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SOMETIMES IT'S GOOD TO BE GILTI

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Doing Business in Florida

Usually, when Congress implements a new tax, taxpayers and their tax advisors spend countless hours planning their way around such a new tax. When Congress added the global intangible low-tax income ("GILTI") tax as part of tax reform in December of 2017, many of us had the typical reaction described above – how do we avoid GILTI? However, a year of studying and understanding GILTI and the proposed GILTI regulations promulgated by the Treasury Department has caused many to rethink and revisit the implicit aversion to new taxes. Prior to the GILTI regime, a U.S. shareholder of a controlled foreign corporation ("CFC") had the ability to defer all foreign-source income of such CFC that was not "Subpart F income" (which is certain foreign passive income and certain foreign related-party income earned by a CFC that is taxed currently to its U.S. shareholders).

For those taxpayers owning shares of a CFC, GILTI and its counterpart, foreign derived intangible income ("FDII"), were intended by Congress to be the typical stick (GILTI) and carrot (FDII). As the stick, GILTI eliminated the ability to defer as described above and requires all income earned by a CFC (other than income effectively connected with a U.S. trade or business, Subpart F income, and other limited exclusions) in excess of a statutory threshold (a 10% rate of return on a CFC's tangible depreciable property) to be included in the gross income of such CFC's U.S. shareholders for the year such income is earned. As the carrot, FDII is intended to provide a reduced effective rate of tax on U.S. domestic corporations who directly operate abroad rather than through a CFC by allowing a 37.5% deduction for a domestic corporation's FDII.

While a carrot and stick may have been intended by Congress, a technical reading of the mechanics of both GILTI and FDII shows that, sometimes, the stick may be preferable to the carrot, particularly for activities that require significant depreciable tangible property, like manufacturing. As mentioned above, active trade or business income earned by a CFC that is not effectively connected with a U.S. trade or business and does not exceed a 10% rate of return on such CFC's tangible depreciable property used in the business is not GILTI and U.S. income tax on such income may be deferred until repatriated to the United States. The same income, if earned directly by a U.S. domestic corporation operating abroad and qualifying as FDII, would be subject to immediate U.S. income tax at an effective rate of 13.125% (assuming no foreign tax credits apply). This creates a possible incentive for those taxpayers operating abroad to do so through a CFC, have their tangible depreciable assets, like manufacturing equipment, owned by the CFC, be subject to the GILTI regime and defer U.S. taxes to the extent the CFC's income does not exceed the statutory threshold. Of course, the choice of entity and whether GILTI or FDII is preferable is not a one-sized-fits all approach and the facts and circumstances of each case should be analyzed by a qualified tax professional.

If you have any questions on this topic, please contact the author, Mitchell W. Goldberg and Bryan S. Appel, on the firm's Business, Finance & Tax Team.

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