UNIVERSITY OF TEXAS ARLINGTON

The Biden Administration's Proposed Changes to U.S. International Taxation After TCJA and BEPS

CPE Day, August 12, 2021

- Presenter
- William J Seeger, PhD
  - Clinical Professor of Economics and Taxation
  - Director of Taxation Program
  - College of Business
  - University of Texas at Arlington
- Contact
  - William. Seeger@UTA.edu
  - 817-272-1816

Introduction: Setting the Stage

- TCJA: Tax Cuts and Jobs Act of 2017
  - Create tax incentives for contributing to job creation in the United States.
  - Encourage businesses to keep their operations in the United States verses foreign jurisdictions
  - Make the U.S. tax system as competitive as other tax systems around the world.
  - Avoid capital flight to lower-tax-rate jurisdictions.
  - Stifles Base Shifting
- Global Initiatives
  - OECD BEPS 15 Articles: Base Erosion and Profit Shifting
  - OECD: Pillar One and Pillar Two

2017 Tax Cuts Jobs Act

- **TCJA**
  - **Scope**: foreign income of U.S. resident individuals and certain entities
    - rules were designed with U.S. multinational corporations in mind
  - **Changes**:
    - Global **minimum tax** on a special type of Income of controlled foreign corporations **(GILTI)**
    - Significant **deduction** for U.S. C corporations earning GILTI and certain export income **(FDII)**
    - An additional **minimum tax "top-off"** imposed on certain corporations that make certain "base erosion payments" to foreign related parties. **(BEAT)**
    - New Foreign Tax Credit **Baskets and calculations**

GLOBAL INTANGIBLE Low-Taxed Income

- **Income Inclusion: Similar to Sub-part F**
  - Creates new category of foreign income applicable to U.S.
  - shareholders that own 10% or more of a CFC
  - Essentially imposes a minimum level of U.S. tax **on foreign Intangible related profits**
  - Excess of U.S. shareholder's "net CFC tested income" less "net deemed tangible income return" less net interest expense
    - Net CFC tested income = **excludes** several categories of income, including income already subject to U.S. tax as Subpart F or as effectively connected income
    - Net deemed tangible income return = 10% of the shareholder's pro- rata share of the qualified business asset investment (QBAI) of each CFC
      - QBAI is determined as the average of the adjusted U.S. tax basis in specified tangible property that is used in the CFC's trade or business and is subject to U.S. tax depreciation

GILTI Deduction

- Full amount is included in a U.S. shareholder's income, but **corporate shareholders are allowed a deduction equal to 50% of GILTI**
- To get Started:
  - Allows a U.S. corporation a deduction equal to 37.5%, providing 13.125% effective tax rate, however;
  - Deduction decreased to 21.875% in 2026

Polling Question #1

Gilti is an income Inclusion like Sub-part F?

- ❑ True
- ❑ False

Foreign-derived Intangible Income (FDII)

- **First and foremost: an export incentive**
- **Incentivize the development of intangibles in the U.S**. by providing a reduced rate of U.S. tax on a domestic corporation's portion of its intangible income **derived from serving foreign markets**
- FDII is the amount of "deemed intangible income" that is attributable to:
  - **sales of property** to foreign persons for use **outside** the U.S., or;
  - **the performance of services** to persons located **outside** the U.S.
- Deemed intangible income is gross income **not** attributable to a CFC or foreign branch, **not** financial services income **nor** domestic oil and gas extraction income, **reduced by:**
  - related deductions
  - and an amount equal to 10% of the aggregate adjusted basis of its tangible depreciable assets

Base Erosion and Anti-abuse Tax (BEAT)

- Targeted at **excessive base erosion payments**, namely, deductible payments to foreign affiliates, such as royalties or management fees, but excluding cost of goods sold
- Ensure that a U.S. corporation pays at least a 10% tax (5% in 2018 and 12.5% beginning in 2026) on its taxable income after adding back these base erosion payments
- Tax applies to U.S. corporations, real estate investment trusts, or S corporations, with average annual gross receipts of at least $500 million

