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Report No. 1486

January 14, 2024

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Re: Report No. 1486 - Report on Coordinating Section 951A with the  
Income Inclusion Rule of the OECD Global Anti-Base Erosion Model  
Rules (Pillar Two)

Dear Ms. Batchelder and Messrs. Werfel and Paul:

I am pleased to submit Report No. 1486 of the Tax Section of the  
New York State Bar Association on coordinating Section 951A of the  
Internal Revenue Code with the Income Inclusion Rule of the OECD  
Global Anti-Base Erosion Model Rules (Pillar Two).

We appreciate your consideration of our Report. If you have any  
questions or comments, please feel free to contact us and we will be glad  
to assist in any way.

Respectfully submitted,

Philip Wagman  
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**New York State Bar Association Tax Section**

**Report on Coordinating Section 951A with the Income Inclusion Rule  
of the OECD Global Anti-Base Erosion Model Rules (Pillar Two)**

**January 14, 2024**

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## Report on Coordinating Section 951A with the Income Inclusion Rule of the OECD Global Anti-Base Erosion Model Rules (Pillar Two)

### I. INTRODUCTION

This report (the “**Report**”)<sup>1</sup> discusses two aspects of the interaction between the existing U.S. federal income tax (“**U.S. tax**”) rules applicable to global intangible low-taxed income (“**GILTI**”)<sup>2</sup> and the GloBE Rules.<sup>3</sup> Under the GloBE Rules, large multinational groups of corporations that file consolidated financial statements are subject to a minimum level of tax on excess profits earned in each country, all as determined under those rules. A “**Top-up Tax**” is imposed with respect to the profits of members of the group in low- or no-tax jurisdictions; the Top-Up Tax is collected under a regime that, in some cases, charges the liability for such tax to various parent entities under a rule known as the income inclusion rule or “**IIR**”. The GILTI rules, which can be considered to similarly operate as a tax on excess profits, have various points of friction with the IIR. These points of friction are of increasing practical significance as many countries have adopted, or will soon adopt, the GloBE Rules into their domestic tax law.

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<sup>1</sup> The principal drafters of this Report were Arvind Ravichandran and Ansgar A. Simon, with research assistance from Chloe Amarilla. Helpful comments were received from Kimberly Blanchard, Peter Connors, Lawrence M. Garrett, Richard Nugent, Deborah Paul, Jason Sacks, Gary Scanlon, David M. Schizer, Michael Schler, Wade Sutton, Joseph Tootle, Philip Wagman and Andrew R. Walker. This Report reflects solely the views of the Tax Section of the New York State Bar Association (“**NYSBA**”) and not those of NYSBA’s Executive Committee or its House of Delegates. Any reference to “**Section**” in this Report is a reference to a section of the Internal Revenue Code of 1986, as amended (the “**Code**”), and any reference to “**Treas. Reg. §**” is a reference to a section of the regulations promulgated thereunder (the “**regulations**”) by the U.S. Department of the Treasury (“**Treasury**”, including as applicable the Internal Revenue Service (“**IRS**”)).

<sup>2</sup> The “**GILTI rules**” or “**GILTI regime**” comprises Section 951A of the Code and the portions of Subpart F of the Code that relate to Section 951A, Section 250 and Section 78, as well as the relevant parts of the foreign tax credit limitation rules under Section 904 and related rules for determining U.S. source taxable income under Sections 861 to 865. The GILTI regime also applies to other, non-corporate United States persons, but any special rules applicable to them are outside the scope of this Report.

<sup>3</sup> Countries that are members of the G20 and the Organization for Economic Cooperation and Development (“**OECD**”) have created an Inclusive Framework, which pursuant to its “**Pillar 2**” initiative has developed the Global Anti-Base Erosion Rules and published them principally in a set of model rules, a commentary and further guidance in OECD, *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS*, Paris 2021 (the “**Model Rules**” or the “**GloBE Rules**”); OECD, *Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two)*, Paris 2022 (the “**2022 Commentary**”); OECD, *Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)*, OECD/G20 Inclusive Framework on BEPS, OECD, Paris 2023 (the “**February 2023 Guidance**”); and OECD, *Tax Challenges Arising from the Digitalisation of the Economy - Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)*, OECD/G20 Inclusive Framework on BEPS, OECD, Paris December 2023 (the “**December 2023 Guidance**”). The December 2023 Guidance modifies the February 2023 Guidance in respects not relevant to the issues addressed in this Report. References in this Report to the “**2023 Guidance**” are to the February 2023 Guidance, as updated to incorporate the December 2023 Guidance. This Report will refer to the Model Rules and will not discuss any particular implementations by the various jurisdictions that have done so.

The first issue regarding the interaction between the GILTI rules and Pillar 2 addressed in this Report, is that U.S. federal income tax imposed on a U.S. corporation in respect of its GILTI inclusions (“**GILTI tax**”) is supposed to be allocated under the GloBE Rules to the U.S. corporation’s foreign subsidiaries. That allocation generally serves to reduce the amount of Top-up Tax imposed on those foreign subsidiaries’ income, in the same manner as a local corporate income tax would. This Report will discuss various methods for such an allocation of GILTI taxes from a U.S. corporation to its foreign subsidiaries, in a multinational group subject to Pillar 2. This allocation is a complex matter because the GILTI regime blends various tax attributes on a world-wide basis, whereas Pillar 2 is a country-by-country regime.

The second issue raised by the widespread adoption of GloBE Rules is a more fundamental one—how might the United States go about enacting an IIR, one of the principal rules of the GloBE regime? As Pillar 2 is enacted worldwide, most in-scope U.S.-headed multinational groups will become subject to Pillar 2 regardless of U.S. legislative action. Because the GILTI regime and Pillar 2 (in particular, the IIR rules in Pillar 2) have fundamental differences, each approach the United States could consider regarding enactment of an IIR requires different trade-offs. This Report identifies and discusses several possible approaches below.

The Report has five parts. Following this Introduction (Part I), Part II summarizes our recommendations and key points for consideration. Part III provides an overview of the GILTI rules, the IIR, and the interaction and some of the points of friction between the two. Part IV analyzes in detail our recommendations regarding the allocation of GILTI tax imposed on a U.S. corporate shareholder to its foreign subsidiaries under the GloBE Rules. Part V analyzes possible approaches the United States could take to enacting an IIR and coordinating it with the existing GILTI rules.

## **II. SUMMARY OF RECOMMENDATIONS AND KEY CONSIDERATIONS<sup>4</sup>**

### **A. Recommendations Related to GILTI Tax Allocation from a U.S. Shareholder-CE to Its CFC-CEs**

1. We do not recommend the existing formulary approach of the 2023 Guidance to allocating GILTI taxes from a U.S. Shareholder-CE to its CFC-CEs.
2. Instead, we recommend that the manner and amounts for such allocation be determined by reference to the U.S. tax principles and determinations underlying the GILTI regime in general.
3. We recommend that GILTI taxes be allocated only to CFC-CEs with tested income.

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<sup>4</sup> Capitalized terms used in Part II that have not yet been defined have the definitions provided in Parts III - V below.

4. We recommend using a multi-step allocation method, to determine the Residual GILTI Tax allocated to each one of a U.S. Shareholder-CE's CFC-CEs as a Covered Tax under the GloBE Rules:
  - (i) First, for each CFC-CE that has positive tested income, the Tentative GILTI Tax imposed on such tested income should be determined. The amount of the Tentative GILTI Tax will be determined prior to reduction on account of Section 960(d) FTCs;
  - (ii) Second, the Tentative Residual GILTI Tax for each CFC-CE should be determined. This is accomplished by reducing such CFC-CE's Tentative GILTI Tax (but not below zero) by the amount of such CFC-CE's Section 960(d) FTCs (computed without regard to the Section 904 limitation). To the extent such CFC-CE has Section 960(d) FTCs in excess of the Tentative GILTI Tax for that CFC-CE, such excess Section 960(d) FTCs should be allocated to other CFC-CEs that have Section 960(d) FTCs that are less than their Tentative GILTI Tax; and
  - (iii) Third, the Section 904 Incremental GILTI Tax of the U.S. Shareholder-CE (that is, the incremental U.S. federal income tax that is owed on GILTI inclusions as a result of the application of the Section 904 limitation to FTCs in the GILTI basket), if any, should be determined. Such tax should be allocated among CFC-CEs either pro rata in accordance with their respective amounts of tested income, or pro rata in accordance with their respective amounts of Section 960(d) FTCs (as computed prior to application of the Section 904). In the case of each CFC-CE, the Tentative Residual GILTI Tax for that CFC-CE, plus the Section 904 Incremental GILTI Tax for that CFC-CE, is equal to the Residual GILTI Tax for that CFC-CE. That is the amount of GILTI tax that is considered to be a Covered Tax of that CFC-CE.
5. With respect to the first step noted above, when a U.S. Shareholder-CE determines the Tentative GILTI Tax for each CFC-CE that has tested income, we believe it is reasonable to treat tested losses as an attribute that is applied pro rata against the relative amounts of the U.S. Shareholder-CE's tested income from each such CFC-CE. It also would be reasonable, although complicated, to make a priority allocation of a CFC-CE's tested losses against the tested income of CFC-CEs that are in the same country as the loss-generating CFC-CE.
6. We recommend that, in determining each tested income CFC-CE's Tentative GILTI Tax, NDTIR should be allocated pro rata in accordance with tested income among tested income CFC-CEs.

7. We recommend that no GILTI tax be allocated to CFC-CEs for which the GILTI high-tax exclusion has been elected and which, as a result, have no tested income.
8. We recommend that, when determining each CFC-CE's Section 960(d) FTCs (before taking into account the effect of Section 904), the inclusion percentage used to calculate all such Section 960(d) FTCs should be the same, single inclusion percentage of the U.S. Shareholder-CE. However, we note that, if it is decided to allocate a CFC-CE's tested losses on a priority basis against the tested income of CFC-CEs that are in the same country as the loss-generating CFC-CE, then it would be necessary to compute different inclusion percentages for the CFC-CEs in different countries.
9. We recommend that domestic expenses of a U.S. Shareholder-CE allocated to its GILTI for purposes of applying Section 904 should be taken into account only for purposes of computing the U.S. Shareholder-CE's Section 904 Incremental GILTI Tax. Such domestic expenses should not otherwise be taken into account when determining the amount of the U.S. Shareholder-CE's GILTI tax to allocate to each of its CFC-CEs.
10. We recommend that Treasury and the IRS add a new schedule to the U.S. federal income tax return that presents the relevant information for GILTI tax allocation.

**B. Key Considerations Related to Incorporating an IIR into the Current U.S. Tax System and Coordinating it with the GILTI Rules**

We have identified three ways in which the U.S. tax laws could be amended to incorporate an IIR. First, the United States could entirely replace the GILTI regime with an IIR. Second, the United States could modify the GILTI regime to resemble an IIR. Third, the United States could introduce an IIR without material modification to the GILTI regime. We have made the determination to refrain from making specific recommendations with respect to any of these options, because the desirability of any option turns in significant part on various tradeoffs between administrability and revenue.

Below is a summary of key considerations we have identified that pertain to an evaluation of these three options.

1. The first option – adopting an IIR as a replacement for the GILTI regime – presents significant questions of scope. The IIR as it exists in the Model Rules applies only to large multinational corporate groups. In order to expand the application of the IIR so that it applies to the full range of taxpayers, including individuals and minority corporate shareholders, that own CFCs and are currently subject to the GILTI rules, novel and difficult design issues would need to be addressed. On the other hand, opting to replace the GILTI rules with an IIR that applies only to large multinational groups would likely involve significant revenue loss for the United

States. In addition, if the United States replaces the GILTI rules with an IIR, it would potentially lose the revenue associated with domestic expense allocation for purposes of Section 904, since the IIR as it is designed in the Model Rules does not provide for such allocation.

2. If the United States opts to modify the GILTI regime to make it more closely resemble an IIR, we expect key changes would include that GILTI computations, and use of Section 960(d) FTCs to reduce GILTI tax, would occur on a country-by-country basis, rather than being blended across all CFCs; the Section 250 deduction would need to be reduced such that the minimum rate imposed on GILTI was at least 15 percent; and NTDIR would need to be more closely aligned with SBIE. A modified GILTI regime would continue to apply to the same range of taxpayers, and have much of the same architecture, as the current GILTI rules. Nevertheless, some significant modifications (for example, of the PTEP rules) would be needed. The United States could choose to retain the domestic expense allocation rules (with modifications to apply them to GILTI income on a country-by-country basis) under this option.
3. Adopting an IIR while leaving the GILTI regime in place would be easier to implement in several respects than either of the options just described, as it would require the fewest incremental statutory or regulatory changes to U.S. law. However, because a substantial group of taxpayers would remain subject to taxation under two different regimes under this option, it would be important to consider whether relief to address substantive issues (such as double taxation of the same income due to timing differences) and/or procedural issues (such as the cost of compliance with each regime) might be available. We do not believe any broad-based relief would be easily workable, although special cases might be considered. In addition, we expect it would be materially more complex to develop any such relief if the United States intended to preserve the domestic expense allocation rules.

### **III. BACKGROUND**

Part III focuses on the existing interaction and frictions between GILTI and the IIR.<sup>5</sup> Prior NYSBA Tax Section reports have discussed each regime extensively. This part discusses the salient features relevant to the interaction between the two.

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<sup>5</sup> The NYSBA Tax Section has previously discussed the GILTI regime and the GloBE Rules individually and extensively in various reports, which may provide additional background. *See* NY State Bar Ass'n Tax Section Report No. 1476, *Report on Foreign Tax Credit Considerations Related to the OECD Global Anti-Base Erosion Model Rules (Pillar Two)* (May 31, 2023); *see also* NY State Bar Ass'n Tax Section Report No. 1394, *Report on the GILTI Provisions of the Code* (May 4, 2018).

## A. Overview of the GILTI Regime

The GILTI regime applies to any corporation that is a “United States shareholder” (“**U.S. Shareholder**”) of a “controlled foreign corporation” (“**CFC**”). A U.S. Shareholder is any U.S. person who owns, directly or indirectly, actually or constructively, 10% or more of the stock in the foreign corporation by vote or by value.<sup>6</sup> A CFC is any foreign corporation, if more than 50% of (1) the total combined voting power of all classes of stock of such corporation entitled to vote or (2) the total value of the shares in such corporation is owned in the aggregate, or is considered as owned through certain attribution rules, by U.S. Shareholders on any day during the tax year of such foreign corporation.<sup>7</sup>

A U.S. Shareholder is required to include in income an amount equal to its GILTI.<sup>8</sup> A U.S. Shareholder’s GILTI is the excess of “net tested CFC income” over the “net deemed tangible income return” or “**NDTIR**”.<sup>9</sup> The net tested CFC income is the sum of the U.S. Shareholder’s pro rata shares of tested income of each CFC reduced by its pro share of “tested loss” of each CFC.<sup>10</sup> The NDTIR is an amount intended to approximate the return on the unlevered portion of tangible assets of CFCs with tested income.<sup>11</sup> “Tested income” or “tested loss” means, broadly, all the income of a CFC (other than Subpart F income (i.e., enumerated types of passive and related-party income), U.S.-source income effectively connected to a U.S. trade or business, dividends from related corporations, high-taxed income, and foreign oil and gas extraction income), less deductions of the CFC properly allocable to such income.<sup>12</sup> Income already taxed as a result of a GILTI inclusion is generally not subject to tax upon its distribution to the U.S. Shareholder under the “previously taxed earnings and profits” regime (“**PTEP**”).<sup>13</sup>

Corporate U.S. Shareholders are allowed a deduction equal to the sum of 50% of their GILTI inclusion, set to decrease to 37.5% in 2026, and 37.5% of their foreign derived intangible income or “**FDII**”, set to decrease to 21.875% in 2026 (the “**Section 250 deduction**”).<sup>14</sup> The

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<sup>6</sup> Section 951(b).

<sup>7</sup> Section 957. Complex constructive ownership rules apply in determining both U.S. Shareholder and CFC status. In general, ownership is attributed upward through partnerships and corporations as well as downward to partnerships and corporations (other than, in the case of corporations, with respect to minority interests). *See* Sections 318(a)(2)(A) and (C), 318(a)(3)(A) and (C) and Section 958(b). A partnership or corporate shareholder is treated as owning all of the stock entitled to vote in a corporation if it owns more than 50% of the total combined voting power of the corporation. *See* Section 958(b)(2).

<sup>8</sup> Section 951A.

<sup>9</sup> Section 951A(b).

<sup>10</sup> Section 951A(c).

<sup>11</sup> Assets of CFCs that generate tested loss are not taken into account in computing NDTIR. Section 951A(d)(2)(A).

<sup>12</sup> Section 951A(c)(2).

<sup>13</sup> Section 951A(d)(1).

<sup>14</sup> Section 250(a)(1).

Section 250 deduction is limited if the taxable income of the U.S. Shareholder is less than the sum of 50% (37.5% after 2025) of GILTI and 37.5% (21.875% after 2025) of FDII.<sup>15</sup>

Under Section 960(d), corporate U.S. Shareholders may credit foreign income taxes paid or accrued by a CFC in respect of tested income as a deemed paid foreign tax credit (the “**Section 960(d) FTC**”).<sup>16</sup> In addition to entitling a corporate U.S. Shareholder to claim this credit, Section 960(d) also limits the U.S. Shareholder’s credit to: (1) the aggregate amount of foreign income taxes paid or accrued by the U.S. Shareholder’s CFCs that are attributable to the tested income (but not any tested loss) of the CFCs, multiplied by (2) 80%, multiplied by (3) the “**inclusion percentage**” i.e., the ratio of the U.S. Shareholder’s GILTI to the aggregate of the U.S. Shareholder’s pro rata shares of the tested income of all of the U.S. Shareholder’s CFCs.<sup>17</sup> Both the Section 250 deduction and the Section 960(d) FTC amount are thus determined on an aggregate or blended basis for the U.S. Shareholder, and not separately for each CFC or on a country-by-country basis.

Section 960(d) FTCs are further subject to the general foreign tax credit limitation under Section 904. For this purpose, deemed paid foreign taxes in respect of GILTI are subject to their own limitation category or “basket”, separately from various other baskets for foreign source income that is, e.g., passive category income, foreign branch income, general category income or any item of income resourced under an income tax treaty.<sup>18</sup> In addition, foreign income taxes in any basket cannot be used to offset U.S. tax in respect of U.S. source income.

The limitation, i.e., the maximum amount of foreign taxes creditable against a U.S. Shareholder’s tentative (pre-credit) U.S. tax liability with respect to income in each basket, is the equal to the U.S. Shareholder’s total tentative U.S. tax liability multiplied by a fraction, (x) the numerator of which is the “foreign source taxable income” of the U.S. Shareholder in the applicable basket and (y) the denominator of which is the U.S. Shareholder’s total worldwide taxable income.<sup>19</sup> Thus, in the case of the Section 951A or GILTI basket, the maximum foreign tax credit is:

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<sup>15</sup> Section 250(a)(2).

<sup>16</sup> Section 960(d). This Report generally refers to foreign tax credits allowed under Section 960(d) or another provision of the Code as “**FTCs**.” Non-corporate U.S. Shareholders are not entitled to the deduction or a deemed paid credit but can make an election to be taxed on a current basis under similar rules, provided that any such income is not PTEP, i.e., distributions by the CFC to the non-corporate U.S. Shareholder are taxable as dividends. Section 962(b).

<sup>17</sup> Section 960(d)(2).

<sup>18</sup> Sections 904(d)(1) and 904(h)(10).

<sup>19</sup> See Sections 904(a) and 904(d).

$$\text{Max. §951A FTC} = \text{Total U.S. Tax} \times \frac{\text{§951A Category Foreign Source Taxable Income}}{\text{Worldwide Taxable Income}}.^{20}$$

The Section 951A category foreign source taxable income is not the same as GILTI, nor the same as GILTI minus the Section 250 deduction. Rather, the taxable income is gross income in the category, less expenses, losses and other deductions which are “properly” apportioned and allocated to that income. This includes some expenses, losses and other deductions that are not “definitely related” to any particular item or class of gross income.<sup>21</sup> Typical expenses that are not definitely related to a specific item or class of gross income include certain interest expense of the U.S. Shareholder (and its affiliated group) and stewardship expenses incurred by the U.S. Shareholder, which are apportioned among baskets to the extent they are allocable to foreign source income.<sup>22</sup> We will refer to these as “**domestic expense allocations**” to the relevant foreign tax credit limitation basket.<sup>23</sup> The Section 250 deduction (to the extent attributable to GILTI, rather than FDII) is properly allocable to foreign source income in the GILTI basket and not further apportioned.<sup>24</sup>

<sup>20</sup> See *Theo. H. Davis & Co. v. Commissioner*, 75 T.C. 443, 444 (1980), *aff’d per curiam*, 678 F.2d 1367 (9th Cir. 1982). For a flat statutory corporate tax rate, Corporate Tax Rate =  $\frac{\text{Total U.S. Tax}}{\text{Worldwide Taxable Income}}$ . Accordingly, Max. §951A FTC = Corporate Tax Rate × §951A Category Foreign Source Taxable Income. We will utilize this simplified formula using the current Section 11(b) rate of 21%.

<sup>21</sup> Section 861(b) (with respect to U.S. source income) and section 862(b) (same with respect to foreign source income).

