,000 | $800,000 |
| 24 | Regular tax + NIIT (when distrib) | $290,698 | $290,698 |

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