OECD BEPS Initiative

- Started in 2012 regarding 15 articles
- Finalized in 2015 EXCEPT for Article 1: Taxation of the Digital Economy
- Because the "Digital Economy" is so pervasive, this initiative is no longer about the Digital Economy, rather it now concerns the Global Economy
- To tax what we regard as the Global Digital Economy, the OECD has proposed two pillars: Pillar one and Pillar two
- Pillar One is is concerned with Intangible Income
- Pillar two is concerned with a minimum tax.

Governments' Response: OECD BEPS
Fifteen Articles to Combat Base Erosion

Polling Question #2

GILTI is part of the 2017 TCJA?

- ❑ Yes
- ❑ No

GILTI Context: CFC Rules

- Controlled foreign corporation (**CFC**) **rules** are features of an income tax system designed to limit artificial deferral of tax by using offshore low taxed entities. The **rules** are needed only with respect to income of an entity that is not currently taxed to the owners of the entity.
- Example: Subpart F Income
- U.S. shareholders of CFCs are NOW also subject to the new minimum tax on "global intangible low-taxed income" or GILTI on a current basis.
- Unlike subpart F, which is limited to certain categories of income, GILTI applies to essentially of all of a CFC's income in excess of certain formula-based thresholds.

GILTI Defined

- Section 951A adds GILTI as a new form of income included under Subpart F mechanics
  - Each United States shareholder includes its pro rata share of GILTI, defined as the pro rata share of the aggregate "net tested income" of CFCs in excess of the "net deemed tangible asset return."
  - Net tested income equals all gross income of the CFC, minus allocable expenses, excluding the following: (1) subpart F income; (2) effectively connected income; (3) income excluded from subpart F by the high- taxed exception; (4) dividends received from a related person; and (5) foreign oil & gas extraction income.

More GILTI Basics

- The net deemed tangible income return equals 10% of the CFC's qualified business asset investment ("QBAI"), minus the amount of the CFC's interest expense allocated to reduce tested income.
- QBAI equals the tangible property of the CFC that is used in a trade or business and subject to an allowance for depreciation under Section 167 of the Code.
    - In case of assets that produce both tested income and non-tested income, e.g., subpart F income, the QBAI is determined by making an allocation of basis between the two uses of the property.

No Deferral with GILTI

- GILTI is subject to current taxation to U.S. Shareholder at ordinary rates as earned by the entity.
- Challenges with GILTI:
  - Generally, no foreign tax credit is available to the individual shareholder for taxes imposed on the CFC
  - No flow-through of losses or carryforward of losses is available
  - No flow-through of capital gain character of income recognized by the CFC is available (i.e., all GILTI is ordinary income)

C-Corp Shareholders Results

- The GILTI rules are lenient in the context of a U.S. C corporation shareholder due to three considerations:
  - Lowering of U.S. corporate rate from 35% to 21%
  - 50% deduction (for years through 2025) for GILTI recognized by a U.S. C Corporation. See IRC Section 250(a).
  - Indirect foreign tax credit for taxes imposed on GILTI under Section 960(d).

GILTI Foreign Tax Credit Rules (new Section 960(d))

- An indirect credit is allowed for the foreign taxes imposed on the GILTI of a U.S. C Corporation's CFCs. This follows the old indirect credit rules with important modifications:
  - FTC is haircut by 20% of the total foreign taxes imposed on the GILTI (i.e., only 80% of taxes are allowed as an FTC).
  - GILTI is a separate basket for Section 904(d) purposes
  - No FTC carryover / carryback is permitted.

More GILTI

- Treatment as Subpart F Income. Except as otherwise provided in regulations, GILTI is generally treated as subpart F income for other purposes of the Code, including Sections 959, 961 and 962.