<sup>22</sup> Section 864(e), Treas. Reg. §§1.861-9T and 1.861-8(e)(4). Generally, interest is allocated based on the adjusted tax basis of the assets that give rise to the income (with adjustment for earnings and profits in the case of CFC stock treated as giving rise to GILTI). Domestic expenses are allocated also to exempt income (and thus do not reduce the gross income in the GILTI basket or U.S. source gross income), i.e., income that arises from exempt assets. Importantly, 50% of CFC stock is an exempt asset to the extent that such stock gives rise to GILTI (or any lower fraction of the Section 250 deduction, if the Section 250 deduction is limited). Treas. Regs. §§1.861-8(d)(2)(ii)(C) and 1.861-8T(d)(2)(i)(A). Thus, in general, 50% of the interest otherwise allocated to GILTI is exempt and does not reduce gross income in the GILTI basket.

<sup>23</sup> The effect of the expense allocation rules can be illustrated by example. Assume that U.S. Parent (“Parent”) wholly owns a foreign subsidiary (“Foreign Sub”) that has an asset basis of \$100 and is located in Country X. Parent’s U.S. operations generate \$140 of gross income, Parent incurs \$40 of interest expense and Parent’s U.S. assets have a basis of \$100. Foreign Sub generates \$100 of gross income, all of which is tested income, and Foreign Sub has no expenses or NDTIR. Parent’s basis in the stock of Foreign Sub is \$300. Foreign Sub pays \$21 of taxes on its income under Country X law. Assume for purposes of this example that there is no deduction for GILTI income and no reduction in foreign tax credits allocable to GILTI, and that Parent and Foreign Sub have no other assets, income or expenses.

Absent any allocation of interest expense, Parent would have \$21 of tax on Foreign Sub’s GILTI (21% of \$100). Parent’s Section 904 limitation in the GILTI basket would also be \$21 (21% of \$100). Therefore, all of Parent’s tax attributable to GILTI would be offset by the \$21 of foreign taxes deemed paid on such income. Parent would in addition pay \$21 of tax on its remaining taxable income (i.e., 21% of the excess of \$140 over \$40). However, under the interest expense apportionment rules, Parent is required to allocate its \$40 of interest expense based on relative asset basis for purposes of determining its foreign tax credit limitation. Accordingly, \$30 of interest expense ( $\frac{\$300}{\$400} \times \$40$ ) is allocated to Parent’s GILTI basket. As a result, Parent’s Section 904 limitation for the GILTI basket is \$14.70 (21% of the excess of \$100 over \$30). Thus, Parent may only offset \$14.70 of Foreign Sub’s foreign income taxes against Parent’s tentative U.S. tax, and Parent pays an additional U.S. tax of \$6.30 (\$21 less \$14.70) with respect to Foreign Sub’s GILTI, for a total tax of \$27.30.

<sup>24</sup> Treas. Reg. §1.861-8(e)(14).

If the Section 904 limitation of a U.S. Shareholder exceeds the otherwise creditable foreign taxes for a basket, the U.S. Shareholder has an “excess limitation” with respect to this basket to the extent of this excess. If by contrast the creditable foreign taxes exceed the Section 904 limitation for a basket, the U.S. Shareholder has “excess foreign tax credits” or “**excess FTCs**” with respect to the basket.

While excess FTCs generally can be carried back for one year, and forward for up to ten years to taxable years for which the U.S. Shareholder has an excess limitation, no such carryback or carryforward is permitted for excess FTCs in the GILTI basket.<sup>25</sup> We understand that most corporate taxpayers that are in an excess-FTC position, are in such position because of domestic expense allocation to foreign source gross income in the GILTI basket. In effect, for these taxpayers, the GILTI rules work to subject income of a U.S. corporation that would have been subject to ordinary U.S. tax had the expenses actually been incurred by the applicable CFC (and not the U.S. corporation) to U.S. tax under the GILTI rules.

## **B. Overview of the GloBE Regime and Its Income Inclusion Rule (IIR)**

In general, the GloBE Rules apply to certain “**MNE Groups**”. An MNE Group is a group of “**Entities**” that are included in the consolidated financial statements of an “Ultimate Parent Entity” (“**UPE**”). An Entity is any legal person (other than a natural person) as well as arrangements such as partnerships. A permanent establishment (“**PE**”) is generally treated as a separate Entity for most purposes of the GloBE Rules. Each Entity in the group is referred to as “Constituent Entity” (“**CE**”). The UPE is a CE that has control over other CEs but which is not itself controlled by another Entity. An Intermediate Parent Entity (“**IPE**”) is a CE that owns CEs but that is owned by another CE (such as a UPE).<sup>26</sup> MNEs are subject to the GloBE Rules if their consolidated revenue is in excess of EUR 750M and the UPE of the MNE and at least one Entity in the group is located in a different jurisdiction.<sup>27</sup>

Under the IIR, the UPE in an MNE Group is liable for payment of Top-up Tax on the GloBE income of any “low-taxed” CE. A CE is “low-taxed” if its GloBE effective tax rate (“**ETR**”) is less than the minimum rate prescribed in the Model Rules (the “**Minimum Rate**”), currently 15%. A CE’s ETR equals its Adjusted Covered Taxes divided by its GloBE income. In general, “**Adjusted Covered Taxes**” are the CE’s current income tax expense and certain other taxes (together, “**Covered Taxes**”), as reported on the relevant financial statements, subject to various adjustments; and “**GloBE income**” (or “**GloBE loss**”) is the CE’s net income (or net loss), as reported on the relevant financial statements, subject to various adjustments. If a CE is low-taxed (i.e., if its ETR is less than the Minimum Rate), then the Top-up Tax generally is an amount determined as follows: (1) CE’s GloBE income is reduced by a “Substance-based Income Exclusion” (“**SBIE**”), and (2) the amount determined in (1) is multiplied by a percentage that

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<sup>25</sup> Section 904(c).

<sup>26</sup> In this Report, “**Parent Entity**” means an IPE, UPE, or POPE (defined below).

<sup>27</sup> See Model Rules, Art. 1.

equals the Minimum Rate minus the CE’s ETR. The SBIE is a formula reduction based on payroll and tangible assets of the CE.<sup>28</sup> This Top-up Tax is then further reduced by any “Qualified Domestic Minimum Top-up Tax” (“**QDMTT**”)—generally a local jurisdiction tax that is imposed under the same general rules as the Top-up Tax.

The determination of whether a CE is low-taxed is made on a jurisdiction-by-jurisdiction basis. If there are multiple CEs in a single jurisdiction, then each of those CE’s GloBE income or loss and Adjusted Covered Taxes are determined separately.<sup>29</sup> Then, however, the GloBE income for the CEs in such jurisdiction is aggregated; and so are the Adjusted Covered Taxes of those CEs. The ETR for the jurisdiction is determined using those aggregated inputs, and SBIE for the CEs in the jurisdiction also is determined on an aggregated basis, as is the amount of Top-Up Tax for the jurisdiction.<sup>30</sup> The resulting Top-up Tax is then apportioned among the CEs in the jurisdiction under a formula.<sup>31</sup>

If a UPE is located in a jurisdiction that has not enacted an IIR, other IPEs of the low-taxed CEs in the MNE Group that are located in jurisdictions that have enacted the IIR will be required to pay Top-up Tax. This is generally done on a “top-down” basis—namely the highest-tier IPE that is located in a jurisdiction that has enacted the IIR is required to pay the Top-up Tax under the IIR.<sup>32</sup>

If no Parent Entity of the low-taxed CE is located in a jurisdiction that has enacted an IIR, the Top-up Tax is collected through the “Undertaxed Profits Rule” (“**UTPR**”). In general, the UTPR requires CEs (other than the IPEs of the relevant low-taxed CE) to pay the Top-up Tax. Where multiple CEs would be required to pay UTPR, the UTPR is apportioned across CEs.

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<sup>28</sup> This is 5% of the payroll costs and carrying value of tangible assets. *See* Model Rules, Art. 5. For a transition period of five years, the rate will be 7.5% instead of 5%.

<sup>29</sup> Model Rules, Art. 4, 5.1.1.

<sup>30</sup> Model Rules, Art. 5.1.2, 5.2, 5.3.

<sup>31</sup> Model Rules, Art. 5.2.4. Note that there may be sub-groupings of entities in a jurisdiction, e.g., for “Investment Entities” versus other CEs in the jurisdiction. Model Rules, Art. 5.1.3. (For a definition of “Investment Entity”, see Art. 10.1 of the Model Rules.) The Top-up Tax for other CEs in the jurisdiction is computed separately from the Top-up Tax for the Investment Entities in such jurisdiction.

Similarly, for certain CEs in which third parties own a substantial stake, Top-up Taxes are computed separately from other CEs in the relevant jurisdiction. Model Rules, Art. 5.6. The same also is true with respect to Top-Up Taxes imposed with respect to joint ventures that are not themselves CEs, in which an MNE Group owns at least a 50% stake. Model Rules, Art. 6.4.

<sup>32</sup> Special rules apply where a Parent Entity is not wholly-owned by other Group members—so called “Partially-owned Parent Entities” (or “**POPEs**”). In general, a POPE collects IIR before a higher-tier Parent Entity, notwithstanding the general top-down approach.

## C. GloBE Tax and CFC Tax Regimes

### 1. Push-Down of Taxes Imposed on a Shareholder Under a CFC Regime to the Shareholder's CFCs

The Model Rules contemplate cases in which the UPE, or another CE in the group, is a direct or indirect shareholder of a lower-tier CE and is subject to current taxation in the UPE's (or other shareholder-CE's) home country under a controlled foreign company regime on income earned by that lower-tier CE.<sup>33</sup> The Model Rules provide that the tax paid by the shareholder under such a regime on income of a CFC-CE can be allocated back to the CFC-CE as a Covered Tax of the CFC-CE, provided that such regime qualifies as a "CFC Tax Regime" within the meaning of the Model Rules.<sup>34</sup> The allocation (or "**push-down**") of such taxes from the shareholder-CE to the CFC-CE has the effect of increasing the amount of Covered Taxes considered to be imposed on the CFC-CE's income and, thus, the CFC-CE's ETR, thereby tending to reduce the amount of Top-up Tax imposed under the Model Rules on the CFC-CE's income.<sup>35</sup> As noted above, under the Model Rules, Covered Taxes are computed separately for each CE in the MNE Group. Accordingly, the push-down of the owner-CE's taxes is made separately to each CFC-CE.

The U.S. CFC rules, including the GILTI regime, constitute a CFC Tax Regime within the meaning of the Model Rules. Although the 2022 Commentary did not expressly confirm this point, the 2023 Guidance does so unequivocally.<sup>36</sup> Push-down of GILTI tax of a U.S. Shareholder that is a CE ("**U.S. Shareholder-CE**") to the CFC-CEs that generated the relevant GILTI thus is called for under the Model Rules. However, devising a methodology to accomplish that push-down

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<sup>33</sup> Model Rules, Art. 4.3.2(c). We refer to a CE that is a controlled foreign company under such a regime as a "**CFC-CE**".

<sup>34</sup> A Controlled Foreign Company Tax Regime or "**CFC Tax Regime**" is defined under the Model Rules as a "set of tax rules under which a direct or indirect shareholder of a foreign entity (the controlled foreign company) is subject to current taxation on its share of part of all of the income earned by the CFC, irrespective of whether that income is distributed currently to the shareholder" (Model Rules, Art. 10). The 2022 Commentary on Article 10.1 clarifies that the distinction between a CFC Tax Regime and general pass-through taxation lies in the fact that the controlled foreign company is not generally treated as fiscally transparent in the shareholder's jurisdiction, so that a shareholder is not subject to tax in respect of its share of the controlled foreign company's income before its distribution unless special additional conditions such as ownership level and combined ownership of the foreign entity are satisfied. 2022 Commentary at 194.

<sup>35</sup> As discussed further in Part III.C.2 below, the Model Rules treat a PE as itself being a separate CE that is a member of the MNE Group. The same basic issues concerning push-down of taxes of a shareholder-CE to a CFC-CE, apply also to a CE in an MNE Group that pays tax in its home country on income of its PE located in another country.

In this Report, we refer to a CE that has a PE, or that is a shareholder which includes income with respect to a CFC-CE, as the "**owner-CE**".

<sup>36</sup> 2022 Commentary to Art. 4.3.2, ¶58, at 98; 2023 Guidance 2.10.3, ¶8, at 68f. Before the Model Rules were adopted, the OECD considered "excess profits" rules, which can be viewed as a rough blueprint for the GILTI regime, as a type of CFC regime. See OECD (2015), *Designing Effective Controlled Foreign Company Rules, Action 3 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, section 4.2.3, ¶¶ 87-95, at 49f. Questions still remain as to whether certain aspects of the U.S. tax code qualify as a CFC Tax Regime, such as the deemed annual inclusion rules under section 367(d).

entails various challenges, because the GILTI tax is imposed on an aggregated amount of tested income and losses of the CFC-CEs, as well as other aggregated attributes (such as NDTIR), of the CFC-CEs. Foreign income taxes relating to GILTI are likewise aggregated and credited to the U.S. Shareholder-CE in an aggregate amount. The 2023 Guidance refers to the GILTI regime as a “**Blended CFC Tax Regime**”, i.e., a CFC Tax Regime “in which the tax charge ... is computed based on a blend of income, losses and / or creditable taxes of multiple CFCs ....”<sup>37</sup>

As discussed below, the 2022 Commentary and 2023 Guidance each contain some discussion that is relevant to the determination of an appropriate method to push down a U.S. Shareholder-CE’s GILTI tax to its CFC-CEs, taking into account the challenges presented by the GILTI regime and its aggregation of income, loss and other items.

Questions related to the choice of a method to push down a U.S. Shareholder-CE’s GILTI tax, and more generally all of its U.S. tax imposed under the U.S. CFC rules, to its CFC-CEs have significant potential importance to a U.S.-parented MNE Group, as well as any other MNE Group that includes a U.S. Shareholder-CE. Fundamentally, by pushing down part of a U.S. Shareholder-CE’s U.S. tax to a CFC-CE and treating it as a Covered Tax that will reduce or eliminate the Top-up Tax imposed by Pillar 2 on the income of that CFC-CE, the Model Rules lessen the possibility of double taxation or over-taxation of those CFC-CEs’ income by different regimes with arguably similar policy goals (i.e., Subpart F and GILTI, and Pillar 2). At present, the United States has not enacted the Model Rules in the Code. However, whether or not that continues to be the case, a number of other countries have adopted, or will soon adopt, the Model Rules as part of their domestic tax laws. An MNE Group that includes a U.S. Shareholder-CE and that also includes a CE located in one of those countries will therefore be subject to both the GILTI regime (and the rest of the U.S. CFC regime) and Pillar 2. Thus, identification of an appropriate, administrable means of pushing down GILTI tax will have potentially considerable practical importance for MNE Groups with U.S. members.

## 2. The 2022 Commentary

The 2022 Commentary does not directly address the push-down of a U.S. Shareholder-CE’s GILTI tax to its CFC-CEs, but it does address an analogous issue: push-down of an owner-CE’s taxes paid in its home country, to PEs it owns.

The Model Rules treat each PE as a separate CE within the MNE Group (a “**PE-CE**”), as noted above. Where the owner-CE pays tax in its home country on income of its PE-CE, the Model Rules provide for such tax to be allocated to the PE-CE as a Covered Tax of the PE-CE.<sup>38</sup> It is possible that the owner-CE may pay such tax on a single base that contains the aggregated items of all of its PE-CEs, as well as items from the owner-CE’s activities in its home country; and the owner-CE’s home country tax laws may permit cross-crediting of foreign income taxes paid in the

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<sup>37</sup> 2023 Guidance 2.10.3, ¶ 8, at 68.

<sup>38</sup> Model Rules, Art. 4.3.2(a).

country where one PE-CE is located, against income generated by the owner-CE's other PE-CEs. The United States, for example, would provide these results for a U.S. owner-CE that has branches in different foreign countries.

The 2022 Commentary outlines an approach for the push-down of the owner-CE's home-country taxes to each of its PE-CEs in such a case. As a first step, this approach determines the standalone net income (or loss), as computed under the tax rules of the owner-CE's home country, of each PE-CE of the owner-CE.<sup>39</sup> Then, the tentative tax liability of the owner-CE in its home country (prior to allowance of any foreign tax credits) is determined. The 2022 Commentary indicates that in general, it would be appropriate to allocate the total home-country tax paid by the owner-CE between a particular PE-CE, and the rest of the owner-CE's assets and activities, by comparing the standalone net income of the PE-CE with the total amount of income from those other assets and activities. Where the owner-CE has total taxable income that is less than the income of its income-generating PE-CEs, the 2022 Commentary indicates all losses and deductions – whether from loss-making PE-CEs, or from domestic activities – are apportioned first to the owner-CE's domestic income, and then to its income from PE-CEs.<sup>40</sup> Finally, where the owner-CE's home country allows a foreign tax credit for tax imposed on income of a PE-CE by the country where the PE-CE is located, the tax paid by such PE-CE is, in the first instance, attributed to the owner-CE's income from that PE-CE. As a result of this methodology, if a PE-CE is in an excess foreign tax credit position on a stand-alone basis (i.e., its income is subject to tax in the country where the PE is located that exceeds the amount of tax that would be imposed on the owner-CE on such income in the owner-CE's home country), then none of the tax incurred by the owner-CE in its home country is pushed down to that PE-CE. If the PE-CE is not in an excess foreign tax credit position, then the owner-CE's home-country tax is generally pushed down in an amount equal to the residual tax liability of the owner-CE, i.e., the excess of the home-country tax the owner-CE would owe before taking into account the foreign tax credit, over the foreign taxes imposed by the country where the PE-CE is located.<sup>41</sup> The 2022 Commentary indicates the approach just described for PE-CEs also generally applies where an owner-CE is subject to tax under a CFC Tax Regime on income imputed to it from CFC-CEs.<sup>42</sup>

The 2022 Commentary to Article 4.3.2(a) of the Model Rules addresses how the owner-CE's residual home-jurisdiction taxes are allocated to its various PEs, when foreign income taxes incurred by each PE-CE are cross-credited. The approach of the 2022 Commentary is that “[W]here cross-crediting is allowed, the Taxes paid [in the owner-CE's jurisdiction] in respect of an inclusion [from a PE or CFC] should be determined by subtracting the credit allowed for Taxes

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<sup>39</sup> 2022 Commentary to Article 4.3.2 ¶47 at 96.

<sup>40</sup> *Id.* ¶48 at 96-97 (“In cases where the PE income is mixed with other income, if the Main Entity's total taxable income is less than the PE income inclusion, all of the pre-foreign tax credit liability is attributed to the inclusion. In other words, domestic losses and losses of other PEs allowed in the Main Entity's taxable income computation under a credit method are first used against domestic income and then applied to PE income inclusions.”).

<sup>41</sup> *Id.* ¶49-50 at 97.

<sup>42</sup> *Id.* ¶58 at 98.

paid by the particular PE, and then further subtracting an appropriate amount of excess creditable Taxes paid by other PEs from the pre-credit tax liability of the PE.”<sup>43</sup>

**Example 1:** U.S.-CE has three permanent establishments, PE-A in Country A, PE-B in Country B, and PE-C in Country C. U.S.-CE has \$400 of worldwide taxable income and \$550 of worldwide gross income. Each of PE-A, PE-B and PE-C has foreign source gross income (before allocation of deductions) of \$100. PE-A incurs an income tax liability of \$36 in Country A, PE-B of \$20 in Country B and PE-C of \$0 in Country C, for a total of foreign creditable income taxes of \$56.

In the first step “the Taxes paid [in the owner-CE’s jurisdiction] in respect of an inclusion [from a PE or CFC] should be determined by subtracting the credit allowed for Taxes paid by the particular PE”. In Example 1, this first step is easily applied. Before taking into account foreign tax credits, each of PE-A, PE-B and PE-C would have a tentative U.S. tax liability of \$21, if considered separately. The excess creditable foreign taxes are \$15 for PE-A (the amount by which the Country A tax liability of \$36 exceeds \$21), and \$0 in the case of PE-B and PE-C, which are in an excess limitation position of \$1 and \$21, respectively.

The excess creditable foreign taxes are then allocated among the PEs in the second step. The 2022 Commentary indicates an “appropriate” allocation means an allocation to PE-B and PE-C pro rata in proportion to their excess limitation amounts, i.e., \$0.68 ( $\$15 \times \$1/\$22$ ) to PE-B and \$14.32 ( $\$15 \times \$21/\$22$ ) to PE-C.<sup>44</sup>

The amount of U.S.-CE’s U.S. federal income tax available for push-down attribution is \$7 (i.e., the excess of the aggregate U.S. tax liability of \$63 over the creditable foreign income tax of \$56). Of this amount, \$0 is pushed down to PE-A; \$0.32 is pushed down to PE-B ( $\$21 - \$20 - \$0.68$ ); and \$6.68 is pushed down to PE-C ( $\$21 - \$0 - \$14.32$ ).

