Treasury Releases Guidance on GILTI

Sept. 21, 2018

On September 13, 2018, the Department of Treasury issued proposed regulations under Section 951A of the Internal Revenue Code ("Code") regarding the current inclusion of global intangible low-taxed income ("GILTI") for U.S. shareholders[1] of controlled foreign corporations ("CFCs").

Section 951A was created by the *Tax Cuts and Jobs Act*, (P.L. 115-97) ("TCJA") and due to its complexity, Treasury has elected to release proposed regulations in three stages. The first, analyzed herein, is a welcome start to implementing the GILTI regime, but more guidance is necessary to understand the more vexing areas of GILTI.

Background

Congress enacted Section 951A in order to subject intangible income earned by a CFC to U.S. tax on a current basis. Due to the administrative difficulty in identifying income attributable to intangible assets (in contrast to tangible assets), intangible income (and thus GILTI) is determined for purposes of Section 951A on a formulaic approach, where a 10 percent return is attributed to certain tangible assets, and then each dollar of certain income above such 10 percent amount is effectively treated as intangible income.

As referenced above, Section 951A requires U.S. shareholders of CFCs to include in their gross income, their GILTI inclusion amount for that tax year. The determination of a U.S. shareholder's GILTI inclusion in gross income begins with a calculation of certain items of each CFC owned by the shareholder, such as tested income, tested loss, or qualified business asset investment ("QBAI"). A U.S. shareholder then determines its pro rata share of each of these CFC-level items, similar to the determination of a shareholder's pro rata share of subpart F income. However, unlike an inclusion under subpart F, the shareholder's pro rata share of these items are not included in gross income, but rather, are taken into account in determining the GILTI inclusion amount.

A U.S. shareholder does not compute a separate GILTI inclusion amount with respect to each CFC for a taxable year, but rather computes a single GILTI inclusion amount by reference to all its CFCs. The shareholder aggregates its pro rata share of each of the CFC-level items into a single shareholder-level amount. A shareholder's GILTI inclusion amount for a taxable year is then calculated by subtracting one aggregate shareholder-level amount from another – the shareholder's net deemed tangible income return ("net DTIR") is the excess of deemed tangible income return over certain interest expense, and, finally, its GILTI inclusion amount is the excess of its net CFC income over its net DTIR.

The proposed regulations under Section 951A provide detailed guidance on items determined at the CFC level – that is, tested income and tested loss, QBAI, and the items necessary to

[1] A U.S. shareholder of a CFC is any U.S. individual, domestic corporation, partnership, trust, or estate that holds at least 10 percent of the (i) total combined voting power, or (ii) total value, of all classes of stock of the foreign corporation.

determine the amount of certain interest expense that reduces net DTIR, as well as rules for determining the U.S. shareholder's pro rata share of these CFC-level items.

The Proposed Regulations

The proposed regulations provide instructions on calculating certain elements of GILTI, explain how the GILTI inclusion interplays with other sections of the Code, specify treatment of GILTI for consolidated groups and domestic partnerships, and detail the GILTI reporting requirements.

This first set of guidance also contains proposed regulations under Sections 951 and 6038 that are aimed at preventing taxpayers from engaging in anti-avoidance transactions, coordinating subpart F and GILTI, and conforming the regulations to other amendments in the TCJA.

The proposed regulations are organized into five substantive areas, each of which provides rules relevant to the calculation of the GILTI inclusion, including:

1. **Section 951A:** The proposed rules pertaining to Section 951A are the most extensive of the five areas, and provide critical information on how certain terms are defined and calculated, including (1) net DTIR, (2) a U.S. shareholder's pro rata share of CFC items, (3) tested income and tested loss, (4) QBAI and specified tangible property, and (5) specified interest expense. The proposed regulations also provide clarity (as Section 951A is silent) on the GILTI inclusion amount for members of consolidated groups and partners in domestic partnerships. Lastly, the proposed regulations explain the interaction of Section 951A with other provisions in the Code and establish anti-abuse rules that will disregard transactions that improperly reduce the GILTI inclusion amount.

2. **Section 951:** The proposed rules under Section 951 address certain avoidance structures the IRS has become aware of, which also implicates Section 951A. The proposed regulations also promulgate rules treating certain controlled domestic partnerships as foreign partnerships for purposes of identifying a U.S. shareholder for purposes of Sections 951 through 964. It also eliminates the 30-day requirement from the former definition of a U.S. shareholder of a CFC.

3. **Section 1502:** This area specifies rules for members of consolidated groups and states that a member's GILTI inclusion should be determined by reference to the relevant items of each CFC owned by members of the same consolidated group. The proposed regulations provide special definitions of net CFC tested income and net DTIR in order to clearly reflect the income tax liability of the consolidated group.

4. **Sections 1.6038-2(a) and 1.6038-5:** The changes to these regulation sections provide details on the new reporting requirements, specifically new Schedule I-1, Information for Global Intangible Low-Taxed Income, to Form 5471, as well as new Form 8992, U.S. Shareholder Calculation of Global Intangible Low-Taxed Income, to provide the information that a U.S. shareholder needs with respect to each of its CFCs to determine the U.S. shareholder's GILTI inclusion amount for a taxable year.

5. **Applicability Dates:** The proposed regulations for Section 951A are to apply to taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

Next Steps

This guidance is just the beginning, and the second installment is expected within the next two months to address larger issues centering around GILTI, principally, those related to the Section 250 deduction for GILTI and the application to GILTI of the foreign tax credit (as the effect of these two items is among the issues leading to potentially higher tax rates on GILTI than the "minimums" intended by Congress).

Treasury has asked for written comments on the published guidance within 60 days of the date the proposed regulations are published in the federal register. We anticipate that the comments will be due in late-November. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place will be published in the federal register.

Given that these rules will significantly impact the taxation for U.S. shareholders of CFCs, we believe that it is important for businesses to engage in the rulemaking process. By doing so, policymakers will have a better understanding of the impact these rules will have on businesses and the challenges businesses will face during the implementation process.

The Brownstein Federal Tax Policy team can assist you consider the impact that these rules will have on your business, including drafting and submitting written comments to the proposed guidance. Our team has significant knowledge on international taxation rules as well as experience with the rulemaking process. To the extent questions are unanswered or the rules are not clear, our team can facilitate a dialogue with policymakers to help resolve your issues.

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