- Effective Date. GILTI applies to taxable years of CFCs beginning after Dec. 31, 2017.

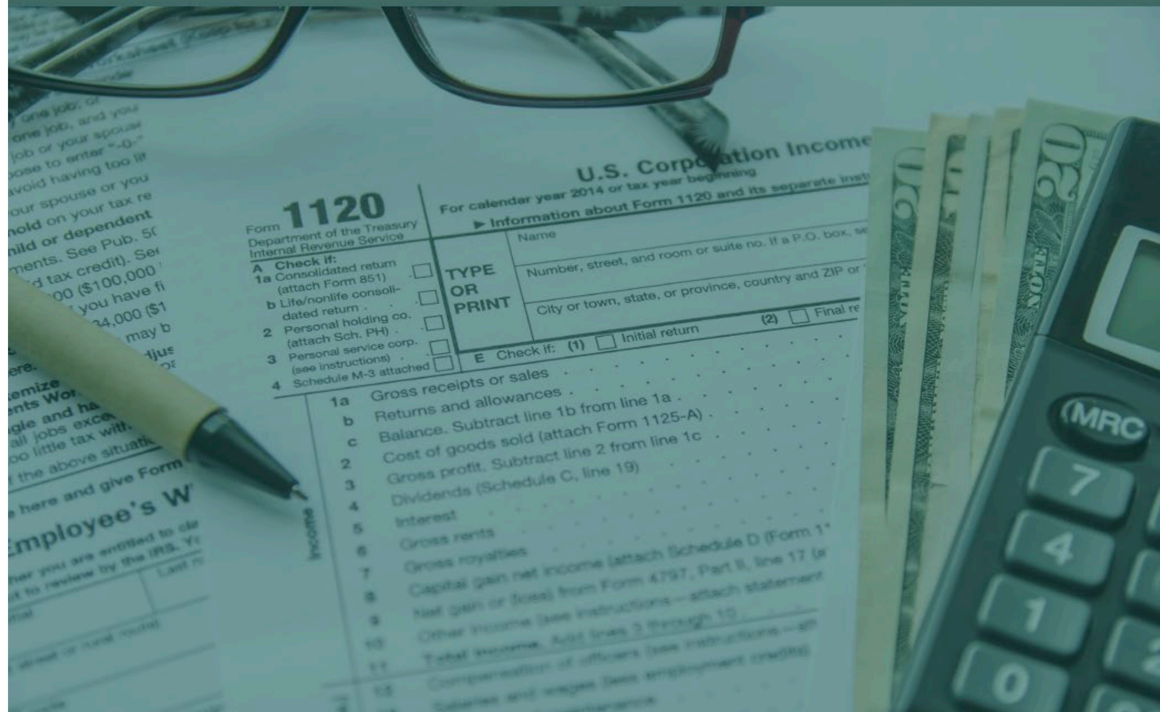
Polling Question #3

Are CFC rules features of an income tax system designed to limit artificial deferral of tax by using offshore low taxed entities.

- ❑ Yes
- ❑ No

Overhauling International Taxation

A framework to invest in the American people by ensuring multinational corporations pay their fair share



Senate Finance Committee Chair Senator Ron Wyden, D-Oregon
Senator Sherrod Brown, D-Ohio
Senator Mark Warner, D-Virginia

April 2021

Biden Administration Changes to TCJA - GILTI

- Overhauling International Taxation: A framework to invest in the American people by ensuring multinational corporations pay their fair share
- Suggested changes to the **global intangible low-taxed income (GILTI)** tax system include:
  - End the incentive to offshore factories
    - Repealing the deduction for qualified business asset investment (QBAI).
      - The Framework describes QBAI as an "irrational incentive" to "earn tax-free income by putting tangible assets [such as factories, machinery, and buildings] abroad."
  - Increase the GILTI rate
  - Move GILTI to a country-by-country system-eliminate Global averaging of high/low tax income.
  - Add an incentive to onshore research and management jobs

Biden's Overhaul - Continued

- End the incentive to offshore factories
  - GILTI gives large, multinational corporations the ability to earn tax-free foreign income by putting tangible assets abroad.
  - The more factories, machinery, and buildings constructed overseas, the more tax-free income the corporations can earn.
  - This incentive to offshore stems from an exemption for qualified business asset investment (QBAI)—roughly the value of offshore tangible assets.