### **3. The 2023 Guidance: Formulary Allocation Key**

#### **a. Formula for Push-Down of Tax Imposed by a Blended CFC Tax Regime**

The 2023 Guidance amended the 2022 Commentary by adding paragraphs 58.1 through 58.7 to the existing paragraph 58 for Blended CFC Tax Regimes. These additions provide a simplifying formula for allocating residual U.S. taxes to CFC-CEs of a U.S. Shareholder-CE (the “**2023 Guidance Formula**”). Technically, the formula applies to all such Blended CFC Tax Regimes, but as a practical matter, it addresses only the GILTI regime. Notably, the 2023 Guidance Formula addresses only the attribution of Covered Taxes to CFCs under Article 4.3.2(c) of the Model Rules. It does not apply to the attribution of Covered Taxes to PEs under Article 4.3.2(a) of the Model Rules. In addition, the 2023 Guidance provides that the 2023 Guidance Formula

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<sup>43</sup> *Id.* ¶52 at 97.

<sup>44</sup> *Id.*

applies only for fiscal years that begin by December 31, 2025, leaving open the question of what approach should be adopted in subsequent years.<sup>45</sup>

The 2023 Guidance Formula allocates residual GILTI taxes pro rata among CFC-CEs with a GloBE jurisdictional tax rate (“**GloBE Jurisdictional ETR**”) below an “**Applicable Rate**”. The Applicable Rate is set at 13.125% for the GILTI regime. This is presumably so because it is the rate at which no residual U.S. tax liability would arise if (1) the GloBE jurisdictional tax attributable to tested income were the same as foreign income taxes for U.S. tax purposes and (2) the 80% limitation under Section 960(d)(1) on the use of the GloBE jurisdictional tax as an FTC, but none of the other limitations, applied. The 2023 Guidance states that it is the “threshold for low taxation” above which the foreign income taxes of the CFC “generally” will fully offset the tax imposed on the shareholder under the Blended CFC Tax Regime.<sup>46</sup>

The GloBE Jurisdictional ETR is not the same as the ETR of Article 5.1 of the Model Rules, because it takes into account only Covered Taxes before the push-down of CFC Tax Regime taxes. In addition, unlike the ETR under Article 5.1, it includes Top-up Taxes paid under a QDMTT. This reflects the fact that a QDMTT should reduce the residual U.S. tax under the Model Rules.<sup>47</sup> Under the 2023 Guidance, a QDMTT imposed in the CFC-CE’s jurisdiction of tax residence is included only if the Blended CFC Tax Regime allows a foreign tax credit for the QDMTT “on the same terms” as for any other creditable foreign income tax.<sup>48</sup>

The 2023 Guidance Formula is based on the fact that GILTI tax is determined on an aggregate basis under U.S. tax law. Under the formula, this aggregate GILTI tax is disaggregated and apportioned among CFC-CEs for push-down by pro-rating solely among CFC-CEs that are located in jurisdictions with a GloBE Jurisdictional ETR below the Applicable Rate. The Allocation Key for each CFC-CE is the hypothetical additional amount of tax that it would have to pay in its jurisdiction if its tested income were subject to tax at the Applicable Rate, i.e., for each CFC:

$$\text{GILTI Allocation Key} = \text{Tested Income} \times (13.125\% - \text{GloBE Jurisdictional ETR})$$

The relevant income for GILTI purposes is the share of tested income, and not of GILTI (i.e., without any reduction on account of NDTIR that may be allocable to the relevant CFC-CE).<sup>49</sup>

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<sup>45</sup> 2023 Guidance, section 2.10.3, ¶ 8, at 68. The 2023 Guidance elaborates that “given the status of GILTI as a Blended CFC Tax Regime and the urgent need for guidance on the allocation of GILTI taxes under Article 4.3.2(c), the Inclusive Framework has agreed a simplified allocation that can be applied to Blended CFC Tax Regimes, including GILTI, for a limited time period. Whether to allow a special allocation methodology for Blended CFC Tax Regimes after that limited time period will be assessed by the Inclusive Framework.” *Id.* at section 2.10.1, ¶ 5, at 67.

<sup>46</sup> 2023 Guidance, section 2.10.3, ¶ 8, at 69.

<sup>47</sup> See NY State Bar Ass’n Tax Section, *Report No. 1476 - Report on Foreign Tax Credit Considerations Related to the OECD Global Anti-Base Erosion Model Rules (Pillar Two)* (May 31, 2023).

<sup>48</sup> 2023 Guidance, Section 2.10.3 ¶ 8, at 68. Notice 2023-80, 2023-52 I.R.B. 1583 would generally allow a FTC for a QDMTT.

<sup>49</sup> See 2023 Guidance, Section 2.10.3, ¶ 8, at 68.

The 2023 Guidance expressly refers to tested income (without reduction for foreign income taxes) of the CFC-CE.

The GILTI tax apportioned and attributed down to a CFC-CE is, accordingly:

$$\frac{\text{GILTI Allocation Key for CFC}}{\text{Sum of GILTI Allocation Keys for all CFCs}} \times \text{Allocable U. S. GILTI Tax}$$

The “**Allocable U.S. GILTI Tax**” is determined as (1) the product of (a) the amount of GILTI, less the Section 250 deduction, and (b) the U.S. corporate tax rate of 21%, (2) “less the foreign tax credit allowed in the GILTI basket”.<sup>50</sup>

While the 2023 Guidance Formula is simpler than the method under the 2022 Commentary, it principally suffers from allocating based on a measure that is divorced from the manner in which the residual U.S. tax of each CFC-CE is determined. GloBE income and Covered Tax determinations, which drive the GloBE Jurisdictional ETR and thus the GILTI Allocation Key for each CFC-CE, vary substantially from U.S. tax law. Allocating U.S. residual taxes in respect of GILTI solely to low-taxed CFC-CEs under GloBE principles is divorced from how the residual U.S. taxes are determined in the first place.

This point is illustrated by Example 2, shown in the table below. In Example 2, a U.S. Shareholder-CE owns three CFC-CEs: CFC-CE-A, in a high-tax jurisdiction; CFC-CE-B, in a low-tax jurisdiction; and CFC-CE-C, in a no-tax jurisdiction. Each one of the three CFC-CEs has \$100 of tested income. The CFC-CEs have QBAI giving rise to \$100 of NDTIR.

Based on these inputs, the U.S. Shareholder-CE has \$200 of GILTI (\$300 - \$100). The U.S. Shareholder-CE’s GILTI, in turn, is reduced by a \$100 Section 250 deduction; the U.S. Shareholder-CE thus has \$100 of income that is subject to tax, resulting in \$21 of GILTI tax (before taking into account FTCs).

In addition, the U.S. Shareholder-CE has \$14 of Section 960(d) FTCs, and it is assumed Section 904 does not apply to limit the use of those FTCs. The allowed foreign tax credit of \$14 is less than the GILTI tax of \$21, and the owner-CE is, accordingly, in an excess limitation position. CFC-CE-A, a CFC-CE in a high-tax jurisdiction (indeed, with excess FTCs on a standalone basis), is nevertheless allocated GILTI tax because its GloBE Jurisdictional ETR falls slightly short of the 13.125% Applicable Rate. However, this does not appear to be a logical result: given that the U.S. Shareholder-CE is in an excess limitation position, it seems that the \$1 of excess credits of CFC-CE-A over its GILTI tax should reduce the amount of residual U.S. tax in respect of GILTI of CE-B and CE-C of \$1 and \$7 respectively, and the \$7 of residual U.S. tax should be entirely allocated to them.

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<sup>50</sup> *Id.*

**Example 2: Operation of Blended CFC Allocation Key**

	CFC-CE-A	CFC-CE-B	CFC-CE-C	TOTAL
1. Tested Income (Given)	\$100	\$100	\$100	\$300
2. Foreign Tax Paid (Given)	\$15	\$11.25	\$0	\$26.25
3. QBAI (Given)	\$800	\$200	\$0	\$1000
4. NDTIR (Given)	\$200			\$100
5. GILTI	\$400			\$200
6. Section 250 Deduction	\$200			\$100
7. Tentative U.S. Tax	\$7	\$7	\$7	\$21
8. Creditable foreign tax (Given) <sup>51</sup>	\$8	\$6	\$0	\$14
9. Residual U.S. tax	\$7			\$7
10. GloBE Jurisdictional ETR (Given)	13%	10.125%	0%	
11. Blended CFC Allocation Key	0.125	3.0	13.125	-/-
<b>12. Residual U.S. GILTI Tax Allocated Under 2023 Guidance Formula</b>	<b>\$0.05</b>	<b>\$1.30</b>	<b>\$5.65</b>	<b>\$7</b>

**b. Applicable Rate of Less Than 15% Is Required**

Whether a CFC Tax Regime qualifies as a Blended CFC Tax Regime within the meaning of the 2023 Guidance Formula requires, apart from aggregating income, losses, and creditable taxes, that the Applicable Rate be less than the GloBE Minimum Rate of 15%. For GILTI, the Applicable Rate of 13.125% is based on a simplified model of the GILTI regime where 80% of the foreign income taxes of a CFC attributable to a U.S. Shareholder’s GILTI inclusion are creditable under Section 960(d) and 50% of GILTI is deducted under Section 250, giving rise to an implied U.S. tax rate on GILTI of 10.5% (50% of 21% or 80% of 13.125%).

<sup>51</sup> In Example 2, the inclusion percentage under Section 960(d)(1) is 66.67%. In the case of CE-A, 80% x 66.67% x \$15 = \$8; and in the case of CE-B, 80% x 66.67% x \$11.25 = \$6. Also, it is assumed Section 904 does not limit the use of the owner-CE’s FTCs.

For a U.S. Shareholder's taxable years beginning after December 31, 2025, the Section 250 deduction is reduced to 37.5% of GILTI, i.e., 62.5% of the GILTI inclusion is subject to U.S. tax under this simplified model. In that case, the Applicable Rate should be 16.40625%, i.e., the threshold rate at which after an 80% foreign tax credit no residual U.S. tax liability would arise at an implied U.S. tax rate for GILTI of 13.125% (62.5% of 21%). For such tax years, the GILTI regime will no longer be a Blended CFC Tax Regime. The 2023 Guidance Formula applies only for fiscal years beginning on or before December 31, 2025, in any event, as noted above. If it were to be extended, however, the Applicable Rate would have to be increased or to cease to be constitutive of a Blended CFC Tax Regime.

#### **4. Push-Down of Taxes Imposed on a Shareholder Under a CFC Regime to the Shareholder's CFCs**

Some high-level observations follow from our review of the 2022 Commentary and 2023 Guidance. First, the method to be used to push down an owner-CE's home country tax to its PE-CEs and CFC-CEs looks to each PE-CE or CFC-CE as a separate unit, to which a specific amount of the owner-CE's tax is pushed down. This is in keeping with the basic mechanical design of the Model Rules, which determine separately for each CE the Covered Taxes it has incurred. Although CEs located in a particular country are ultimately combined into a jurisdictional unit for which Top-up Tax is computed, this happens at a later, separate step provided in the Model Rules.<sup>52</sup>

Second, for purposes of computing the amount of home-country tax paid by the owner-CE on income of a particular CFC-CE or PE-CE, such income is computed under the tax rules of the home country.

Third, where the home country grants a tax credit for taxes paid by the CFC-CE or PE-CE in the country where it is located, that credit is computed in accordance with such home country rules, including any limitations on the credit provided in such rules. Such limitations may need to be applied using "reasonable assumptions." In addition, in keeping with the notion of reasonable assumptions, both the 2022 Commentary and 2023 Guidance (in different ways) seek to take into account credits allowed in the owner-CE's home country for the foreign taxes paid by CFC-CEs and PE-CEs in different countries, in a manner that gives effect to the different tax rates in those

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<sup>52</sup> See Article 5 of the Model Rules. As described above in footnote 31, there may be jurisdictional sub-groupings of entities in a jurisdiction, for, e.g., "Investment Entities" versus other CEs in the jurisdiction (Article 5.1.3 of the Model Rules). The push-down of taxes from an owner-CE to a CFC-CE that is an Investment Entity is limited. The maximum amount of domestic taxes of the owner-CE in respect of passive income of the Investment Entity that can be pushed down is (x) the excess of the Minimum Rate over the Investment Entity's ETR, determined without regard to the Covered Taxes incurred with respect to such passive income by the owner-CE, multiplied by (y) the amount of the Investment Entity's passive income includible in the income of the owner-CE. Model Rules, Art. 4.3.3. Where there are multiple Investment Entities in a jurisdiction, the limit just described is computed in the aggregate for the group of such entities.

The Top-up Tax for other CEs in the jurisdiction is computed separately from the Top-up Tax for the Investment Entities in such jurisdiction.

countries. This is consistent with the fundamental emphasis in Pillar 2 on disparities in the rates of tax paid by an MNE Group in the different countries where it has operations.

The recognition in the 2022 Commentary and 2023 Guidance of a role for assumptions points to a final, broader observation. Given the numerous and, often, substantial differences between the base for an owner-CE's home-country tax incurred with respect to income of a PE-CE or CFC-CE, the attribution of the owner-CE's home-country tax to its PE-CEs and CFC-CEs as Covered Taxes of the PE-CEs and CFC-CEs that may reduce the amount of Top-up Tax imposed with respect to such CEs inherently involves a substantial amount of imprecision. Thus, in adopting a formula for push-down of a U.S. Shareholder-CE's GILTI tax to its CFC-CEs, an approach that does "rough justice," and that is largely based on existing calculations already made for purposes of the U.S. Shareholder-CE's U.S. tax reporting under the Code, seems appropriate. Part IV discusses our proposals for such a formula in detail.

While identification and broad international acceptance of such a formula would seem to be a necessary step in the effective reconciliation of the GILTI regime with Pillar 2, a number of other measures would further contribute to achieving such reconciliation. In Part III.D immediately below, we identify areas where we expect the application of Pillar 2 and GILTI to overlap. Later in this Report, in Part V, we address certain measures the United States might consider in relation to such potential overlap, involving possible adoption of a U.S. IIR either in conjunction with or as a replacement for the current GILTI regime.

#### **D. Potential GILTI/IIR Overlap Issues**

This Part III.D identifies various issues that arise once the GloBE Rules are enacted worldwide (i.e., ex-United States), such that the GILTI regime, IIR and UTPR are in effect simultaneously. These issues will become relevant immediately beginning with the implementation of an IIR for any group in which there is a U.S. corporation that holds foreign subsidiaries (or has foreign operations). One such situation is where the foreign subsidiaries are held in a chain, such that an intermediate parent CFC holds subsidiary CFCs. In this case, the U.S. ultimate parent would be subject to GILTI tax while the parent CFC would have imposed the IIR. In addition, the IIR could impose tax costs in the case of a foreign-parented group with a U.S. subsidiary that itself has foreign subsidiaries in a so-called "sandwich" structure. It could also be imposed with respect to a U.S.-parented group that owns a foreign subsidiary that itself owns a U.S. group that owns foreign subsidiaries or has foreign operations in a so-called "club sandwich" structure. For any other U.S.-parented group not just described, while an IIR adopted by another country would not apply, these issues would still become relevant following enactment of a UTPR, which has been delayed to at least 2025.

One set of issues relates to the potential for double tax. This can arise because the tax bases for GILTI and Pillar 2 are different and may reflect income or deductions at different times. As an extreme example, consider:

**Example 3:** U.S. Parent (“Parent”) owns all of the stock of a foreign holding company, which is incorporated in a jurisdiction that has enacted the IIR, but which has no other assets or income (“Holdco”), and Holdco owns all of the stock of Subsidiary S (“S”) located in Country X with no corporate tax. In Year 1, X earns \$1,000 of prepaid revenue. Under applicable U.S. tax rules, S would be required to include the revenue in income in Year 1 but for financial statement purposes, the revenue is not included until earned. Assuming Parent has no other foreign subsidiaries (or other interests in CFCs), Parent will be required to pay \$105 of tax on S’s income under the GILTI regime. In year 2, the CFC performs the relevant services and earns the deferred revenue for financial statement purposes. Under Pillar 2, and assuming no other income, deductions or SBIE, there would be \$150 of tax imposed under the IIR, which would be collected by Holdco.

This extreme example is intended to be illustrative and unlikely to occur in the real world, but there are innumerable differences between the U.S. computation of taxable income—and, therefore, GILTI—and GloBE income such that mismatches are virtually inevitable. Because neither GILTI taxes (under the Code) nor Pillar 2 taxes (under the Model Rules) can be carried forward to credit against one another, any timing difference has the potential to give rise to double tax.<sup>53</sup> Note that the issue would be the same even if Parent directly held S, so long as Parent also held stock of a foreign entity that had enacted the UTPR.<sup>54</sup>

The second issue is the potential for revenue loss to the U.S. government. Currently, GILTI taxes take precedence over the IIR and UTPR. As a result, the U.S. revenue collection comes first with respect to CFCs. But if the IIR would impose *additional* taxes, the U.S. government simply misses out on these taxes because of the disconformity between the GILTI regime and an IIR. Put another way, the total tax in the system has increased because of the enactment of an IIR but the United States does not benefit from this at all.

This issue is especially prominent in a U.S.-parented structure. In this case, *other* foreign subsidiaries may pay Top-up Tax through the UTPR. Yet the UTPR is intended to be a “last line of defense”. Given that the U.S. parent is subject to tax on that income under the GILTI regime, which is intended to address income shifting to a low-tax jurisdiction, it might be seen as strange

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<sup>53</sup> We understand that a small minority of U.S. taxpayers apply deferred tax accounting with respect to GILTI, such that the acceleration of revenue for U.S. taxable income purposes results in the creation of a deferred tax asset on a financial statement. If this were the case, some of the problematic timing differences between U.S. and GloBE income may be ameliorated because the creation of the deferred tax asset would reduce the amount of Covered Taxes deemed paid in Year 1 and the reduction of the deferred tax asset in Year 2 and beyond would increase Covered Taxes (capped at the Minimum Rate). Our understanding is that the treatment of these deferred tax assets in respect of GILTI taxes and other imputation regimes may be addressed in future guidance from the OECD.

<sup>54</sup> We do not expect the relief for timing mismatches in Article 4.4 of the Model Rules would be helpful here. This is because the rules key off the creation of deferred tax assets or liabilities in financial statements, which generally would only arise due to mismatches between GloBE Rules and *local country* taxation and have no mechanism to account for CFC taxes attributable to such entity.

for the same income to be subject to a further residual anti-income-shifting tax in the hands of the U.S. parent's foreign subsidiaries.<sup>55</sup>

A third set of issues relates simply to administrability of multiple global minimum tax regimes. MNEs will already be required to comply with Pillar 2 because of its widespread enactment in other countries. The additional requirement of a U.S. parent corporation to comply with the GILTI regime and reconcile the GILTI regime with an IIR would be a unique burden vis-à-vis other MNEs. While it is already the case that the United States' imposition of GILTI tax differs from the rest of the world, arguably, the impetus for the GILTI regime might be considerably reduced with widespread adoption of Pillar 2. In this case, the GILTI regime would mostly offer increased administration costs for MNEs and the IRS without much revenue benefit (other than, perhaps, as a result of domestic expense allocation, differences in the tax base, and/or a lack of NTDIR for payroll expenses).

In all cases, we recognize that if the vast majority of countries enact the QDMTT, perhaps these issues will be largely mitigated. This is because the QDMTT is creditable against GILTI tax and also reduces the Top-up Tax imposed pursuant to the IIR.<sup>56</sup> In other words, if the local jurisdictions are themselves imposing a minimum tax, there will be little or no substantive role for the IIR nor additional taxes to collect (or, practically, to administer) with either the GILTI regime or an IIR. Note that the GILTI regime might still collect additional tax as a result of the expense allocation rules, tax base differences, or differences between the SBIE and NDTIR; but there would not be an incremental issue in reconciling this aspect of the GILTI regime with the GloBE Rules.

#### **IV. GILTI TAX PUSH-DOWN ATTRIBUTION UNDER THE GLOBE RULES**

This Part IV will explore approaches under the Model Rules to attributing taxes imposed on a U.S. Shareholder-CE's GILTI from the shareholder to its CFC-CEs, such that they are treated as Covered Taxes of the CFC-CEs. Part IV.A will propose a general method to determine the amount of a U.S. Shareholder-CE's GILTI tax attributable to each CFC-CE, before taking into account the impact of Section 960(d) FTCs on the attribution of GILTI taxes to CFC-CEs. Part IV.B will discuss how Section 960(d) FTCs should be taken into account in the push-down methodology. Part IV.C will address additional administrative considerations. Part IV.D contains a concluding summary.

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<sup>55</sup> Notice 2023-80 indicates that a U.S. parent would typically not be entitled to a foreign tax credit for a UTPR collected by a foreign subsidiary. *See* Notice 2023-80, Section 2.02(2) – (4). Although the United States will miss opportunities to collect additional tax revenue if it does not adopt an IIR, denial of a FTC for the UTPR means the United States generally will not collect significantly less tax revenue from U.S.-parented groups as a result of other countries' adoption of UTPRs. The same is true in a case like Example 3 where an intermediate holding company below a U.S. parent collects an IIR. *See* Notice 2023-28, Section 2.02(6)(a), Example 1.

<sup>56</sup> Mismatches between QDMTT and GILTI might still cause issues, *see* NY State Bar Ass'n Tax Section Report No. 1465, *Report on the OECD Global Anti-Base Erosion Model Rules (Pillar Two)* (July 21, 2022).

