International Tax Changes After the Tax Cuts and Jobs Act

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On the STA Money Hour on February 11th, Scott Bishop interviewed Roland Garcia related to maximizing opportunities in today's international trade market. This is especially important for US Companies that are active in international trade. Scott and Rolando talked about many topics, but as Rolando is a JD, CPA and International Tax Director with Doeren Mayhew CPAS, they talked quite a bit about the tax changes related to the 2017 tax law changes in the Tax Cuts and Jobs Act (TCJA) in December 2017. In the paper below, Rolando discusses in detail one of the tax changes that we briefly discussed on the STA Money Hour (click here to for a replay of the full show – Show Replay). If you want to learn more about international trade, Doeren Mayhew, STA Wealth and several others are sponsoring a breakfast on February 26th from 7:30am to 9:30am. Attendance is free, but limited. Please click below to RSVP:
RSVP: Maximizing Opportunities in Todays' Trade Market.

GILTI – Costly Impact for Non-C Corporate Shareholders

By now, businesses involved in cross-border activities have dealt with the international tax provisions enacted by the TCJA. It has been a frustrating year for both tax practitioners and clients due to the timing in which both the Internal Revenue Service and the Treasury Department rolled out guidance and proposed regulations, creating an aura of haste.

The focus has now shifted from the Section 965 Transition Tax to the Global Intangible Low-Taxed Income (GILTI) provision of TCJA.

Understanding GILTI

The GILTI regime requires any U.S. person who is a shareholder (whether directly or indirectly as through a partnership, sub-S corporation or trust) of a controlled foreign corporation (CFC) and owns stock in the CFC on the last day of the CFC's tax year to be subject to U.S. federal income tax on the owner's pro-rata share of the CFCs' GILTI. GILTI is defined to include most business income of a CFC, reduced by 10 percent of the adjusted tax basis of the CFC's depreciable tangible personal property.

Taxpayers who are U.S. C corporations are entitled to reduce their GILTI by 50 percent, plus are subject to a U.S. federal corporate tax rate of only 21 percent and are entitled to claim a credit for up to 80 percent of the foreign taxes paid or accrued by the CFC on the GILTI. These all act to mitigate the net U.S. federal tax liability arising from GILTI for corporate shareholders. So, in short, the GILTI rules generally impose a U.S. corporate minimum tax of 10.5 percent (50 percent x 21 percent) and, to the extent foreign tax credits are available to reduce the U.S. corporate tax, may result in no additional U.S. federal income tax being due.

Non-C corporation U.S. Shareholders Pay More
U.S. shareholders who are *not* C corporations are *not* entitled to the 50 percent deduction or the deemed paid foreign tax credit. In addition, GILTI may very well be taxed at the highest U.S. marginal federal income tax rate of 37 percent. In total, non-corporate shareholders face taxation on GILTI at a 37 percent rate without the benefit of a credit for any foreign taxes imposed on the CFC's GILTI.

Because of this unbalanced impact of the GILTI rules to non-C corporation U.S. shareholders, it is important that these taxpayers with investments in foreign corporations assess the U.S. federal income tax impact of the GILTI provisions on their foreign investments and consider whether it may be beneficial to take advantage of one of the following planning strategies:

> **Use of a Domestic C corporation Blocker:** A non-C corporation U.S. shareholder may want to consider transferring their interest in its CFC to a U.S. C corporation. A U.S. C corporation holding company for CFCs would be particularly beneficial where the CFC has foreign tax credits that would essentially eliminate the U.S. corporation's U.S. tax liability. The non-C corporation U.S. shareholder would not be taxed on the GILTI until distributed by the U.S. holding company to the shareholder so the U.S. taxation of the GILTI would essentially be deferred until distributed by the U.S. C corporation to its shareholder, at ostensibly qualified dividend rates.
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> **Elect Section 962 Treatment**: Section 962, which has been in the Code since 1962, provides a special rule that allows U.S. individual shareholders, including U.S. individual partners of partnerships and U.S. individual shareholders of S corporations, to elect to be taxed on subpart F amounts included in their gross income at corporate rates and to get the benefit of Section 960 foreign tax credits with respect to such income, similar as for a U.S. C corporation. However, it remains uncertain whether the 50 percent deduction against GILTI which C corporation U.S. shareholders enjoy is made available to individual shareholders who make a Section 962 election.
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> Therefore, the benefits to non-C corporation U.S. shareholders of making a Section 962 election are:
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> (1) GILTI is subject to U.S. tax at the 21 percent corporate rate (10.5 percent if the 50 percent deduction is allowed) rather than the higher 37 percent U.S. individual tax rate
> (2) U.S. tax on GILTI may be offset by foreign tax credits. A distribution of GILTI for which a 962 election was made will be subject to U.S. tax upon distribution to the

extent that the distribution exceeds the amount of U.S. tax previously imposed on such income under the GILTI rules and such amount will not be treated as previously taxed income (PTI). Thus, modeling will be essential to determine the overall tax impact of making the election.

In addition to quantifying this option, other issues to consider include whether or not GILTI is subject to the net investment 3.8 percent income tax as well as the recent Tax Court decision in *Barry M. Smith v. Commissioner*, which stands for the proposition that distributions from the CFC to the U.S. C corporation holding company and then on to the individual shareholder are not deemed dividends for purposes of potentially characterizing them as "qualified" dividends.

Owning Foreign Operations in Pass-Through Form: It may also make sense to have non-C corporation U.S. shareholders set up foreign operations through foreign entities that they elect to treat as pass-throughs for U.S. federal income tax purposes under the check-the-box rules. This would render GILTI inapplicable and would result in a pick-up of income annually, but without the complex calculation. In addition, this structure should get the benefit of foreign tax credits.

GILTI Takeaway

The new GILTI regime creates an entirely new category of taxable income affecting all taxpayers who are U.S. persons. As a result of GILTI, income of a U.S. shareholder's CFCs is now part of the U.S. shareholder's annual U.S. federal income tax analysis. The effect of GILTI on non-corporate taxpayers who are U.S. shareholders of CFCs is particularly harsh. Such taxpayers would be prudent to evaluate their exposure under GILTI and investigate planning and restructuring alternatives.

Clearly, no single approach applies to every existing or planned foreign investment, and taxpayers will want to structure their operations only after evaluating all the relevant factors that will influence their foreign investments.

For assistance navigating GILTI or to learn more about the tax reform impact on your international business, contact our international tax experts today.