The Biden Framework for Overhaul – continued

- Increasing the GILTI rate.

  - The Framework states that it is an open question whether the GILTI rate should equal the US corporate tax rate or remain at a lower proportion of the US rate (e.g., 75% as proposed by the Biden administration).
  - According to the Framework, the GILTI rate should depend on corresponding decisions on other issues, including the US corporate rate and other international reforms.

    - It also is noted that prior Democratic proposals have suggested taxing foreign earnings at a rate between 60% and 100% of the US corporate tax rate.
    - ***Note***: For reference, after accounting for the 80-percent limit on foreign tax credits, the current 13.125% GILTI rate is 62.5% of the regular rate and is scheduled to increase to 78.125% of the regular rate after 2025.

Biden Overhaul - Continued

- Move GILTI to a country-by-country system
  - NO Global Averaging
  - Current System: Encourages USE and ABUSE of Tax Havens
    - The net amount of GILTI tax owed to the U.S. depends, in part, on the amount of tax paid to foreign countries, through the foreign tax credit system.
  - But it does so on a global basis, combining all foreign income and taxes in one global average calculation.
    - Under GILTI, the best tax-avoidance planning structures match high-tax income (typically from real business operations in major economies, such as Germany or Japan) with low-tax income (often from intangibles stashed in tax havens)
    - For every dollar of income earned in a country that applies a substantive tax, a corporation will try to shift profits to a tax haven to reduce or eliminate its GILTI taxes

Biden Overhaul – Continued

- Solutions:
  - The Framework notes a country-by-country option with the use of separate foreign tax credit baskets for each country in which a company operates.
  - A second option noted is to divide a company's global income into two groups: low-tax and high-tax. It also is suggested that the Treasury Department could implement reforms in this area by revisiting guidance issued by the Trump administration and providing a "mandatory high-tax exception" to "target offshore tax haven abuse by multinational corporations."

Biden Overhaul – Continued

- Adding an incentive to onshore research and management jobs.
  - The Framework suggests that research and management expenses that actually occur in the US should be treated as entirely domestic source expenses:
    - This action would eliminate foreign tax credit penalties under GILTI and helping retain these activities in the US
    - the interaction of the GILTI regime with the foreign tax credit limitation can create perverse incentives.

Biden’s Overhaul – continued

- A prime example: taxes owed under GILTI increase when a corporation invests in research and development in the U.S. or expands a U.S. headquarters office.
  - These expenses are often related to good-paying U.S. jobs and investments that have positive spillover effects, and we should not retain unnecessary incentives to offshore them.
  - A simple change will help create more incentives for doing research and locating administration in the U.S.: expenses for research and management that actually occur in the U.S. should be treated as entirely domestic expenses, eliminating foreign tax credit penalties under GILTI and helping retain these activities in the U.S.

Polling Question #4

One proposed change to GILTI is to raise the GILTI rate?

- ❑ True
- ❑ False

Summary and Conclusion

- **Essential Elements of International aspects of TCJA**
  - GILTI (An income inclusion)
  - BEAT (A minimum top-off tax)
  - FDII (An income exclusion/deduction)

- **OECD BEPS**
  - Pillar One: Taxes Intangible income
  - Imposes a Global minimum tax
  - Tax planning structures that are perceived to shift profit and erode a Government's tax base

Thank You

Dr. William J Seeger, PhD.

Clinical Professor of Economics
The University of Texas at Arlington
William.Seeger@UTA.edu
817-272-1816