## A. GILTI Tax Attributable to Each CFC-CE (Before Reduction for Foreign Tax Credits)

As an initial point, we note that we do not recommend continuing to use, after its scheduled expiration at the end of 2025, the 2023 Guidance Formula.<sup>57</sup> As noted in Part III.C.3 above, although the 2023 Guidance Formula is relatively simple, and does incorporate some U.S. tax calculations, in our view it suffers from allocating based on a measure that is largely divorced from the manner in which the residual U.S. tax with respect to each CFC-CE is actually determined under the Code. GloBE income and Covered Tax determinations, which are key inputs in the 2023 Guidance Formula, vary substantially from GILTI and Section 960(d) FTCs as determined under U.S. tax law.

In our view, the determination of the amount of a U.S. Shareholder-CE's GILTI tax to push down to a particular CE should be made primarily based on the rules and methodology that are incorporated in the GILTI regime.<sup>58</sup> Doing so would allocate the GILTI tax to those CFC-CEs which are responsible under U.S. tax law for generating that tax. This would be a practical approach and would, we believe, be consistent with the basic approach taken in the 2022 Commentary and, to a significant extent, in the 2023 Guidance (although we would discard the specific formula adopted in that guidance).

Accordingly, we propose beginning the process for pushing down GILTI tax by determining the amount of the U.S. Shareholder-CE's GILTI from its CFC-CEs as computed under the Code, reduced by the U.S. Shareholder-CE's Section 250 deduction.<sup>59</sup> We compute a tentative amount of GILTI tax of the U.S. Shareholder-CE on that amount of GILTI net of the Section 250 deduction, without regard to any reduction on account of Section 960(d) FTCs (the "**Aggregate Tentative GILTI Tax**"). We then attribute a portion of the Aggregate Tentative GILTI Tax to each CFC-CE that has tested income; with respect to the CFC-CE, its attributed share of the Aggregate Tentative GILTI Tax is the "**Tentative GILTI Tax**" with respect to that CFC-CE. As

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<sup>57</sup> See Recommendation 1 in Part II.A above.

<sup>58</sup> See Recommendation 2 in Part II.A above.

<sup>59</sup> For simplicity, in this Part IV, except where otherwise expressly stated, the discussion addresses only the case of a U.S. Shareholder-CE that has GILTI exclusively from wholly-owned CFCs that are CEs in the U.S. Shareholder-CE's MNE Group.

It is possible that, in practice, a U.S. Shareholder-CE may have GILTI inclusions attributable to its share of tested income of CFCs that are not CEs in such MNE Group, e.g., where a CFC is majority-owned by U.S. Shareholders that are unrelated to the U.S. Shareholder-CE. We note at various points in this Part IV where refinements to our proposed methodology would be appropriate, in order to take into account CFCs that are not CEs in the MNE Group.

Another complicating factor is that CFC-CEs under the Model Rules are not congruent with CFCs under U.S. tax law, as defined in Section 957. PEs of a Section 957 CFC, as well as disregarded entities of a Section 957 CFC, are generally treated as separate CFC-CEs under the Model Rules but part of the Section 957 CFC under U.S. tax law. It would appear generally appropriate to apply the methodology for push-down of a U.S. Shareholder-CE's GILTI taxes separately to such CFC-CEs, in a similar manner to a CFC-CE that also constitutes a Section 957 CFC, perhaps by allocating Covered Taxes based on tested units as defined in the GILTI high-tax exclusion regulations, which generally corresponds to the definition of a CE in the Model Rules.

indicated, the impact of Section 960(d) FTCs on the push-down analysis is considered later, in Part IV.B.

Because of the detailed nature of the calculations needed in order to execute this approach, we believe it is helpful to illustrate the proposed approach using a simple fact pattern, shown below in Example 4. Example 4 involves a U.S. Shareholder-CE that owns two CFC-CEs, located in jurisdictions A and B. We will refer to Example 4 throughout the various steps in our analysis below, to help elucidate those steps. In some cases, we also provide additional numerical examples to demonstrate important aspects of the analysis.

***Example 4: GILTI Tax Push-Down – Fact Pattern***

	<b>CFC-CE-A</b>	<b>CFC-CE-B</b>	<b>U.S. Shareholder-CE</b>
1. Tested Income (Given)	\$200.0	\$200.0	\$400.0
2. Foreign Income Taxes (Given)	\$30.0	\$15.0	\$45.0
3. QBAI (Given)	\$0.0	\$400.0	\$400.0
4. NDTIR	\$40.0		\$40.0
5. GILTI	\$360.0		\$360.0
6. Section 250 Deduction (i.e., 50% of GILTI) <sup>60</sup>	\$180.0		\$180.0
7. Tentative GILTI Tax <sup>61</sup>	\$18.9	\$18.9	\$37.8

Example 4 highlights that there are several variables that impact the U.S. Shareholder-CE's Aggregate Tentative GILTI Tax: (1) tested income (or loss) of each of its CFC-CEs; (2) QBAI in the case of tested income CFCs, which determines NDTIR; (3) the U.S. Shareholder-CE's Section 250 deduction; and (4) the decision whether any deductions or expenses of the U.S. Shareholder-CE, other than just the Section 250 deduction, should be set off against the U.S. Shareholder-CE's GILTI, for purposes of determining Aggregate Tentative GILTI Tax.

Consistent with the calculations called for by Section 951A(a), the U.S. Shareholder-CE's Aggregate Tentative GILTI Tax in Example 4 is \$37.80, determined by aggregating its tested income from CFC-CEs A and B (\$400); reducing that total by the aggregate NDTIR from those CFCs (\$40), resulting in \$360 of GILTI before taking into account the Section 250 deduction; and

<sup>60</sup> In the fact pattern in Example 4 and all other examples in this Part IV, it is assumed that the U.S. Shareholder-CE does not have a net loss from its domestic activities and has no foreign assets or activities other than ownership of the CFC-CEs shown and, accordingly, that the Section 250 deduction is not limited to less than 50% of the U.S. Shareholder-CE's GILTI.

<sup>61</sup> In Part IV.B below, we show how the Tentative GILTI Tax for each CFC-CE is adjusted on account of FTCs, in order to arrive at the Residual GILTI Tax for each CFC-CE.

then applying the 50% Section 250 deduction to yield the amount of GILTI subject to U.S. tax (\$180). That \$180 is multiplied by the 21% statutory rate to produce \$37.80 of Aggregate Tentative GILTI Tax.

Notably, under our proposed approach, the U.S. Shareholder-CE's Aggregate Tentative GILTI Tax is not reduced on account of any deductions or expenses of the U.S. Shareholder-CE, other than the Section 250 deduction. We believe it is appropriate to take into account the U.S. Shareholder-CE's Section 250 deduction because such deduction is computed directly and (except in cases where the U.S. Shareholder-CE's taxable income is less than its GILTI) solely by reference to the U.S. Shareholder's GILTI inclusion. Such deduction is commonly viewed, both by the U.S. government and in the OECD's guidance, as inextricably tied to such income.<sup>62</sup> By comparison, other expenses and deductions of the U.S. Shareholder-CE do not have a similarly tight tie to U.S. Shareholder-CE's GILTI. Some domestic expenses incurred by a U.S. Shareholder-CE are, as noted in Part III.A, taken into account for purposes of limiting under Section 904 the Section 960(d) FTCs that can be used to reduce the U.S. Shareholder-CE's GILTI tax. However, the architecture of the Code does not otherwise require an offset of those expenses against the U.S. Shareholder-CE's GILTI. For reasons described in detail in Part IV.B.2 below, we believe the rules allocating domestic expenses for purposes of Section 904 should be taken into account in the GILTI tax push-down analysis only in order to determine the amount of Section 960(d) FTCs allowed as a credit against a U.S. Shareholder-CE's GILTI tax that is potentially available to push down to CFC-CEs. The domestic expenses allocated for purposes of Section 904 should not be treated as reducing the amount of GILTI that is used to compute the U.S. Shareholder-CE's tentative (pre-FTC) GILTI tax. Stated differently, the Aggregate Tentative GILTI Tax should not be reduced as a result of expense allocation.

### 1. **Apportionment of Aggregate Tentative GILTI Taxes Among CFC-CEs**

Once a U.S. Shareholder-CE's Aggregate Tentative GILTI Tax is determined in the manner just described, we believe it is reasonable to calculate each CFC-CE's Tentative GILTI Tax by apportioning the Aggregate Tentative GILTI tax among the CFC-CEs based on their respective "**Tentative Allocation Fraction.**"<sup>63</sup> The Tentative Allocation Fraction is the ratio of the U.S. Shareholder-CE's pro rata share of a CFC-CE's tested income, to the aggregate of the U.S. Shareholder-CE's pro rata shares of all CFC-CEs' tested income (without reduction for tested losses or NDTIR).

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<sup>62</sup> Essentially, the deduction is viewed as a mechanic through which to adjust the rate of tax on such income. *See, e.g.,* Joint Committee on Taxation, General Explanation of Public Law 115-97 378, 381-382 (December 2018); Deduction for Foreign-Derived Intangible Income and Global Intangible Low-Taxed Income (T.D. 9901), 85 Federal Register 43042, 43072 (July 15, 2020); 2023 Guidance, section 2.10.3, ¶ 8, at 68.

<sup>63</sup> See Recommendations 3 and 4(i) in Part II.A above.

CFC-CE Tentative GILTI Tax =

$$\frac{\text{Pro Rata Share of Tested Income of CFC-CE}}{\text{Aggregate Pro Rata Shares of Tested Income of CFC-CEs}} \times \text{Aggregate Tentative GILTI Tax of U.S. Shareholder} - \text{CE}$$

The Tentative Allocation Fraction, in other words, takes the approach that the Aggregate Tentative GILTI Tax is equally apportioned to each dollar of tested income. Implicitly, this means that the benefit of tested losses and NDTIR, as attributes that offset tested income and, thus, reduce the Aggregate Tentative GILTI Tax, is generally allocated equally to each dollar of tested income. One could imagine other approaches, for example, in which tested losses of a CFC-CE located in a particular country and/or NDTIR attributable to QBAI of a CFC located in a particular country, are allocated as a matter of priority to offset tested income of CFC-CEs located in that same country. However, as discussed below, we believe such alternative approaches would generally be more complex than the method we have proposed, without being preferable as a policy matter. In addition, we do not believe that they would reflect the manner in which GILTI and Aggregate Tentative GILTI Tax is determined under U.S. tax law.<sup>64</sup>

## 2. Tested Losses

Example 4 does not address the effect of CFC-CEs with tested losses. Tested losses reduce the amount of GILTI by reducing the net tested income. There is no obvious method to follow regarding how tested losses are supposed to reduce each separate CFC-CE's tested income.

However, we believe it is reasonable to take the approach described immediately above in Part IV.A.1. In other words, the effect of apportioning a U.S. Shareholder-CE's Aggregate Tentative GILTI Tax pro rata among the CFC-CEs with tested income, in proportion to the U.S. Shareholder CE's shares of their respective tested incomes, is to allocate the impact of any tested losses pro rata among the CFC-CEs with tested income, in accordance with the U.S. Shareholder CE's shares of their respective tested incomes.<sup>65</sup> For instance, in Example 5 below, the U.S. Shareholder-CE owns three CFC-CEs: A, with \$200 of tested income, B with \$200 of tested loss, and C with \$400 of tested income. The table shows how the approach just described would apply.

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<sup>64</sup> Our proposed approach is consistent with that adopted in Section 951A(f)(2), which provides that for purposes of determining (for example) PTEP of each CFC, a U.S. Shareholder's GILTI is allocated among CFCs in proportion to the U.S. Shareholder's share of tested income of each of the CFCs.

<sup>65</sup> See Recommendation 5 in Part II.A above.

**Example 5: GILTI Tax and Section 960(d) FTC Determination with Tested Loss CFC**

	<b>CFC-CE-A separately</b>	<b>CFC-CE-B separately</b>	<b>CFC-CE-C separately</b>	<b>U.S. Shareholder- CE</b>
1. Tested Income	\$200.0	(\$200.0)	\$400.0	\$400.0
2. NDTIR	\$0.0			\$0.0
3. GILTI	\$400.0			\$400.0
4. Tentative GILTI Tax	\$14.0	n/a	\$28.0	\$42.0

In Example 5, there would be only \$42 of Aggregate Tentative GILTI tax imposed in respect of total tested income of \$600, as it is offset by \$200 of tested loss. The Aggregate Tentative GILTI Tax would be allocated 1/3, or \$14, to CFC-CE-A (\$200/\$600) and 2/3, or \$28, to CFC-CE-C (\$400/\$600).

We believe there are multiple reasons for adopting such an approach. First, as described in Part III.C above, the OECD’s guidance under the Model Rules reflects a general preference for looking to an owner-CE’s home-country tax rules, when determining how much of the owner-CE’s home-country income taxes should be attributed to a particular CFC-CE or PE-CE. In this regard, the approach just described appears completely consistent with the basic design of the GILTI regime. A U.S. Shareholder-CE’s share of CFC-CEs’ tested losses are aggregated under Section 951A(a), and the aggregated amount of such loss shares then is set off against the U.S. Shareholder’s aggregate share of CFC-CEs’ tested income: the tested losses relate to aggregate tested income and not to particular income-earning CFC-CEs. Such tested losses therefore reduce each dollar of tested income equally. Second, the approach just described also involves relatively straightforward calculations, using numbers that would be reported on a U.S. Shareholder-CE’s U.S. federal income tax return and schedules.

We note, however, that it may also be reasonable to adopt a different approach, in which tested losses of a CFC-CE located in a particular country are first used to offset tested income of CFC-CEs in the same country. Only if, and to the extent that, tested losses of CFC-CEs in a particular jurisdiction exceed the tested income of CFC-CEs in that country, would such tested losses be used to reduce tested income of CFC-CEs in another country. For instance, in Example 5, suppose two of the CFC-CEs (CFC-CE-A and CFC-CE-B) are in Country 1. CFC-CE-A has tested income of \$200 and CFC-CE-B has a tested loss of \$200. Assume Country 1 has a high tax rate, but provides for tax consolidation; and, for simplicity, assume these two CE’s income/loss as computed for Country 1 purposes, is about the same as their GloBE income/loss and tested income/loss. In addition, the U.S. Shareholder-CE also owns CFC-CE-C in Country 2, which does not impose corporate income taxes. CFC-CE-C has tested income of \$400. None of the CFC-CEs has QBAI. Before taking into account the impact of a push-down of the U.S. Shareholder-CE’s

GILTI taxes to its CFC-CEs, one would expect in this fact pattern that Top-up Tax would be imposed on the income of CFC-CE-C as it is located in a no-tax jurisdiction. It also would be expected that little or no Top-up Tax would be imposed in respect of the GloBE income of CFC-CE-A and CFC-CE-B in Country 1, because their aggregate GloBE income is close to \$0. If the U.S. Shareholder-CE has \$42 of GILTI tax in this example, it may seem that much of that tax would be “wasted,” if the GILTI tax was pushed down to CFC-CE-A and CFC-CE-C ratably in proportion to their respective tested incomes, i.e., 1:2 (or \$14 to CFC-CE-A and \$28 to CFC-CE-C). By comparison, none of the GILTI tax would under this view be “wasted,” if the entire \$42 was pushed down to CFC-CE-C: the entire amount of GILTI tax, rather than only two-thirds of such tax, would serve to reduce the Top-up Tax imposed on CFC-CE-C’s income. This type of methodology could be seen as consistent with the basic country-by-country approach to measuring the GloBE Income that is subjected to Top-up Tax. On the other hand, such methodology also would involve more complex calculations than would the first method we have described, and is not rooted in the basic structure of the GILTI regime.<sup>66</sup> Note also that if the facts were different (e.g., if CFC-CE-C was subject to tax at a rate above the Minimum Rate in Country 2, while Country 1 was a no-tax or low-tax jurisdiction, and CFC-CE-B’s losses were not large enough to offset CFC-CE-A’s income), then an allocation of a significant portion of the GILTI tax to CFC-CE-A might reduce the total Top-up Tax imposed here. Moreover, there is no provision under the GILTI regime that would give preference to CFC-CE-C over CFC-CE-A for the allocation of GILTI taxes in this case, as GILTI is not imposed on a jurisdictional basis.<sup>67</sup>

### 3. NDTIR

While QBAI is an attribute of each tested income CFC-CE, NDTIR is an amount determined in the aggregate at the level of the U.S. Shareholder-CE.<sup>68</sup> NDTIR is an aggregate amount that offsets another aggregate amount, net tested income, and is not limited, with respect to any CFC-CE, to such CFC-CE’s tested income. For that reason, no CFC-CE should have a stronger “claim” on the NDTIR than any other CFC-CE, regardless of the fact that it may have contributed the QBAI from which the NDTIR is derived. On this view, disaggregating NDTIR is not warranted under the GILTI regime. If such a disaggregation were nevertheless attempted, it could give rise to complicated scenarios where a CFC-CE is in a “negative GILTI” position on a separate basis because its NDTIR exceeds its tested income. This, in turn, might suggest there is a

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<sup>66</sup> Regardless of which of the approaches described in the text is adopted for tested losses of CFC-CEs, it appears appropriate to us to treat a U.S. Shareholder-CE’s share of tested losses of a CFC that is not a CFC-CE, as an attribute that ratably reduces the Tentative GILTI Tax imposed on each dollar of tested income. There is no reason to give any CFC-CE with tested income priority use of such tested losses, over other CFC-CEs with tested income.

<sup>67</sup> Under the Model Rules, there may be sub-groupings of CEs within a jurisdiction in order to compute the Top-up tax imposed (see footnote 31 above). Thus, if tested losses of a CFC-CE were allocated on a priority basis to CFC-CEs in the same country, it might be necessary to further allocate those tested losses first, specifically to the subgroup to which the CFC-CE with such tested losses belongs (e.g. Investment Entities in such country versus other types of CEs there). This would add, potentially significantly, to the complexity of this approach.

<sup>68</sup> Section 951A(d).

need for to allocate excess NDTIR from one CFC-CE to others, perhaps first those located in the same jurisdiction and then other CFC-CEs.

We find less justification for attempting such a task, than there may be in the case of tested losses. As discussed immediately above in Part IV.A.2, tested loss of a CFC-CE conceivably could correspond to a GloBE loss of the CFC-CE; in such a case, that loss would be offset against income of CEs in the same jurisdiction for purposes of computing Top-up Tax in the same jurisdiction, resulting in less of a need to push down Covered Taxes of the U.S. Shareholder-CE to CFC-CEs in that jurisdiction. By comparison, NDTIR is an attribute that exists solely for purposes of the GILTI regime. While it might be seen as conceptually akin to SBIE, it is computed quite differently, using different inputs. There thus seems to be little justification for an approach that would depart from the basic design of the GILTI regime, which applies NDTIR as an aggregate amount to offset aggregate tested income.

In light of the structure of the GILTI regime and the complexities that would be involved in departing from it, we recommend treating NDTIR as a blended item allocated pro rata in accordance with tested income among tested income CFCs.<sup>69</sup> The Tentative Allocation Fraction methodology that we have proposed above reflects such treatment of NDTIR.

#### **4. GILTI High-Tax Exclusion**

Under the high-tax exclusion of Section 954(b)(4) as applied to Section 951A,<sup>70</sup> a CFC-CE's "tentative gross tested income" (i.e., its income that would be tested income but for the exception) is excluded from tested income and thus the GILTI regime if its "tentative tested income" (i.e., its tentative gross tested income less expenses) is subject to an effective rate of foreign income tax in excess of 90% of the highest U.S. federal corporate income tax rate specified in Section 11. At the current rate of 21%, this applies if the foreign tax rate is more than 18.9%, as determined based on tentative tested income calculated under U.S. tax principles. This may be more, or less, than the headline tax rate of the relevant jurisdiction. The determination, moreover, is made on a "tested unit" basis. This generally should coincide with CEs for GloBE purposes, as each branch or disregarded entity is a tested unit and a CFC is a tested unit separately from its branches or disregarded entities.

If an election is made with respect to a CFC-CE, then the tentative gross tested income of any tested unit with an effective foreign tax rate in excess of the threshold rate would be excluded from tested income.<sup>71</sup> Further, neither the tangible assets nor the foreign income taxes of such

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<sup>69</sup> See Recommendation 6 in Part II.A above.

<sup>70</sup> See Section 951A(c)(2)(A)(i)(III) and Treas. Regs. § 1.951A-2(c)(7). For the high-tax exclusion of Subpart F income, see Section 954(b)(4) and Treas. Regs. § 1.954-1(d).

<sup>71</sup> Treas. Reg. § 1.951A-2(c)(1)(iii), (c)(7)(i).

tested unit are considered QBAI or tested foreign taxes for purposes of computing NDTIR and Section 960(d) FTCs, respectively.<sup>72</sup>

CFC-CEs for which the GILTI high-tax exclusion has been elected and which, as a result, have no tested income should not be included in the determination of the GILTI tax push-down.<sup>73</sup> Their income is not subject to any additional U.S. tax, and none of their tax attributes factor into the residual U.S. tax in respect of the U.S. Shareholder-CE's GILTI inclusion.<sup>74</sup>

## **B. Actual GILTI Tax Attributable to each CFC-CE Taking Into Account Foreign Tax Credits**

Once the Tentative GILTI Tax for each CFC-CE has been determined using the methodology outlined in Part IV.A, it remains to reduce such Tentative GILTI Tax to reflect the Section 960(d) FTCs the U.S. Shareholder-CE is entitled to claim against that Tentative GILTI Tax. We believe it is appropriate to reflect the impact of Section 960(d) FTCs in two steps. First, as described in Part IV.B.1 below, the amount of foreign income taxes incurred by each CFC-CE that would be creditable under Section 960(d) (disregarding the effect of the Section 904 limitation) should be determined. The U.S. Shareholder-CE then should reduce its Tentative GILTI Tax for each CFC-CE, to take into account the availability (but for Section 904) of credits for the foreign taxes the CFC-CE has incurred. Where a particular CFC-CE has incurred foreign taxes creditable under Section 960(d) that exceed the amount of the Tentative GILTI Tax on that CFC-CE's income, such excess foreign taxes should be applied against the Tentative GILTI Taxes of other CFC-CEs whose income has been more lightly taxed (or not taxed at all) by the countries where such CFC-CEs are located (i.e., the effects of cross-crediting of Section 960(d) FTCs should be taken into account). This would be similar to the approach in the 2022 Commentary. The Tentative GILTI Tax for each CFC-CE, as reduced to reflect both Section 960(d) FTCs for foreign taxes that such CFC-CE has itself paid or accrued and excess Section 960(d) FTCs allocated to such CFC-CE from other CFC-CEs (and before application of the Section 904 limitation), is the **"Tentative Residual GILTI Tax"** for such CFC-CE.<sup>75</sup>

Second, as described in Part IV.B.2 below, the U.S. Shareholder-CE's total Tentative Residual GILTI Tax for all its CFC-CEs, should be adjusted (increased) to take into account the impact of the Section 904 limitation for FTCs in the GILTI basket. The incremental GILTI tax that

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<sup>72</sup> See Treas. Reg. §§ 1.951A-3(c)(1), 1.960-2(c)(1).

<sup>73</sup> See Recommendation 7 in Part II.A above.

<sup>74</sup> If the high-tax exclusion were mandatory, this would reduce the potential for cross-crediting with respect to the tested income of CFC-CEs in different jurisdictions. However, making such exclusion mandatory would not completely eliminate the possibility of cross-crediting, as there should still be the potential for somewhat-high-taxed CFC-CEs that are below the exclusion and that, on a stand-alone basis would have excess credits that can be cross-credited with lower taxed CFC-CEs. This potential for cross crediting will be further mitigated once the Section 250 deduction decreases in taxable years beginning after December 31, 2025.

<sup>75</sup> Note that the first step described above in the text is necessary only when the U.S. Shareholder-CE's Section aggregate Section 960(d) FTCs are less than the Aggregate Tentative GILTI Tax. Only in such a case would the U.S. Shareholder-CE have a positive Tentative Residual GILTI Tax for any CFC-CE.

the U.S. Shareholder-CE incurs as a result of the application of the Section 904 limitation to FTCs in the GILTI basket should then be allocated among its CFC-CEs. We discuss below two reasonable approaches to making such allocation. The U.S. Shareholder-CE's Tentative Residual GILTI Tax for each CFC-CE, increased by the share of incremental GILTI tax resulting from the Section 904 limitation that is allocated to such CFC-CE, is the "**Residual GILTI Tax**" for such CFC-CE.<sup>76</sup>

### **1. Impact of Foreign Tax Credits, Prior to Application of the Section 904 Limitation**

In the first step of our approach to dealing with Section 960(d) FTCs, the amount of foreign income taxes incurred by each CFC-CE that would be creditable under Section 960(d) (disregarding the effect of the Section 904 limitation) should be determined. The U.S. Shareholder-CE then should reduce its Tentative GILTI Tax for each CFC-CE, to take into account the availability (but for Section 904) of credits for such foreign taxes.<sup>77</sup>

The pre-credit foreign income taxes of a CFC-CE that are taken into account in this step, are those attributable to its tested income. Under Section 960(d), the aggregate of all such foreign income taxes incurred by a U.S. Shareholder-CE's CFC-CEs is multiplied by 80%, and then is further multiplied by the "inclusion percentage" for the U.S. Shareholder-CE (i.e., the ratio of its GILTI, to its aggregate tested income from CFCs) in order to determine the amount of Section 960(d) FTCs available to the U.S. Shareholder-CE.

Under Sections 951A and 960(d), the inclusion percentage is an attribute of the U.S. Shareholder-CE, not of each separate CFC-CE. In Part IV.A.2 and 3 above, we explained that it is reasonable not to disaggregate the U.S. Shareholder-CE's tested losses and NDTIR and attempt to attribute them specifically to particular CFC-CEs with tested income (e.g., on a country-by-country basis), but instead to allocate those attributes ratably to each dollar of the U.S. Shareholder-CE's tested income from all of its CFC-CEs in order to determine Tentative GILTI Tax for each CFC-CE. If tested losses and NDTIR are allocated ratably in this manner, then it follows logically that the U.S. Shareholder-CE's inclusion percentage for each CFC-CE – i.e., the fraction of the U.S. Shareholder-CE's aggregate tested income that constitutes GILTI after taking into account tested losses and NDTIR— should be the same. We suggest this approach be adopted.<sup>78</sup> For instance, in Example 4, the U.S. Shareholder-CE's inclusion percentage under Section 960(d) is 0.9, i.e., \$360 of GILTI / \$400 of aggregate tested income.<sup>79</sup> That same percentage would be applied, under our recommended approach, to the foreign income taxes incurred by each of CFC-CE-A and CFC-

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<sup>76</sup> Note that this second step just described may be required even if the first step was not required because the Section 960(d) FTCs exceeded Aggregate Tentative GILTI Tax. This is so because the Section 904 limitation may reduce the allowed Section 960(d) FTCs to less than the Aggregate Tentative GILTI Tax.

<sup>77</sup> See Recommendation 4(ii) in Part II.A above.

<sup>78</sup> See Recommendation 8 in Part II.A above.

<sup>79</sup> Section 960(d)(2)(B), cross-referencing Section 951A(c)(1)(A).

CE-B to determine their respective share of the Section 960(d) FTCs of the U.S. Shareholder-CE that reduce their respective Tentative GILTI Tax to obtain the Tentative Residual GILTI Tax. Thus, in Example 4, the U.S. Shareholder-CE would have a total of \$32.40 of Section 960(d) FTCs (i.e., 0.9 times 80% of the sum of \$30 and \$15 of foreign income taxes), of which CFC-CE-A is treated as having paid or accrued \$21.60 (0.9 times 80% of \$30) and CFC-CE-B is treated as having paid or accrued \$10.80 (0.9 times 80% of \$15).

In Part IV.A.2, we noted that although it is reasonable to attribute tested losses to CFC-CEs with tested income pro rata in proportion to each such CFC-CE's tested income, it also may be reasonable to attribute tested losses incurred by a CFC-CE first to CFC-CEs located in the same country that have tested income. If that methodology were adopted, it would be necessary to compute a separate inclusion percentage for the CFC-CEs with tested income in each country, in order to take into account the fact the CFC-CEs with tested income located in one country may have had a larger portion of such tested income offset by tested losses, than did CFC-CEs with tested income located in a different country.

Once the Section 960(d) FTCs with respect to each CFC-CE have been determined, the impact of cross-crediting must be accounted for. This is easy in the case of two CFC-CEs, such as in Example 4. The U.S. Shareholder-CE has Section 960(d) FTCs of \$32.40, to offset an Aggregate GILTI Tax of \$37.80, for an aggregate Tentative Residual GILTI Tax of \$5.40. In the case of CFC-CE-A, as indicated above, it has Section 960(d) FTCs of \$21.60 that can be applied against its Tentative GILTI Tax of \$18.90. Accordingly, CFC-CE-A has no Tentative Residual GILTI Tax, and has \$2.70 of excess Section 960(d) FTCs. CFC-CE-B, by contrast, has only \$10.80 of Section 960(d) FTCs to offset \$18.90 of Tentative GILTI Tax. CFC-CE-B's standalone Tentative Residual GILTI Tax of \$8.10 (i.e., \$18.90 minus \$10.80) is reduced, however, as a result of allocating CFC-CE-A's \$2.70 of excess Section 960(d) FTCs to CFC-CE-B. This leaves CFC-CE-B with \$5.40 of Tentative Residual GILTI Tax (i.e., \$8.10 minus \$2.70). Thus, the aggregate Tentative Residual GILTI Tax of the U.S. Shareholder-CE is entirely attributed to, and pushed down to, CFC-CE-B.

If more than one CFC-CE has Tentative Residual GILTI Tax (before taking into account any allocation of excess Section 960(d) FTCs), and the U.S. Shareholder-CE also owns at least one CFC-CE that has excess Section 960(d) FTCs, then such excess Section 960(d) FTCs should be allocated among the CFC-CEs that (pre-allocation of excess Section 960(d) FTCs) have Tentative Residual GILTI Tax. More specifically, the aggregate amount of excess Section 960(d) FTCs should be determined, for all CFC-CEs that have Section 960(d) FTCs in excess of their Tentative GILTI Tax; and that aggregate amount of excess Section 960(d) FTCs should then be allocated among the CFC-CEs that have positive Tentative Residual GILTI Tax (before taking into account such allocation), in proportion to each such CFC-CE's (pre-allocation) Tentative Residual GILTI Tax. As before for the allocation of tested losses and NDTIR, the rationale here is that no CFC-CE's amount of Tentative Residual GILTI Tax (pre-allocation of excess Section 960(d) FTCs) has a stronger claim to be reduced by excess Section 960(d) FTCs, than any other CFC-

CE's Tentative Residual GILTI Tax (pre-allocation of excess Section 960(d) FTCs). This approach is consistent with the 2022 Commentary.<sup>80</sup>

The calculations just described with respect to Example 4 are shown in the table below, in the shaded boxes:

	CFC-CE-A	CFC-CE-B	U.S. Shareholder-CE
1. Tested Income (Given)	\$200.0	\$200.0	\$400.0
2. Foreign Income Taxes (Given)	\$30.0	\$15.0	\$45.0
3. QBAI (Given)	\$0.0	\$400.0	\$400.0
4. NDTIR	\$40.0		\$40.0
5. GILTI	\$360.0		\$360.0
6. Section 250 Deduction (i.e., 50% of GILTI)	\$180.0		\$180.0
7. Tentative GILTI Tax	\$18.9	\$18.9	\$37.8
8. Inclusion Percentage	0.9		0.9
9. Section 960(d) FTC	\$21.6	\$10.8	\$32.4
10. Excess Section 960(d) FTC Allocated to Other CFC-CE	(\$2.7)	\$2.7	n/a
11. Tentative Residual GILTI Tax ((7) - (9) - (10))	\$0.0	\$5.4	\$5.4

## 2. Application of the Section 904 Limitation

Once a U.S. Shareholder-CE's Section 960(d) FTCs (prior to application of the Section 904 limitation for the GILTI basket) have been taken into account in the manner outlined in Part IV.B.1, the final step in our proposed push-down methodology is to apply Section 904 and determine the impact (if any) on the allowance of Section 960(d) FTCs. Under this approach, domestic expense allocation affects only the amount of Section 960(d) FTCs that reduce the U.S. Shareholder-CE's Tentative GILTI Tax for each of its CFC-CEs.

Below, we explain in Part IV.B.2.a why, in our view, it is appropriate to take into account domestic expense allocation in this fashion in the push-down analysis, rather than adopting other possible ways of dealing with domestic expense allocation rules in such analysis. We then discuss

<sup>80</sup> See 2022 Commentary to Art. 4.3, ¶¶ 52, 58, at 97-98.

in Part IV.B.2.b what the incremental effect of Section 904 and domestic expense allocation is on the aggregate amount of GILTI tax that a U.S. Shareholder-CE pushes down to its CFC-CEs – i.e., how to measure the increase (if any) in the aggregate amount of GILTI tax to be pushed down that results from the application of Section 904 to FTCs in the GILTI basket – and we also address how that incremental increase in GILTI tax can appropriately be allocated among the U.S. Shareholder-CE’s CFC-CEs.

**a. Domestic Expense Allocation is Properly Taken into Account to Determine the Amount of a U.S. Shareholder-CE’s Section 960(d) FTCs Allowed, and Not for Any Other Purpose in the Push-Down Calculations**

For the reasons explained below, domestic expense allocation should be taken into account only for purposes of applying Section 904 to reduce otherwise allowable Section 960(d) FTCs in the GILTI basket, and not for any other purpose in the methodology for pushing down a U.S. Shareholder-CE’s GILTI taxes to its CFC-CEs.<sup>81</sup>

The 2022 Commentary and 2023 Guidance do not expressly state how to deal with the Section 904 limitation. We believe that in principle, there are three different ways in which domestic expense allocation could affect the methodology for pushing down a U.S. Shareholder-CE’s GILTI tax to its CFC-CEs.

**(1) Expenses Affect Calculation of Net Income:** The U.S. Shareholder-CE could take into account the allocated domestic expenses when determining the U.S. Shareholder-CE’s tentative GILTI tax with respect to its CFC-CEs, before taking into account Section 960(d) FTCs. In other words, such tentative U.S. tax liability would be computed with respect to the U.S. Shareholder-CE’s GILTI, net of not only the Section 250 deduction but also the domestic expense allocation. Under this approach (the “**Net Income**” method), if U.S. taxes are imposed on a U.S. Shareholder-CE’s GILTI from its CFC-CEs because the domestic expense allocation reduces the net amount of foreign source taxable income in the GILTI basket, then those U.S. taxes would not be pushed down to the CFC-CEs and treated as Covered Taxes of such CE. Instead, such U.S. taxes would be considered Covered Taxes of the U.S. Shareholder-CE on its domestic income.

**(2) Expenses Affect Calculation of the FTC Limitation:** The U.S. Shareholder-CE could compute its tentative (pre-FTC) GILTI tax without any reduction on account of the domestic expenses that are allocated for purposes of applying the Section 904 limitation. Instead, the domestic expense allocation would affect only the amount of Section 960(d) FTCs that the U.S. Shareholder-CE is allowed to claim: the Section 960(d) FTCs would be the amount actually allowed to the U.S. Shareholder-CE as a credit, after taking into account the Section 904 limitation. In other words, the U.S. Shareholder-CE’s GILTI taxes to be pushed down to its CFC-CEs would be the U.S. Shareholder-CE’s tentative U.S. tax liability with respect to the full amount of GILTI

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<sup>81</sup> See Recommendation 9 in Part II.A above.

from the CFC-CEs (reduced by the Section 250 deduction, but not by the domestic expense allocation), minus the Section 960(d) FTCs that the U.S. Shareholder-CE is actually entitled to claim after application of Section 904 (taking into account domestic expense allocation when determining the Section 904 limitation on Section 960(d) FTCs allowed). This is the “**FTC Limitation**” method.

**(3) Expenses Are Disregarded:** Conceivably, a method could be adopted in which the U.S. Shareholder-CE does not make any allocation of domestic expenses, either for purposes of computing the net amount of GILTI subject to U.S. tax (pre-FTCs), or for purposes of computing the amount of Section 960(d) FTCs that the U.S. Shareholder-CE can claim with respect to GILTI. Instead, the domestic expenses would simply be ignored when computing the amount of GILTI tax to be pushed down from a U.S. Shareholder-CE to its CFC-CEs. This is the “**Expenses Disregarded**” method.

Example 6 illustrates these three methods.

***Example 6:*** U.S. Parent-CE is the owner of a single CFC-CE, CFC-CE-A in Country A. U.S. Parent-CE has \$200 of U.S. source gross income, \$0 of NDTIR, \$100 of domestic expenses to be allocated and apportioned and \$200 of GILTI (before domestic expense allocation) from CFC-CE-A. CFC-CE-A incurs an income tax liability of \$25 in Country A in respect of its \$200 of tested income. Domestic expenses of U.S. Parent-CE in the amount of \$100 are, for FTC limitation purposes, allocated \$20 to CFC-CE-A’s \$100 of GILTI (i.e., \$200 of GILTI, net of a 50% Section 250 deduction), and \$80 to U.S. Parent-CE’s U.S. source income. U.S. Parent-CE incurs a tentative, pre-credit U.S. tax liability of \$42, i.e., 21% of \$200 of worldwide net income, against which \$16.80 (21% of \$100 of GILTI minus \$20 of allocated expenses) of foreign income tax is creditable. This results in a total residual U.S. tax liability of \$25.20. U.S. Parent-CE has excess Section 960(d) FTCs with respect to CFC-CE-A of \$3.20 and incurs aggregate U.S. federal and Country A income taxes of \$50.20.

Under the Net Income method, CFC-CE-A’s income for the push-down would be \$80. Its tentative U.S. tax liability would be \$16.80 (before Section 960(d) FTCs), which is exactly equal to the Section 904 limitation (\$42 times \$80 divided by \$200). As a result, after taking into account the Section 960(d) FTCs, no residual U.S. tax would be attributed down to CFC-CE-A. Instead, the U.S. tax liability of \$25.20 would all be Covered Taxes of U.S. Parent-CE in respect of its U.S. income and would factor into the determination of U.S. Parent-CE’s ETR under the GloBE Rules.

The FTC Limitation method by contrast sees CFC-CE-A’s GILTI (net of Section 250 deduction) of \$100, with tentative U.S. tax of \$21. The domestic expense allocation would be reflected in determining the amount of Section 960(d) FTCs allowed, so the tentative U.S. tax would be offset by \$16.80 of Section 960(d) FTCs, and \$4.20 of residual U.S. tax would be attributed down to CFC-CE-A. CFC-CE-A thus has total Covered Taxes of \$29.20 (\$25 of Country A tax plus \$4.20 of residual U.S. tax). The remaining U.S. tax liability of \$21 (i.e., \$25.20 minus

\$4.20 allocated to CFC-CE-A) would be Covered Taxes of U.S. Parent-CE in respect of its U.S. income for purposes of the GloBE Rules.

Under the Expenses Disregarded approach, the Section 904 limitation is ignored. In Example 6, the tentative U.S. tax liability with respect to CFC-CE-A of \$21 would be reduced by creditable foreign taxes of \$20, yielding \$1 of residual U.S. tax to be attributed down to CFC-CE-A. CFC-CE-A thus has total Covered Taxes of \$26 (\$25 of Country A tax plus \$1 of residual U.S. tax). The remaining U.S. tax liability of \$24.20 (i.e., \$25.20 minus \$1 allocated to CFC-CE-A) would be Covered Taxes of U.S. Parent-CE in respect of its U.S. income for purposes of the GloBE Rules.

The table below summarizes how the three methods for dealing with the domestic expense allocation affect the Covered Tax attribution to CFC-CE-A, in Example 6.

<b>CFC-CE-A</b>	<b>Net Income Method</b>	<b>FTC Limitation Method</b>	<b>Expenses Disregarded Method</b>
1. GILTI (net of 50% Section 250 Deduction)	\$100.0	\$100.0	\$100.0
2. Foreign Taxes Paid	\$25.0	\$25.0	\$25.0
3. Section 960(d) FTC	\$20.0	\$20.0	\$20.0
4. Domestic Expense Allocation	\$20.0	\$20.0	n/a
5. GILTI, Net of Domestic Expense Allocation ((1) – (4))	\$80.0	\$80.0	n/a
6. Tentative U.S. Tax	\$16.8	\$21.0	\$21.0
7. Section 904 FTC Limitation	\$16.8	\$16.8	n/a
8. Excess Section 960(d) FTC	\$3.2	\$3.2	-/-
9. Allowed Section 960(d) FTC	\$16.8	\$16.8	\$20.0
10. Residual GILTI Tax (Pushed Down to CFC-CE-A)	\$0	\$4.2	\$1.0

On balance, we believe that among the three methods described above, the FTC Limitation method is the appropriate choice. The argument in favor of this method is that U.S. tax law limits the maximum amount of foreign taxes that are creditable against tentative GILTI tax. This limit results in additional, residual U.S. tax for a U.S. Shareholder-CE in an excess credit position regardless of the fact that it paid sufficient tax in the foreign country. As the domestic expense

allocation is not taken into account in the foreign jurisdiction, the portion of GILTI reduced by this allocation is taxed fully in the foreign country and also in the United States. In each case, the tax relates to the same income.

In addition, the domestic expense deduction of the U.S. Shareholder-CE is not allocated to the CFC-CEs to reduce their respective GloBE income, and thus does not increase the ETR under the GloBE Rules for those CFC-CEs that are located in a non-zero tax jurisdiction. In determining the Covered Tax of the CFC-CE, the entire income subject to GloBE tax in the foreign jurisdiction should be the basis not only for the Covered Taxes in the CFC-CE's jurisdiction but also for the U.S. residual taxes relating to it. This requires that residual U.S. tax in respect of income in the GILTI basket (unreduced by an allocation of domestic expense deductions) be treated as a tax imposed on GILTI and be available for attribution to the CFC-CEs.

By comparison, we believe application of the Net Income method described above has weaker conceptual underpinnings. Under the Net Income method, the domestic expense allocation affects the net amount of GILTI which is used to compute the U.S. Shareholder-CE's tentative (pre-FTC) GILTI tax. The argument in favor of this method is that U.S. law only "really" sees the net income in the GILTI basket as GILTI; and GILTI taxes should be solely those taxes imposed on the net income in such basket. Under this approach, the U.S. Shareholder-CE has residual U.S. tax in respect of GILTI if, and only if, the U.S. Shareholder-CE is in an excess limitation position in the GILTI basket. The premise of this position appears incorrect, because U.S. tax law in fact imposes tax on the entire GILTI inclusion, at a reduced rate by way of the related Section 250 deduction. Section 904 determines solely the amount of Section 960(d) FTCs allowed as a credit against such tax.

The third method identified above for dealing with the domestic expense allocation rules is the Expenses Disregarded method. We find this method as well to be less compelling than the FTC Limitation method. The argument in favor of the Expenses Disregarded method is that the domestic expense allocation is, in substance, a U.S. policy choice to raise additional tax by effectively disallowing a deduction that could otherwise be claimed against U.S. source income. The effective disallowance, under this view, is of a deduction against U.S. source income, not GILTI. Accordingly, the incremental U.S. tax resulting from the domestic expense deduction should be treated as an additional tax against U.S. source income of the U.S. Shareholder-CE from sources other than the GILTI inclusion. Again, we find this to be at odds with the actual manner in which U.S. tax law operates to impose tax on GILTI.

We also note that the FTC Limitation method is consistent with the 2022 Commentary, while neither the Net Income method nor the Expenses Disregarded method seem to conform to the Inclusive Framework's expressed views. The 2022 Commentary states that "the Taxes paid *in respect of an inclusion* should be determined by subtracting the *credit allowed for Taxes paid*" (emphasis added).<sup>82</sup> Both relevant expressions can only be understood to refer to the local rules of

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<sup>82</sup> 2022 Commentary to Art. 4.3, ¶ 52, at 97.

the owner-CE, i.e., the U.S. tax law determination with respect to the U.S. Shareholder-CE, in the case of GILTI.<sup>83</sup> Under these local (i.e., U.S.) rules, contrary to the Net Income method, taxes in respect of the entire inclusion, and not an amount reduced by additional deductions, provides the base on which the residual tax imposed.<sup>84</sup> Moreover, the emphasis on the foreign tax credit actually allowed under local (U.S.) law is at odds with the Expenses Disregarded method.

The 2023 Guidance is likewise consistent with the FTC Limitation method. In particular, the reference to the “foreign tax credit *allowed in the GILTI basket*” (emphasis added) in the 2023 Guidance requires, contrary to the Expenses Disregarded method, that the residual U.S. tax on GILTI is not determined by reference to pre-Section 904 limitation creditable foreign taxes, but by the (generally lesser) FTC actually available for the GILTI basket to offset tentative U.S. tax on that basket.

The FTC Limitation method tends to allocate more residual U.S. tax to the CFC-CEs than the Net Income and Expenses Disregarded methods do. Whether that is preferable from the U.S. Shareholder-CE’s perspective is not pre-ordained and may vary. For a U.S. Shareholder-CE with multiple low-taxed CFC-CEs, this may reduce Top-up Taxes otherwise imposed on these CFC-CEs. But for a U.S. Shareholder-CE with an ETR under the GloBE Rules close to or below the Minimum Rate of 15%, the Expenses Disregarded method or Net Income method could yield better results by avoiding or reducing Top-up Taxes in respect of the U.S. Shareholder-CE’s domestic income. Even if that were the case, though, reductions in Top-up Taxes could be greater if more of the U.S. Shareholder-CE’s U.S. tax is pushed down to a CFC-CE, than if such U.S. tax were retained by the U.S. Shareholder-CE and treated as a Covered Tax on U.S. income. How the domestic expense allocation is treated is not *per se* beneficial or detrimental to a U.S. Shareholder-CE or a U.S.-parented MNE Group.

#### **b. Allocation Among CFC-CEs of the Impact of the Section 904 Limitation on Section 960(d) FTCs.**

For the reasons just described, it is appropriate for a U.S. Shareholder-CE to push down to its CFC-CEs an amount of GILTI tax reduced by the FTCs in the GILTI basket that are actually allowed after application of the Section 904 limitation – in other words, to adopt the FTC Limitation method. In the aggregate, this method is fairly simple to apply. It is not difficult to determine the additional GILTI tax (if any) that a U.S. Shareholder-CE incurs as a result of the application of Section 904:

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<sup>83</sup> In a similar vein, the 2022 Commentary also states that “creditable” foreign taxes “may be subject to limitations,” in which case “the MNE Group will need to determine the allowed credit for foreign taxes on each [...] income inclusion based on the rules of the jurisdiction.” *Id.* ¶ 51, at 97.

<sup>84</sup> In addition, as noted in Part III.C.2 above, the 2022 Commentary indicates that where an owner-CE’s taxable income is less than the income from a PE-CE or CFC-CE, all of the owner-CE’s home-country tax should be pushed down to the PE-CE or CFC-CE. *Id.* ¶ 48, at 96-97. It would be somewhat difficult to square that approach with use of the Net Income method, although it does fit with FTC Limitation.

(1) The U.S. Shareholder-CE's excess (if any) of the Aggregate Tentative GILTI Tax with respect to all of its CFC-CEs, over the U.S. Shareholder-CE's total Section 960(d) FTCs, can be calculated. This is the U.S. Shareholder-CE's aggregate Tentative Residual GILTI Tax for all its CFC-CEs.<sup>85</sup>

(2) In addition, the excess (if any) of the U.S. Shareholder-CE's total Aggregate Tentative GILTI Tax over Section 960(d) FTCs actually allowed (after application of Section 904) also can be computed. This is the U.S. Shareholder-CE's Residual GILTI Tax.

If the Residual GILTI Tax exceeds the Tentative Residual GILTI Tax, the excess is the incremental U.S. tax due as a result of the application of Section 904 (the "**Section 904 Incremental GILTI Tax**").

To simplify the calculations described above, the Section 904 Incremental GILTI Tax equals the U.S. Shareholder-CE's Section 960(d) FTCs<sup>86</sup> reduced by the Section 960(d) FTCs actually allowed after application of Section 904; but not less than \$0. For a U.S. Shareholder-CE in an excess limitation position after application of Section 904, there is no Section 904 Incremental GILTI Tax.

We have already discussed the method we view as appropriate to push down the U.S. Shareholder-CE's Tentative Residual GILTI Tax among its CFC-CEs. Our recommended approach largely implements the approach that the 2022 Commentary outlines. However, it is less clear how to push down any Section 904 Incremental GILTI Tax.

One possibility, which we believe would be reasonable, would be to allocate the Section 904 Incremental GILTI Tax ratably among CFC-CEs based on their respective tested income. Under this approach, the Section 904 limitation, and resulting increase in U.S. tax imposed on GILTI, could be viewed as a factor like NDTIR and tested losses that impacts the amount of U.S. tax imposed on the aggregate amount of tested income from the U.S. Shareholder-CE's shareholdings in CFC-CEs. Like NDTIR and tested losses, the effect of the Section 904 limitation could thus be viewed as applying equally to each dollar of tested income. This approach would be relatively simple to administer, and can be seen as generally consistent with the design of the Code.

Example 7, below, shows the results of adopting such an approach in the same fact pattern as is used in Example 4, with one new fact added: the amount of the U.S. Shareholder CE's domestic expenses allocated to its GILTI. The calculations related to Section 904 Incremental GILTI Tax are highlighted in the shaded boxes:

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<sup>85</sup> This Tentative Residual GILTI Tax will be zero if the creditable foreign income taxes determined under Section 960(d) exceed the Tentative GILTI Tax.

<sup>86</sup> For a U.S. Shareholder-CE whose Section 960(d) FTCs exceed its Aggregate Tentative GILTI Taxes, the amount of the U.S. Shareholder-CE's Section 960(d) FTCs taken into account here is limited to such Aggregate Tentative GILTI Taxes.

**Example 7: Section 904 Incremental GILTI Tax Determination**

	<b>CFC-CE-A (Separately)</b>	<b>CFC-CE-B (Separately)</b>	<b>U.S. Shareholder- CE (Aggregated)</b>
1. Tested Income (Given)	\$200.0	\$200.0	\$400.0
2. Foreign Income Taxes (Given)	\$30.0	\$15.0	\$45.0
3. QBAI (Given)	\$0.0	\$400.0	\$400.0
4. NDTIR	\$40.0		\$40.0
5. GILTI	\$180.0	180.0	\$360.0
6. Section 250 Deduction (i.e., 50% of GILTI)	\$90.0	\$90.0	\$180.0
7. Tentative GILTI Tax	\$18.9	\$18.9	\$37.8
8. Inclusion Percentage	0.9		0.9
9. Section 960(d) FTC	\$21.6	\$10.8	\$32.4
10. Excess Section 960(d) FTC Allocated to Other CFC-CE	(\$2.7)	\$2.7	n/a
11. Tentative Residual GILTI Tax ((7) - (9) - (10))	\$0.0	\$5.4	\$5.4
12. Domestic Expense Allocation (Non-exempt) (Given)	\$30.0		\$30.0
13. Income in Section 904 GILTI Basket	\$150.0		\$150.0
14. Allowed Foreign Tax Credit	\$31.5		\$31.5
15. Section 904 Incremental GILTI Taxes ((9) - (14), but not less than \$0)	\$0.9		\$0.9
16. Allocation of Section 904 Incremental GILTI Taxes (Pro Rata to Tested Income (line (1)))	\$0.45	\$0.45	\$0.9

In Example 7, the result of adopting such an approach would be that of the \$0.90 of Section 904 Incremental GILTI Tax, \$0.45 is attribute to each of CFC-CE-A and CFC-CE-B. Thus, the total Residual GILTI Tax for CFC-CE-A is \$0.45 (\$0 of Tentative Residual GILTI Tax + \$0.45 of

Section 904 Incremental GILTI Tax), and is \$5.85 for CFC-CE-B (\$5.40 of Tentative Residual GILTI Tax + \$0.45 of Section 904 Incremental GILTI Tax).

A possible drawback of the approach just described is that arguably it often may lead to an over-allocation of the U.S. Shareholder-CE's Section 904 Incremental GILTI Tax to CFC-CEs located in no-tax or low-tax countries. For example, suppose a U.S. Shareholder-CE owns CFC-CE-1 in a high-tax country and CFC-CE-2 in a no-tax country, each with \$100 of tested income. In addition, suppose that (despite the absence in many cases of reliable, readily available information that would allow this, a point discussed further below) it is possible to determine the domestic expense allocation to each CFC-CE on a standalone basis. In our example, suppose there is a domestic expense allocation of \$100 to CFC-CE-1 on account of its assets and a \$0 domestic expense allocation to CFC-CE-2.<sup>87</sup> Under the approach described above, 50% of the U.S. Shareholder-CE's Section 904 Incremental GILTI Tax would be allocated to each of CFC-CE-1 and CFC-CE-2, even though arguably the entire amount of such incremental tax should be viewed as attributable to CFC-CE-1. The push-down of half of such Section 904 Incremental GILTI Tax to CFC-CE-2 in a no-tax country would be of more use in reducing Top-up Tax on CFC-CE-2's GloBE income, than would be a push-down of that amount of incremental GILTI tax to CFC-CE-1 in a high-tax country.<sup>88</sup>

Another possible alternative methodology, which we also view as reasonable, would address the potential concern just described. A U.S. Shareholder-CE could allocate its Section 904 Incremental GILTI Tax among CFC-CEs based on the amount of Section 960(d) FTCs paid or accrued by each CFC-CE. Under this alternative methodology, CFC-CEs whose tested income is subject to a high rate of foreign income tax would generally attract a push-down of a larger portion of the Section 904 Incremental GILTI Tax than CFC-CEs whose income is subject to a low rate of, or no, foreign income tax. The rationale behind this approach would be that the Section 904 Incremental GILTI Tax can be seen as imposed because of the disallowance of Section 960(d) FTCs that belong to the specific CFC-CE. Under this view, the incremental U.S. tax relates equally to each dollar of Section 960(d) FTC, reflecting a "haircut" on the portion of that dollar which is actually allowed as a credit.

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<sup>87</sup> Because CFC-CE-2 is in a no-tax country, whether CFC-CE-2 has a domestic expense allocation would not be relevant, if Section 904 were applied to CFC-CE-2 on a standalone basis (there would be no FTCs that could be limited). However, the aggregate amount of Section 904 Incremental GILTI Tax imposed on the U.S. Shareholder-CE is a function of the aggregate domestic expense allocation to all of its CFC-CEs (including those in no-tax or low-tax countries).

<sup>88</sup> Although the method we have described thus involves simplifications that sometimes will lead to what can be seen as favorable results, it should be noted that the entire methodology we propose in this Part IV involves simplifications that could be seen as distortive in some cases. (For instance, treating tested losses as an attribute shared by all tested income CFCs pro rata in proportion to their tested income, rather than making a priority allocation of tested losses to tested income CFC-CEs in the same country as the loss-generating CFC-CE, may in some cases generate results that could be seen as inappropriately unfavorable, as discussed in Part IV.A.2 above.) The basic task of pushing down GILTI tax to CFC-CEs is an inherently imprecise one.

In the facts in Example 7, this approach would mean that the \$0.90 of Section 904 Incremental GILTI Taxes is allocated between CFC-CE-A and CFC-CE-B in the ratio of 2:1 (\$21.60 : \$10.80). Thus, CFC-CE-A is attributed \$0.60 of Section 904 Incremental GILTI Tax, and CFC-CE-B is attributed \$0.30 of Section 904 Incremental GILTI Tax in addition to \$5.40 of Tentative Residual GILTI Tax. The Residual GILTI Tax for CFC-CE-A thus would be \$0.60, and for CFC-CE-B would be \$5.70.<sup>89</sup>

Notably, although this approach tends to address the potential concern described above – that an allocation of Section 904 Incremental GILTI Taxes pro rata to tested income may over-allocate such taxes to CFC-CEs that have high foreign taxes and high domestic expense allocations – it does not actually require a taxpayer to determine a domestic expense allocation for each CFC-CE. It is thus relatively simple to apply this approach.

If it could be determined accurately how much of the U.S. Shareholder-CE’s aggregate domestic expense allocation for purposes of Section 904 relates to the assets of a particular CFC-CE, then a final possible approach here would be to allocate the Section 904 Incremental GILTI Tax to each CFC-CE in a manner that takes into account the domestic expense allocation attributable to that CFC-CE.

In practice, however, it may be highly difficult to derive the amount of domestic expense allocation that is attributable to each CFC- CE.

First, the amount of the domestic expense allocation attributable to each CFC-CE is not available from the U.S. federal income tax return. Unlike the other “inputs” for the GILTI push-down calculation discussed here, IRS Form 1118 *Foreign Tax Credit—Corporations* provides only the aggregate amounts of domestic expense allocations to FTC baskets on Schedule A as well as the referenced portions of Schedule H. This information also is not available on IRS Form 8992 *U.S. Shareholder Calculation of Global Intangible Low-Taxed Income (GILTI)* or IRS Form 5471 *Information Return of U.S. Persons With Respect to Certain Foreign Corporations*. If the separate domestic expense allocation were directly available for each CFC-CE, a separate Section 904 limitation could be determined for each CFC-CE. But unlike tested income and foreign income taxes paid or accrued, this is not an amount provided on an entity basis on the forms included by a U.S. Shareholder-CE’s tax return.

The manner in which the IRS Forms are designed is in keeping with the basic structure of the Code. The Section 904 limitation applies to the aggregate amount of income in the GILTI basket. No method is provided in the Code for the limitation, or the domestic expense allocation

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<sup>89</sup> A variation on this approach would take into account the effect of allocating excess Section 960(d) FTCs between the income of CFC-CEs. Under this variation, in Example 7, \$18.90 of FTCs would be viewed as attributable to CFC-CE-A, after taking into account allocation away from CFC-CE-A of its \$2.70 excess FTCs ( $\$18.90 = \$21.60 - \$2.70$ ); and \$13.50 of FTCs would be viewed as attributable to CFC-CE-B ( $\$10.80 + \$2.70$ ). If the \$0.90 of Section 904 Incremental GILTI Tax was allocated in proportion to such amounts (i.e., in the ratio of 1.4 : 1 between CFC-CE-A and CFC-CE-B), then \$0.53 would be allocated to CFC-CE-A and \$0.37 would be allocated to CFC-CE-B. The total Residual GILTI Tax for CFC-CE-A would be \$0.53, and the total Residual GILTI Tax for CFC-CE-B would be \$5.77.

that gives rise to the limitation, to be apportioned to particular CFC-CEs. While one could imagine designing an approach that apportions the limitation in a manner that reflects the domestic expense allocation to each CFC-CE, it would be burdensome to do so, given the lack of pre-existing architecture in the U.S. tax system that could be adapted for this purpose and the need to use information not otherwise readily available.

Moreover, we note that even if it could be reliably determined how much of a U.S. Shareholder-CE's domestic expense allocation related to each of its CFC-CEs, a methodology that pushed down Section 904 Incremental GILTI Tax to each CFC-CE in a manner that reflected its domestic expense allocation would involve calculations that would be complex and, in some cases, counterintuitive. The simplest way to proceed, would be to push down the Section 904 Incremental GILTI Tax pro rata to each CFC-CE based on its expense allocation. However, it might well be the case that a CFC-CE with a tested loss, or a comparatively small amount of tested income, has a large domestic expense allocation and thus received a large allocation of the U.S. Shareholder's Section 904 Incremental GILTI Tax – a result that appears anomalous.

Alternatively, a more complicated approach using each CFC-CE's domestic expense allocation would involve the following steps: (1) compute a separate Section 904 limitation for each CFC-CE based on its domestic expense allocation; (2) use that separate Section 904 limitation to determine, on a standalone basis, what the amount of Residual GILTI Tax for that CFC-CE would be; (3) compare that with the amount of Tentative Residual GILTI Tax for the CFC-CE, in order to determine, on a standalone basis, what the amount of Section 904 Incremental GILTI Tax would be for the CFC-CE; and then (4) allocate the U.S. Shareholder-CE's actual amount of Section 904 Incremental GILTI Tax pro rata among the CFC-CEs that, on a standalone basis, have Section 904 Incremental GILTI Taxes, in proportion to such standalone amounts of Section 904 Incremental GILTI Tax for each CFC-CE. For instance, in Example 7, suppose it could be reliably determined that CFC-CE-A and CFC-CE-B have domestic expense allocations of \$10 and \$20, respectively. In that example, each CFC-CE has GILTI (net of the Section 250 deduction) of \$90. Thus, CFC-CE-A has net foreign source GILTI of \$80 (\$90 - \$10) in its separate Section 904 GILTI basket, translating to a separate Section 904 limitation of \$16.80; and CFC-CE-B has net foreign source GILTI of \$70 (\$90 - \$20) in its separate Section 904 GILTI basket, translating to a separate Section 904 limitation of \$14.70.

CFC-CE-A, on a standalone basis, would have Residual GILTI Tax of \$2.10 as a result of its Section 904 limitation: \$18.90 of Tentative GILTI Tax on its \$90 of GILTI, minus \$16.80. By comparison, CFC-CE-B, on a standalone basis, would have \$4.20 of Residual GILTI Tax: \$18.90 of Tentative GILTI Tax on its \$90 of GILTI, minus \$14.70. (CFC-CE-B has only \$10.80 of Country B FTCs. However, \$4.80 of excess Country A FTCs from CFC-CE-A are available for to be allocated to CFC-CE-B (\$21.60 - \$16.80). Of those excess Country A FTCs, \$3.90 can be allocated to CFC-CE-B to reach the Section 904 limitation of \$14.70 (\$10.80 of Country B FTCs + \$3.90 of Country A FTCs).)

As shown in the table above in Example 7, CFC-CE-A has Tentative Residual GILTI Tax of \$0, and CFC-CE-B has Tentative Residual GILTI Tax of \$5.40. Thus, on a standalone basis, the Section 904 Incremental GILTI Tax for CFC-CE-A is \$2.10 (\$2.10 of Residual GILTI Tax - \$0 of Tentative Residual GILTI Tax). By comparison, for CFC-CE-B, on a standalone basis (but taking into account FTCs made available due to CFC-CE-A's excess FTC position), the Section 904 Incremental GILTI Tax is actually a negative number: -\$1.20 (\$4.20 of Residual GILTI Tax - \$5.40 of Tentative Residual GILTI Tax).

The U.S. Shareholder-CE's actual amount of Section 904 Incremental GILTI Tax in Example 7 is \$0.90. This entire amount would be allocated to CFC-CE-A, which on a standalone basis has a positive amount for its Section 904 Incremental GILTI Tax. (Note that U.S. Shareholder's \$0.90 of Section 904 Incremental GILTI Tax equals CFC-CE-A's \$2.10 of Section 904 Incremental GILTI Tax on a standalone basis, plus CFC-CE-B's negative \$1.20 of Section 904 Incremental GILTI Tax on a standalone basis.)

Thus, even in a relatively simple fact pattern like the above involving only two CFC-CEs, an effort to pull apart the Section 904 limitation, based on a separate domestic expense allocation for each CFC-CE, can rapidly lead to complicated calculations. However, since Section 904 permits Section 960(d) FTCs to be cross-credited within the GILTI basket, the results of this effort inevitably will be different than if the Code required separate basketing of Section 960(d) FTCs on a CFC-by-CFC, or country-by-country, basis. (For instance, due to the effects of cross-crediting, the amount of residual GILTI tax for CFC-CE-B actually decreased in the above fact pattern (by \$1.20) when the Section 904 limitation was applied.) It is not clear there is a strong justification for the complexity that an approach like the one outlined above would entail, even if information were readily available to determine a separate domestic expense allocation for each CFC-CE.

### C. Documenting Residual GILTI Tax Push-Down

In order to communicate U.S. tax determinations in a uniform manner to other GloBE jurisdictions that may have to rely on them, we recommend that Treasury and the IRS add a new schedule to the federal income tax return that presents the GILTI tax push-down information.<sup>90</sup> The information on this “**New Form**” would draw entirely on information from the existing U.S. federal income tax return of the U.S. Shareholder-CE (or the consolidated group). It would have the information summarized from and tied to other IRS forms or schedules in an easily accessible format, and specify the push-down calculations based on U.S. tax concepts, without having to rely on any GloBE calculations. This New Form should be prepared for any U.S. Shareholder-CE that is a member of an MNE Group, whether as the parent or an intermediate entity with CFC subsidiaries.

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<sup>90</sup> See Recommendation 10 in Part II.A above. It should be noted, however, that a minority of the working group for this Report questioned whether the United States should require tax return filings that are not related to the computation or payment of a U.S. tax.

Currently, the principal forms relating to the GILTI regime that have to be included in the corporate U.S. tax return of a U.S. corporate taxpayer that is a U.S. Shareholder of one or more CFCs and that contain relevant information for determining the GILTI tax push-down attributions are IRS Form 8992 *U.S. Shareholder Calculation of Global Intangible Low-Taxed Income (GILTI)* and IRS Form 1118 *Foreign Tax Credit—Corporations*. In addition, information might also have to come from IRS Forms 5471 *Information Return of U.S. Persons With Respect to Certain Foreign Corporations*, for example.

Non-U.S. jurisdictions should have to rely on the information of the New Form in making their GloBE calculations. A single New Form would simplify their task of administering the GloBE Rules. By providing a self-contained set of information, it can be reviewed by a non-U.S. tax administrations. It can also be derived without any additional work by U.S. taxpayers, as it is a re-assembling of information already presented elsewhere.

In addition, the correctness of the information provided on the New Form is backed by the tax system of the United States, including its audit function. This can ensure uniformity of the amounts for the GILTI tax push-down among non-U.S. jurisdictions, e.g., if determination of the UTPR is to be made by several jurisdictions or if for any other reason disagreement between jurisdictions might otherwise arise regarding the amounts at issue.

This Report does not address how any adjustment to GILTI-related determinations during the U.S. audit process would affect GloBE determinations, in particular whether such adjustments should be carried back to the fiscal year of the MNE Group to which they originally related or whether they should be reflected in the fiscal year of the MNE Group in which the adjustment is made. An important consideration here will be that, unlike adjustments affecting only the entity whose items are adjusted, adjustments to GILTI-related determinations may, and likely will, also affect the CFCs and their branches to which they relate and to which the GILTI taxes are attributed. These CFCs or branches may no longer be members of the MNE Group in the fiscal year of the adjustment. If that is the case, there may no longer be a target for a modified push-down attribution.

Another complicating factor is any foreign tax credit redetermination that may be required as a result of an adjustment in the non-U.S. jurisdiction of the CFC or its branches that increases or reduces foreign income taxes. Both U.S. and non-U.S. adjustments, in short, raise important timing issues. But they do not affect the method chosen for the GILTI tax push-down as such. In any event, any issues arising from adjustments are not unique to the recommended approach to the GILTI tax push-down. Adjustments are likewise possible for any other GloBE tax determinations.

#### **D. Summary of Proposed Methodology for GILTI Tax Push-Down**

In summary, we recommend a multi-step allocation method to determine the Residual GILTI Tax allocated to each one of a U.S. Shareholder-CE's CFC-CEs as a Covered Tax under the GloBE Rules.

First, as described in Part IV.A above, for each CFC-CE that has positive tested income, the Tentative GILTI Tax imposed on such tested income should be determined.

- The Tentative GILTI Tax for each CFC-CE is a portion of the U.S. Shareholder-CE's Aggregate Tentative GILTI Tax with respect to its GILTI from all its CFC-CEs.
- Such Aggregate Tentative GILTI Tax of the U.S. Shareholder-CE is calculated taking into account the U.S. Shareholder CE's Section 250 deduction, but without taking into account any other deductions and without taking into account any Section 960(d) FTCs.
- The Aggregate Tentative GILTI Tax is allocated to each CFC-CE that has positive tested income, by reference to the U.S. Shareholder-CE's share of such tested income, relative to the aggregate of the U.S. Shareholder-CE's shares of all of its CFC-CEs' tested income. The tax so allocated to a CFC-CE, is the Tentative GILTI Tax for that CFC-CE.

Second, as described in Part IV.B.1, the Tentative Residual GILTI Tax for each CFC-CE should be determined. This is accomplished by reducing such CFC-CE's Tentative GILTI Tax (but not below zero) by the amount of such CFC-CE's Section 960(d) FTCs (computed without regard to the Section 904 limitation). To the extent such CFC-CE has Section 960(d) FTCs in excess of the Tentative GILTI Tax for that CFC-CE, such excess Section 960(d) FTCs should be allocated to other CFC-CEs that have Section 960(d) FTCs that are less than their Tentative GILTI Tax.

Third, as described in Part IV.B.2, the Section 904 Incremental GILTI Tax of the U.S. Shareholder-CE (that is, the incremental U.S. federal income tax that is owed on GILTI inclusions as a result of the application of the Section 904 limitation to FTCs in the GILTI basket), if any, should be determined. Such tax should be allocated among CFC-CEs either pro rata in accordance with their respective amounts of tested income, or pro rata in accordance with their respective amounts of Section 960(d) FTCs (as computed prior to application of the Section 904).

In the case of each CFC-CE, the Tentative Residual GILTI Tax for that CFC-CE, plus the Section 904 Incremental GILTI Tax for that CFC-CE, is equal to the Residual GILTI Tax for that CFC-CE. Such Residual GILTI Tax is the amount of GILTI tax that should be considered to be a Covered Tax of that CFC-CE under the GloBE Rules. As discussed in Part IV.C, the New Form should set forth information that appears elsewhere on a U.S. Shareholder-CE's U.S. federal income tax return, organized in a format that supports the calculations described above.

## **V. COMBINING AN IIR AND THE CURRENT U.S. GILTI REGIME**

This Part V evaluates the manner in which the U.S. tax system could incorporate an IIR. Practically, there are three possibilities. First, the United States could entirely replace the GILTI

regime with an IIR (“**Option 1**”). Second, the United States could modify the GILTI regime to resemble an IIR (“**Option 2**”). Third, the United States could introduce an IIR without material modification to the GILTI regime (“**Option 3**”).<sup>91</sup>

As discussed above in Part IV, the amount of a U.S. Shareholder-CE’s GILTI tax liability is driven to a significant degree by the domestic expense allocation rules. In our initial evaluation of the three options below, we generally disregard the impact of domestic expense allocation. In other words, we evaluate purely from the notion of the GILTI regime and an IIR, each operating as a worldwide minimum tax regime. We then specially consider the consequences of the domestic expense allocation rules and how those rules might affect each of these three options.

We recognize there are substantial revenue and other non-technical aspects to the potential enactment of an IIR. For the avoidance of doubt, we note that our comments relate only to technical issues that are relevant to consider in determining an approach to an IIR. We do not express a view on other aspects of the desirability of enacting an IIR or making modifications to the GILTI rules. In addition, we note that our evaluation is premised on the continued acceptance of the GILTI rules (whether or not modified) as a CFC Tax Regime that generally reduces taxes owed under the IIR.

Similarly, we generally target our discussion to modifications the United States would make to its own rules. However, modifications to the GloBE Rules might also ease several of the issues in reconciling the GILTI regime and an IIR. We understand that the United States is maintaining an ongoing dialogue with the rest of the Inclusive Framework governments regarding the interaction of U.S. rules and GloBE Rules. Accordingly, although a full discussion of this is outside the scope of this Report, we do note in some places below particular circumstances in which Pillar 2 modifications might be relevant in such discussions.

#### **A. Option 1: Replace the GILTI Regime with an IIR**

Option 1 is that Congress would repeal the GILTI regime in its entirety and pass an IIR in its stead.<sup>92</sup> One substantial virtue of this approach is that it would offer the most administrative simplicity to multinationals already subject to an IIR, as it would eliminate the need to conduct GILTI calculations also. In fact, if Congress were willing to rely solely on the IIR to police efforts

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<sup>91</sup> In our view, the current GILTI regime functions in a manner that can be seen as at least broadly similar to an IIR, ensuring that when a multinational group has a U.S. parent, the worldwide income of the group is generally subjected to a minimum level of tax. By comparison, the historic Subpart F rules in the Code can be seen as serving a purpose that is somewhat distinct, i.e., preventing deferral or elimination of U.S. tax on passive-type and certain other specified types of income realized by CFCs. As a result, we do not believe the analysis and conclusions necessarily need be the same for how the GILTI rules, versus the historic Subpart F rules, would most appropriately be coordinated with a U.S. IIR. (For example, it might be decided to retain part or all of historic Subpart F even if the GILTI regime is replaced with a U.S. IIR.)

<sup>92</sup> Paragraph 1 in Part II.B summarizes the considerations discussed below related to Option 1.

by U.S. taxpayers to shift income abroad, it might be possible to eliminate most aspects of the CFC regime, including foreign tax credit and expense allocation rules.<sup>93</sup>

However, there are several important scope differences between the GILTI regime and an IIR that we anticipate would present meaningful hurdles to this approach. In particular, the GILTI regime is applicable to a broader category of U.S. taxpayers than an IIR. As discussed above, the GILTI regime applies to individuals while the IIR does not. Similarly, the GILTI rules apply to minority shareholders of foreign corporations, while an IIR generally only applies to entities in a commonly controlled chains of entities and branches. The GILTI regime also applies regardless of the amount of revenue generated by either the foreign entity or the overall group.

The GILTI rules also apply to entities that are not controlled by a single parent entity, so long as those entities are CFCs.<sup>94</sup> Note also that under current law, an entity may be a CFC as a result of constructive ownership to U.S. persons that are not otherwise direct or indirect owners of the CFC. This is not possible under an IIR. Accordingly, GILTI taxes are imposed on a larger number of U.S. persons than would be subject to an IIR, and also with respect to a larger number of entities.

We recognize that, in principle, some of these issues could be solved by applying an IIR more broadly—*i.e.*, to individuals and minority owners. However, we expect this would entail substantial complexity since the IIR rules were not conceived to apply to these situations. Thus, the United States would need to develop its own bespoke rules to apply the concepts of an IIR to the full universe of U.S. persons subject to the GILTI regime. For example, it would be necessary to “back out” the effect of reductions in an IIR for QDMTT or actual local country taxes in the case of individuals. Otherwise, the IIR calculation as applied to individuals would have the same effect as a deemed paid foreign tax credit, contrary to the approach taken in current U.S. law. Put another way, individuals are not currently eligible to offset GILTI tax by taxes actually paid by the foreign corporation. However, an IIR is reduced by actual local country taxes (including the QDMTT). Therefore, for the United States to apply an IIR to individuals under principles similar to the GILTI regime, it would be necessary to ignore the reduction of an IIR by local country taxes. It would also likely be necessary to preserve aspects of the foreign tax credit rules, particularly related to matters such as cross-crediting, since the United States has a worldwide taxation system (while an IIR in other countries is a backstop to their territorial systems). This might very well result in borrowing large parts of the current GILTI regime, effectively undoing any simplifications that are the benefits of repeal.

Similarly, there would be substantial costs for small and medium-sized businesses in switching over from the GILTI regime to an IIR. These businesses are unlikely to be familiar with

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<sup>93</sup> Adopting an IIR would present a practical issue, however, that would limit gains in administrative simplicity. Adoption of an IIR would probably not be a one-time exercise. It would likely be necessary for Congress to ratify changes to Model Rules that have been made through Administrative Guidance, in the same manner that many U.S. states must periodically incorporate the Code.

<sup>94</sup> See *supra* footnote 59.

the GloBE Rules in the first instance,<sup>95</sup> and it would likely impose substantial one-time costs to modify their tax systems to become compliant. There may also be significant knock-on costs, as the GloBE Rules fundamentally rely on the preparation of comprehensive financial statements for non-tax purposes, something that small and medium-sized businesses may not undertake at the same level as MNE Groups.

An alternative approach Congress could take would be to enact an IIR while leaving the GILTI regime in place, and to permit U.S. persons that would otherwise be subject to both an IIR and GILTI tax to apply only the IIR. This is similar to the circumstance where the United States enacts an IIR without modifying the GILTI regime, and we further evaluate the technical aspects of this approach below in Part V.C. In any event, in this case, Congress would need to be comfortable with two very different regimes applying to taxpayers in the alternative and depending on their status. This would be especially unusual since the computation of an IIR differs in so many fundamental respects from the GILTI regime.

As a result, a full replacement of the GILTI regime with an IIR would generally result in meaningful simplification only if Congress were willing to substantially curtail the imposition of U.S. taxes on foreign operations, in particular those held by U.S. taxpayers who are not part of MNE Groups. This would likely be inconsistent with the U.S. worldwide tax system. Alternatively, Congress would have to be willing to accept different tax systems for individuals and smaller businesses than for large businesses. Although there are some tax regimes that apply based on business size, such as corporative alternative minimum tax (“**CAMT**”) and the base erosion and anti-abuse tax (“**BEAT**”), these are generally incremental to the baseline tax system. Having two vastly different systems for the taxation of foreign operations based on taxpayer status would be unprecedented.<sup>96</sup>

Curtailed U.S. taxation of foreign operations held by taxpayers other than U.S. companies that are CEs in MNE Groups would also have a potentially substantial tax revenue impact on the United States. Indeed, even if the GILTI regime remained in place for those taxpayers, and only U.S. companies in MNE Groups were subjected to the IIR, there would still be a potential revenue impact as a U.S. intermediate parent company of CFC-CEs in an MNE Group that has a foreign parent located in a country that has adopted an IIR, would generally not be required to pay U.S. IIR whereas it would be required to pay GILTI tax on the CFC-CEs’ income.

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<sup>95</sup> In addition to being an unfamiliar regime for these taxpayers, the IIR also is generally more complex than the GILTI rules.

<sup>96</sup> We acknowledge Congress has accepted different treatment of certain items for specific industries, such as the mark-to-market regime for dealers and traders. *See* Section 475. But these are bespoke cases and not a matter of fundamental system design.

## B. Option 2: Make the GILTI Regime More Like an IIR

Option 2 is that Congress could consider modifying the GILTI regime in certain key respects to resemble an IIR, without a wholesale replacement of the GILTI regime.<sup>97</sup> In particular, we expect several key changes would substantially (albeit not completely) align the GILTI regime with an IIR. These changes would be:

- GILTI computations, and use of foreign tax credits to reduce GILTI tax, would occur on a country-by-country basis, rather than being blended across all CFCs;<sup>98</sup>
- The Section 250 deduction for GILTI would need to be reduced so that the effective rate for GILTI was at least the 15% Minimum Rate;<sup>99</sup>
- The rate of reduction in GILTI for NDTIR would need to be reduced and also include further reductions for payroll expenses, in each case to better align with the SBIE (or, alternatively, to simply substitute SBIE for NDTIR).

Many of these changes were proposed by the Biden administration in the Build Back Better Act.<sup>100</sup>

Note that we have assumed one change that would not be made would be to use financial statement income in lieu of taxable income. This assumption reflects the United States' worldwide income tax system and that the United States does not generally use financial statement income as a base on which to calculate tax liability. We acknowledge that under the U.S.'s CAMT rules, large U.S. corporations are subject to an additional minimum tax based partly on book income. CAMT applies also to foreign operations of these U.S. corporations.<sup>101</sup> Accordingly, there is precedent at least for an *additional* tax based on financial statement income for foreign operations. However, we do not expect the United States would tolerate the use of financial statement income as the *sole* basis for foreign income but taxable income for domestic income.<sup>102</sup>

In any event, assuming the Inclusive Framework accepts an altered GILTI regime as an IIR, this approach would offer meaningful simplification for U.S.-parented MNE Groups, as they would not have to undertake UTPR or IIR calculations in their group since the GILTI rules would

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<sup>97</sup> Paragraph 2 in Part II.B summarizes the considerations discussed below related to Option 2.

<sup>98</sup> It would need to be determined whether multiple sub-groupings of entities (e.g., Investment Entities) in a particular country would have to be provided for, in a modified GILTI. *See supra* footnote 31.

<sup>99</sup> As noted above, the U.S. effective tax rate for GILTI would be above 15% beginning in 2026, absent a change in law.

<sup>100</sup> *See* Sections 138121, 138124, 13826 of H.R. 5376, BUILD BACK BETTER ACT, House Comm. Print No. 117-18 (2021). In this Part V, we focus on legislative changes. As noted above, a potential regulatory modification to the current GILTI regime that would bring it incrementally closer to an IIR would be to make the high-tax exclusion mandatory. *See* footnote 74 *supra*.

<sup>101</sup> *See* NY State Bar Ass'n Tax Section Report No. 1482, *Report on Selected International Issues Relating to the Corporate Alternative Minimum Tax* (October 12, 2023).

<sup>102</sup> We also note that any effort to do so would entail immense complexity in reconciling the treatment of income, expenses and foreign tax credits for tax purposes versus financial statement purposes.

supplant Pillar 2.<sup>103</sup> (We recognize, however, that Pillar 2 principles would still apply to the extent countries enacted QDMTTs.) In addition, the increased rate and move to a country-by-country approach may have the effect of resulting in similar revenue as would arise if the United States enacted an IIR as an additional tax. Finally, assuming the GILTI regime qualified as an IIR, double taxation should not occur since there would not be a separate IIR tax computed under GloBE principles.

We also note again that we have assumed even a modified GILTI regime would continue to be accepted as a CFC Tax Regime. We appreciate that conceptually, Pillar 2 treats an IIR and a CFC Tax Regime as separate categories, and we recognize that, in general, a CFC Tax Regime does not qualify as an IIR.<sup>104</sup> However, for purposes of our analysis in this Part V, we have assumed that in any discussions with the Inclusive Framework to confirm the status of modified GILTI regime as a qualified IIR for purposes of the GloBE Rules, it would also be clarified that the GILTI regime continues to constitute a CFC Tax Regime consistent with its current status. If this is not the case, adoption of modified GILTI regime as an IIR would result in revenue loss in a sandwich structure, similar to the result where the United States replaces the GILTI regime with an IIR.

At the same time, however, the United States would need to consider modifications to several rules ancillary to the operation of the GILTI regime in order to accommodate these changes. In the first instance, it would be necessary to modify the foreign tax credit rules to account for country-by-country taxes. In effect, there would need to be separate basketing on a country-by-country basis.<sup>105</sup> It may also be appropriate to provide for a carryforward of GILTI foreign tax credits. We understand the lack of a carryforward was driven in part by the low GILTI rate as well as the general use of blending across jurisdictions (both in terms of foreign tax credits and the ability to offset losses of one CFC against income of another). In the absence of blending, it may be appropriate to permit an FTC carryforward to smooth out differences between foreign tax computations and the GILTI tax computation.<sup>106</sup>

Other rules would also require modification. For example, PTEP could continue to be administered on an entity-by-entity basis, but there would need to be allocation rules where multiple CEs were tax resident in the same country. Similarly, there would need to be a modification of the rules for partnerships. On the one hand, these rules would need to reflect the

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<sup>103</sup> See Model Rules, Arts. 2.1.3 and 2.5.2 (generally eliminating Top-up Tax if there is a Parent Entity that has a qualified IIR).

<sup>104</sup> See definition of “Controlled Foreign Company Tax Regime”, Article 10.1 of Model Rules (excluding IIR from CFC regimes).

<sup>105</sup> The effect of these changes would be to prevent the use of high-taxed foreign income in one country to offset low-taxed foreign income in another. In some sense, however, this result would already arise as a result of Pillar 2 (because Pillar 2 tax is already computed country-by-country and does not permit cross-crediting), and so the effect of these changes would be for the United States to capture the resulting tax revenue in lieu of another country.

<sup>106</sup> The Build Back Better Act would have provided a five-year carryforward. Section 138124 of H.R. 5376, 117th Cong. (2021).

lack of blending across CFCs; but on the other hand, such rules also would need to account for the fact that partners may have interests in multiple CFCs in the same jurisdiction, not all of which are owned in the same partnership.<sup>107</sup>

By not wholly removing the GILTI regime, this approach would solve several of the scope problems in a scenario where an IIR replaces the GILTI regime, while also offering simplicity to multinational taxpayers (assuming the modified GILTI regime is accepted as an IIR). However, it would require very significant work by Congress, Treasury and the IRS to modify the current universe of GILTI and CFC rules to account for the changes necessary to the GILTI regime. Taxpayers would also have to update their own practice to reflect the updated GILTI rules, which could be time-consuming, with the lack of blending especially likely to lead to additional administrative effort. In sum, this approach simplifies coordinating the GILTI rules with an IIR but requires substantial effort by the United States in modifying its international tax rules.

### **C. Option 3: Retain the GILTI Regime (Unmodified) and Add an IIR**

Option 3 is that Congress would not substantially modify the GILTI regime, and would simply enact an IIR as an additional tax regime.<sup>108</sup> At the outset, we observe this would require many large U.S. taxpayers to navigate several minimum (or pseudo-minimum) tax regimes all operating simultaneously, i.e., GILTI, IIR, CAMT and BEAT. This would result in a meaningful burden on both taxpayers and the IRS to administer these rules, alone and together. Although outside the scope of this Report, if the United States implements a separate IIR, it may be advisable to consider whether a simplification or elimination of these regimes would be desirable.

In any event, one main benefit to this approach is that it would eliminate any “lost revenue” issues for U.S.-parented MNE Groups—i.e., those cases where jurisdictions in which a U.S. parent’s foreign subsidiaries are collecting tax revenue under Pillar 2 as a result of an IIR or UTPR. There are also other benefits to this approach. First, this would require the least change to pre-existing statutory or administrative rules, such as expensing or foreign tax credit calculation, to account for modifications to the GILTI regime since the GILTI regime itself would not be modified at all. Second, the United States could leverage the work already done by the OECD in accommodating the GILTI rules into IIR calculations, as discussed above in Part IV. Indeed, in some sense, enacting an IIR would require little incremental statutory, regulatory or administrative work to implement.<sup>109</sup>

The primary disadvantage to this approach is that it perpetuates the administrative complexity required to comply with both the GILTI regime and Pillar 2, as discussed above.

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<sup>107</sup> As an additional example, the GloBE Rules generally disregard gains and losses with respect to subsidiary equity in determining GloBE income. Thus, the United States could consider replacing the PTEP regime with a participation exemption regime that applies to both gains and losses.

<sup>108</sup> Paragraph 3 in Part II.B summarizes the considerations discussed below related to Option 3.

<sup>109</sup> Of course, this is mostly a product of the fact that the enactment of Pillar 2 itself required much of this work to be undertaken regardless of whether the United States chose to enact the GloBE Rules.

Because each regime has meaningfully different rules, it will generally be necessary for affected taxpayers (and the IRS) to run full calculations under each set of rules to determine their total tax due. This would involve layering on the complex CFC Tax Regime push-down rules discussed above in Parts III.C and IV. Moreover, the overall revenue benefit of this administrative complexity is unclear. For many taxpayers, the IIR may result in higher taxes than the GILTI rules, given that the GILTI regime has a lower rate and is determined on a blended basis. However, given factors including base differences, differences between SBIE and NDTIR, and (if preserved as part of the GILTI regime – a topic discussed in Part V.D below) domestic expense allocation, this may not always be the case.

Note also that this approach would *not* eliminate all “lost” U.S. tax revenue in sandwich structures, because under Pillar 2, the UPE has the first right to collect taxes owed as a result of an IIR. Put another way, because of the current ordering rule—the GILTI regime first, then UPE IIR, and then other parent entity IIR—Congress cannot collect IIR revenue in a sandwich structure merely by implementing the IIR. Thus, although a U.S. intermediate company in a sandwich structure would pay U.S. GILTI tax on its CFC subsidiaries’ income, to the extent the IIR exceeded GILTI tax, that excess tax would be paid by the UPE in its home country.

If Congress does determine to implement an IIR with or without modifications of the GILTI regime, we consider below whether it might be possible for Congress or Treasury to provide simplification or relief rules to minimize the cost and administrative burden on the IRS and taxpayers subject to both regimes simultaneously.

## **1. Relieving the Double Tax Problem**

One area of potential relief is the double taxation problem identified above. In concept, Treasury or Congress could consider providing relief under the GILTI regime to the extent taxes are paid under an IIR. We evaluate two methods under which this type of relief could be granted: (1) an “item tracing” method; and (2) a “taxes paid” method.

*Item Tracing.* Under the item tracing method, relief rules would attempt to trace to particular tax items that were includible in one year in one regime and another year in another regime. For example, there could be an exemption from (or credit against) GILTI tax to the extent the corresponding income was clearly included in a prior year and subject to tax under the IIR regime. A similar relief tool would be needed for the reverse situation— where an item is previously included under the GILTI regime and later included under the IIR.

This type of relief would necessarily be highly complex even in relatively straightforward cases. From an administrability perspective, it would likely be necessary to require meaningful substantiation from taxpayers claiming relief, while also limiting instances of relief to well-defined

cases where there are clear mismatches between financial accounting and taxable income.<sup>110</sup> In the case of some types of mismatches, for example involving whether asset basis is stepped-up in M&A transactions and the schedule for depreciation and amortization deductions with respect to the basis of purchased assets, it may be relatively easy to identify them in advance and provide guidance. However, we expect it may be difficult in many other instances to construct this relief in advance, and instead it may be necessary to react to types of mismatches as they arise.

It would also be necessary to ensure any relief does not conflict with other GILTI rules. Consider, for example, the circumstance where income is includible in a prior period under IIR principles but does not result in additional tax under the IIR regime, because the subsidiary's ETR is above 15%. In this case, it is not clear a future exclusion from GILTI, or a credit to offset GILTI tax on a future inclusion, is appropriate as the income was not in fact subject to the IIR in a prior period. A similar principle would presumably apply if no IIR is due because the subsidiary paid QDMTT as a result of the income.

It also would arguably be necessary in any kind of credit system to differentiate between taxes that give rise to an IIR-GILTI mismatch against those that give rise to a local country tax-GILTI mismatch. Otherwise, a credit against GILTI tax would have a similar effect to a GILTI foreign tax credit carryforward, which is not consistent with the Code.

As a final consideration, it would be necessary to determine how the relief rules impact the amount, and taxable year, in which a U.S. Shareholder is considered to pay GILTI tax and, thus, is entitled to push down such tax to its CFCs as a Covered Tax. In addition, it would be important to confirm with the Inclusive Framework that any credit for GILTI tax against a later-imposed U.S. IIR is not considered to prevent the U.S. IIR from qualifying as a Pillar 2-compliant tax. Moreover, a complex set of rules potentially would be required to associate any credit for GILTI tax with a particular CFC in order to reduce the amount of the IIR imposed on CEs in the country where the CFC is located, similar to the issues discussed in Part IV above regarding GILTI tax push-down to particular CFCs.

*Taxes Paid.* Under the taxes paid method, the United States would offer a credit against GILTI tax for IIR taxes paid in prior periods (in excess of the standalone GILTI tax calculation for those prior periods). This approach would avoid the difficulty of tracing through items. However, it would require introducing a mechanism to account for tax credit carryforwards applied to GILTI tax. (We observe that this approach provides a credit for IIR taxes, not foreign income taxes, and therefore is not necessarily inconsistent with denial of carryforwards for unused GILTI foreign tax credits.) It may also be reasonable to determine whether there are tax items includible under an IIR that would never be included in GILTI and deny any credit for these items; however, doing so would reintroduce some of the complexity of the item tracing approach. Similar to the point made above at the end of the discussion of item-tracing relief rules, it also would be important to confirm

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<sup>110</sup> This would be similar in concept (albeit smaller in scope) to the approach the IRS has taken to automatic accounting method changes—identifying common, discrete problems and providing relief. *See* Rev. Procs. 2015-33, 2016-1, 2017-59, 2021-26, 2021-34, 2022-14 and 2023-23.

with the Inclusive Framework whether a credit for IIR tax paid in a prior year reduced the amount of GILTI tax considered to be imposed that could be pushed down to CFCs as a Covered Tax in a later year.

In addition, one limitation to this approach is that it would only address the situation where an IIR imposes tax before the GILTI regime. In the reverse case, there is no GILTI carryforward and thus no relief. As in the item tracing method, Congress could conceivably provide for an alternative to the extent GILTI taxes exceed IIR taxes otherwise imposed, subject to ensuring the credit does not reduce Covered Taxes. Under the current OECD guidance it does not appear possible to offset the IIR with carryforwards of CFC Tax Regime taxes from prior periods. If this option were desirable, Treasury could consider obtaining specific guidance from the Inclusive Framework that the carryforward of CFC Tax Regime tax credits is permitted.

*Conclusion.* We have not identified a broad-based relief rule that can easily be constructed, and that both provides comprehensive relief and is relatively easy to administer. We believe either of the approaches above could be considered by Congress and Treasury, and it may be appropriate for Congress to permit Treasury to exercise authority to provide relief from double taxation in clear cases. As a final point, we also observe a combination of the two rules might be considered appropriate. For instance, situations where IIR tax is imposed before GILTI tax could be handled through a credit system using the “taxes paid” approach, while situations where GILTI tax is imposed before the IIR could use an “item tracing” approach.

## **2. An Election to Substitute an IIR for the GILTI Regime**

One possible simplification approach is to permit taxpayers subject to both the GILTI regime and an IIR to elect to apply only the IIR and effectively ignore the GILTI regime. This approach is similar to the option described in Part V.A in which an IIR replaces the GILTI regime, but because it is restricted to only taxpayers otherwise subject to both the IIR and GILTI regimes, there would not be a scope issue. It also provides substantial simplification to taxpayers, who would not need to go through the effort of calculating GILTI taxes and allocating them under the complex rules above to constituent entities to determine the IIR, as well as tax authorities who would not need to evaluate taxpayer efforts on this front.

However, several complexities are still present. The first issue is the nature of the election. Any election to substitute an IIR for the GILTI regime would generally need to be irrevocable so long as the taxpayer remained within the scope of the IIR in order to avoid abuse. But difficult questions would arise in the M&A context. Should the election transfer if a subsidiary is sold to another group? Alternatively, if a subsidiary of a group that did not make such an election is transferred to one that did, should there be an opportunity to revoke the election? What about two corporations that merge, one that made the election and one that did not?

If the election could be “revoked” (whether as a result of a transaction or because it was revocable) or if there are taxpayers that fall out of the IIR because of a decline in revenues, there would need to be further coordination rules to reconcile various differences between the GILTI

regime and the IIR. First, it would be necessary to determine the amount of QBAI that would be available in the first GILTI year. One approach would be for the taxpayer to reconstruct asset depreciation schedules for a CFC-CE's assets to arrive at an appropriate amount of QBAI, but this could be quite cumbersome if the taxpayer had not been subject to the GILTI regime for many years. Alternatively, Congress or regulations could provide that the election into the IIR would result in a forfeiture of all current asset basis for QBAI purposes going forward (although this might discourage taxpayers from making such an election).

In addition, there would need to be rules to determine whether asset basis arising as a result of transactions undertaken while subject to the IIR would be available in the calculation of QBAI. The history of the GILTI regime suggests this is possible—after all, asset basis arising before the passage of the Tax Cuts and Jobs Act (“TCJA”)<sup>111</sup> was factored into the determination of QBAI. But there is also a need to police transactions that result in asset basis with little or no other cost to the taxpayer, as evidenced by the regulations on transactions that created asset basis immediately prior to the passage of TCJA.<sup>112</sup> Thus, as with pre-election asset basis, it may be a condition of the election that no transaction occurring post-election would give rise to asset basis.

In the same vein, it would be necessary to police situations in which alternating between the GILTI regime and the IIR might be abused, by, for example, electing into the IIR in years in which income would be included under the GILTI regime but not the IIR, and vice versa. This might be addressed by adopting a similar concept to a Section 481 adjustment—i.e., by requiring payment of all taxes that would have been payable had the taxpayer been subject to the method it is electing into for all pre-election periods.

Problems would also arise with respect to any CFCs that are not wholly owned. Consider, for example, a case where a U.S. individual owns 20% of a CFC and 80% is owned by a U.S. corporation. Suppose the U.S. corporation elects to apply the IIR in lieu of the GILTI regime. A rule would be necessary for NDTIR, tested income (or tested loss), PTEP and other tax items of the CFC with respect to the U.S. individual. For example, it might be appropriate to compute such items for the CFC, and tax the U.S. individual with respect to their share of those items, while simultaneously maintaining a set of accounts with the GloBE income and asset basis of the CFC under the GloBE Rules for use by the 80% U.S. corporate parent.

Practically, we believe the foregoing may only scratch the surface of all the potential complexity in a general election between the GILTI regime and the IIR. At a minimum, we anticipate an elective regime would require several conditions to be administratively workable, including that the election be irrevocable and that the taxpayer effectively “give up” any GILTI-related attributes, such as NDTIR and PTEP.<sup>113</sup> It would also be necessary to determine how to

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<sup>111</sup> P.L. 115-97.

<sup>112</sup> See Treas. Reg. § 1.245A-5 (special rules for extraordinary dispositions).

<sup>113</sup> This could apply also for non-wholly owned CFCs, and in that case it would be up to taxpayers to negotiate appropriate commercial terms to reflect the loss of GILTI-related attributes for minority owners of the CFC.

treat a taxpayer that was no longer subject to the IIR because its revenue decreased below the applicable threshold. One approach would be to only apply the GILTI regime going forward (with historic GILTI attributes having been lost as a result of the election). This would forego permanently any revenue that could have been collected under the GILTI regime in those past periods. Another approach would be to require a Section 481-like adjustment to recalculate past GILTI taxes. This would collect the revenue but would be extremely complicated and might reduce the benefit of the election.

We also observe that if any such election were implemented, it is possible that, over time, most large MNE Groups would be subject to the IIR only, thereby creating an alternative tax system for large businesses as compared to small businesses and individuals. This is so even though the GILTI regime (absent domestic expense allocation) might result in fewer taxes than the IIR, because MNE Groups will be subject to an IIR and UTPR in most jurisdictions (including in this case, the United States itself), and as such they will already be subject to the higher taxation imposed by the Pillar 2 regime. In addition, MNE Groups with a history of revenue substantially in excess of the Pillar 2 threshold and a UPE that is a U.S. corporation would be unlikely to fall out of the IIR, except in limited circumstances (such as distressed circumstances), and so would have strong reason to make the election.<sup>114</sup> As a result, the election could function as a “one-way street” whereby the largest MNEs would progressively “opt out” of the GILTI regime.

### **3. Use of Financial Statements for GILTI Calculations**

We have considered whether, instead of a wholesale election between the IIR and the GILTI regime, Congress could permit GILTI to be calculated on a financial statement basis rather than a taxable income basis.<sup>115</sup> The principal benefit of this approach would be to allow taxpayers to leverage work already done for the IIR and simply apply GILTI rules to the relevant items.

In a sense, this is a variation on making the GILTI regime more like the IIR. By retaining the GILTI concept, there are fewer issues to reconcile as opposed to when the IIR wholly substitutes for the GILTI regime. For example, items relevant to GILTI (like QBAI) could still be calculated and applied for individual shareholders or others not subject to the IIR. Further, if there are substantial differences in the computation of GILTI tax versus IIR tax (independent of the income base), those differences would still be captured since GILTI computations would still apply. However, issues related to electivity would remain, albeit perhaps in a somewhat more manageable form since all taxpayers would still be subject to the GILTI regime.

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<sup>114</sup> Although M&A transactions and spin-offs might also result in falling out of the IIR, we expect for very large MNE Groups, this would not be a common occurrence given the relatively low gross revenue threshold for Pillar 2. Only sales or spinoffs of smaller divisions would present the issue.

<sup>115</sup> In 1992, the IRS issued proposed regulations that would allow calculations on a financial statement basis by permitting inventories to follow U.S. GAAP and introducing GAAP recovery methods for depreciation adjustments. However, it specifically stated it could not fully replace the determination of income. *See* Internal Revenue Service, Notices of Proposed Rulemaking, INTL-18-92, (Jul. 1, 1992), Federal Register Publication Date: July 1, 1992.

Whether this approach would be desirable is difficult to judge without practical experience under the IIR, and also depends on the specific rules for the GILTI regime (including the rate) at the time the approach is considered. Accordingly, we recommend Congress and Treasury identify this as an area of possible study and potentially provide regulatory authority for such an election if the revenue consequences would not be significant.

#### **D. Expense Allocation**

When evaluating the possible options outlined in Parts V.A – C above, a key variable is whether Congress will continue to require domestic expense allocation when making GILTI foreign tax credit calculations—in effect, whether it intends to impose taxes on expenses it believes are over-allocated to the United States through the GILTI regime rather than by disallowing the expenses. We explain this point further below.

*Option 1: Replace the GILTI Regime with an IIR (Part V.A).* This option does not, by default, include domestic expense allocation rules, since the IIR does not incorporate this concept. Accordingly, in this option, Congress would need to live with revenue loss if and to the extent the IIR calculation without domestic expense allocation is less than the current GILTI calculation. The magnitude of this loss (if any) would necessarily need to be evaluated based on the GILTI and domestic expense allocation rules at the time Congress was considering this decision.

Alternatively, Congress and Treasury could attempt to add on expense allocation rules to a U.S. version of an IIR. However, this would further offset any simplifying benefit of this option and would be another instance where the U.S. version of an IIR would need to adopt bespoke versions of pre-existing U.S. rules.

*Option 2: Make the GILTI Regime More Like an IIR (Part V.B).* Congress would similarly need to consider the revenue effects of this option with and without domestic expense allocation rules. We note, however, that with an increase to the GILTI tax rate as well as a move to country-by-country computations, Congress might determine that any additional revenue collected from domestic expense allocation is not significant, or, alternatively, that domestic expense allocation as a concept is not relevant. In this regard, we note that under the Build Back Better proposal, no expenses were allocated to GILTI at all.<sup>116</sup>

On the other hand, if Congress determined to preserve domestic expense allocation while modifying the GILTI regime, it would be necessary decide whether to allocate expenses in a different manner than under current law, in particular to align expenses with the country-by-country GILTI computation. In principle, the current approach in the regulations could be adapted to a country-by-country approach fairly easily because it is generally mechanical.<sup>117</sup> However, it would need to be considered whether the effect of these mechanical rules on a country-by-country basis produces Congress's desired objective. In addition, there could be a substantial

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<sup>116</sup> H.R. 5376, 117th Cong., Section 138124 (2021).

<sup>117</sup> See discussion above at Part III.A.

administrative burden on taxpayers to perform these calculations on a country-by-country basis rather than on an aggregate basis as under current law, and this would also need to be weighed against Congress's objectives.

*Option 3: Retain the GILTI Regime and Add an IIR (Part V.C).* As an initial matter, this option would not, on its own, modify the GILTI regime and as a result it would preserve the current rules on domestic expense allocation. Thus, the domestic expense allocation point is consistent with the other benefits of this option in that it requires the fewest modifications to pre-existing rules and practice.

If Congress otherwise determined not to preserve domestic expense allocation, we expect the relief provisions described above in Part V.C.1 and 2 may be easier to accommodate. For example, it would generally be easier to implement any approach needed to avoid double taxation without the complexity of backing out the impact of domestic expense allocation. Similarly, an election to substitute the IIR for GILTI might be tolerable because, as discussed above, absent domestic expense allocation, in many cases an IIR might collect more revenue than the GILTI regime. In other words, the administrative convenience of using only one method may outweigh any revenue effects. However, without any modification to the GILTI regime, this approach would be similar to replacement of the GILTI regime by an IIR, in that it could result in revenue loss in sandwich structures.

On the other hand, if Congress otherwise determined to preserve domestic expense allocation, the effect of domestic expense allocation would likely reduce the desirability and simplicity of any relief approaches. For example, any approach to avoid double taxation described in Part V.C.1 above would potentially need to track the effect of domestic expense allocation to avoid inappropriate crediting, which could render the entire exercise practically unworkable.

Similarly, an election to substitute an IIR for the GILTI regime would need to be evaluated differently. First, the election could result in meaningful revenue loss to the extent the GILTI regime collects more taxes, after accounting for domestic expense allocation, than the IIR. Second, it would likely be more important to include a true-up mechanism for a taxpayer that fell out of the IIR, in order to prevent use of the election as a way to avoid domestic expense allocation. It might be possible to ameliorate this by preserving a version of domestic expense allocation in a modified IIR; but just as with a scenario in which the GILTI regime is replaced by an IIR, we anticipate this would undo much of the simplification benefit of the election.

## **E. Conclusion**

We have made the determination to refrain from making specific recommendations with respect to any of the above options – or, in the case of the option in which a U.S. IIR is adopted while GILTI is left in place in its current form, the relief provisions discussed in Part V.C.1 - 3 – because the desirability of any option or benefit of any relief turns in significant part on the various tradeoffs between administrability and revenue. Further, each of these will depend on the outcome of negotiations with the Inclusive Framework as well as the actual implementation of Pillar 2.

Accordingly, in lieu of recommendations, this Part V concludes with a table summarizing the principal considerations for each option.

	<b><u>Double Tax</u></b>	<b><u>Sandwich Structures</u></b>	<b><u>Administrative Simplicity</u></b>	<b><u>Expense Allocation</u></b>
<i>Option 1: Replace the GILTI Regime with an IIR (Part V.A)</i>	No continuing issue	U.S. would lose revenue due to “Top-Down” approach for IIR collection	Simple for MNE Groups, but likely complex and potentially unworkable for individuals and other businesses	IIR contains no rules for domestic expense allocation; Congress would need to craft special rules
<i>Option 2: Modify the GILTI Regime (Assumes GILTI is accepted as an IIR and remains a CFC Tax Regime) (Part V.B)</i>	No continuing issue	No continuing issue	Substantial simplification for MNE Groups but significant burden on Congress and Treasury to reform U.S. international rules	Would need to substantially reconsider domestic expense allocation rules in light of other changes to GILTI
<i>Option 3: Enact an IIR without Modifying the GILTI Regime (Part V.C)</i>	Continuing issue – relief provisions possible but complex	Less revenue loss than Option 1 as a result of continuing GILTI collections	Most complex for MNE Groups, but simplest to enact and implement for Congress and Treasury; no clearly workable simplifying relief	Preserves domestic expense allocation but substantial complexity and uncertainty in fully reconciling domestic expense allocation with Pillar 2 Rules