CFCS AND SUBPART F INCOME

¶735 Foreign High Return Amounts of U.S. Shareholders of Controlled Foreign Corporations (CFCs)

NEW LAW EXPLAINED

Global intangible low-taxed income and foreign-derived intangible income.—A person who is a U.S. shareholder of any controlled foreign corporation (CFC) is required to include its global intangible low-taxed income (GILTI) in gross income for the tax year. The amounts are treated in the same manner as subpart F income for various purposes, including for example, determining previously taxed earnings and profits (Code Sec. 951A(a), (f), as added by the Tax Cuts and Jobs Act). The Treasury may issue rules and other guidance to assist in coordinating the GILTI inclusion with provisions that require the determination of subpart F income at the CFC level (Code Sec. 961A(f)(1)(B), as added by the 2017 Tax Cuts Act).

GILTI defined. The term "global intangible low-taxed income" is defined as the excess (if any) of (1) the U.S. shareholder's net CFC tested income for that tax year, over (2) the U.S. shareholder's net deemed tangible income return for that tax year (Code Sec. 951A(b)(1), as added by the 2017 Tax Cuts Act).

Net deemed intangible income return. The term "net deemed tangible income return" means with respect to any U.S. shareholder for the tax year, the excess (if any) of (1) 10 percent of the aggregate of its pro rata share of the qualified business asset investment (QBAI) of each CFC in which it is a U.S. shareholder, over (2) the amount of interest expense taken into account in determining its net CFC tested income for the tax year to the extent that the interest expense exceeds the interest income properly allocable to the interest expense that is taken into account in determining its net CFC tested income (Code Sec. 951A(b)(2), as added by the 2017 Tax Cuts Act).

The formula for calculating GILTI is: GILTI = Net CFC Tested Income - [(10% x QBAI) - Interest Expense]. As noted in the Conference Agreement, if the amount of interest expense exceeds 10% x QBAI, then the quantity in brackets in the formula equals zero in the determination of GILTI (Conference Report on H.R. 1, Tax Cuts and Jobs Act (H. Rept. 115-466)).

Net CFC tested income. A CFC's tested income for any tax year is the gross income of the corporation in excess of the properly allocated deductions, without regard to the following:

1) effectively connected income of the CFC, defined in Code Sec. 952(b);
2) gross income taken into account in determining subpart F income;
3) gross income excluded from foreign base company income and insurance income as high-taxed income under Code Sec. 954(b)(4);
4) dividends received from related persons, defined in Code Sec. 954(d)(3); and
5) foreign oil and gas extraction income, as defined in Code Sec. 907(c)(1) (Code Sec. 951A(c)(2)(A), as added by the 2017 Tax Cuts Act).

A CFC's tested loss for any tax year is the excess of the properly allocated deductions over the CFC's tested income (Code Sec. 951A(c)(2)(B), as added by the 2017 Tax Cuts Act).

The term "net CFC tested income" means with respect to a U.S. shareholder for any tax year of the shareholder, the excess (if any) of (1) the aggregate of the shareholder's pro rata share of the tested income of each CFC with respect to which the shareholder is a U,S. shareholder for the tax year of the U.S. shareholder, over (2) the aggregate of the shareholder's pro rata share of the tested loss of each CFC with respect to which the shareholder is a U.S. shareholder for the tax year of the U.S. shareholder. The amounts are determined for each tax year of the CFC which ends in or with such tax year of the U.S. shareholder (Code Sec. 951A(c)(1), as added by the 2017 Tax Cuts Act).

COMMENT

The definition of a U.S. shareholder was expanded by the 2017 Tax Cuts Act to include a U.S. person that owns at least 10 percent of the total value of all classes of stock of the foreign corporation, in addition to a U.S. person that owns at least 10 percent of the voting stock of the foreign corporation. The definition applies for purposes of Title 26 and not just subpart F (Code Sec. 951(b) and Code Sec. 957(a), as amended by the 2017 Tax Cuts Act).

Qualified business asset investment (QBAI). The term "qualified business asset investment " is defined by reference to specific tangible personal property used in a trade or business that is depreciable under Code Sec. 167. Specified tangible property is property used in the production of tested income, unless the rule for dual use property applies. Specifically, QBAI is the CFC's average aggregate adjusted bases as of the close of each quarter of the tax year in the property (Code Sec. 951A(d)(1), as added by the 2017 Tax Cuts Act). Dual use property-property used both in the production of tested income and income that is not tested- is treated as specified tangible property in the same proportion that the CFC's tested income produced with respect to the property bears to the total gross income produced with respect to the property (Code Sec. 951A(d)(2)(B), as added by the 2017 Tax Cuts Act).

The adjusted basis of the property is determined using the alternative depreciation system under Code Sec. 168(g) and allocating depreciation deductions for the property ratably to each day during the period in the tax year to which the depreciation relates (Code Sec. 951A(d)(3), as added by the 2017 Tax Cuts Act).

Further, if a CFC holds an interest in a partnership at the end of the CFC's tax year, the CFC takes into account its distributive share of the aggregate of the partnership's adjusted basis in tangible property held by the partnership if the property is used in the trade or business of the partnership, is of a type to which a deduction is allowed under Code Sec. 167, and is used in the production of tested income. The CFC's distributive share of the adjusted basis of any property is the CFC's distributive share of income with respect to the property (Code Sec. 951A(d)(3)[sic], as added by the 2017 Tax Cuts Act; Conference Report on H.R.1, Tax Cuts and Jobs Act (H. Rept. 115-466)).

Pro rata share. A shareholder's pro rata share for purposes of determining GILTI and net CFC tested income is determined under the rules ofCode Sec. 951(a)(2) with respect to subpart F income. The pro rata shares are taken into account in the tax year of the U.S. shareholder in which or with which the tax year of the CFC ends (Code Sec. 951A(e)(1), as added by the 2017 Tax Cuts Act). A person is treated as a U.S. shareholder of a CFC only if the person owns, within the meaning ofCode Sec. 958(a) (direct or indirect ownership) stock in the foreign corporation on the last day of the tax year of the foreign corporation on which the foreign corporation is a CFC (Code Sec. 951A(e)(2), as added by the 2017 Tax Cuts Act). A foreign corporation is treated as a CFC for any tax year if the foreign corporation is a CFC at any time during the tax year (Code Sec. 951A(e)(3), as added by the 2017 Tax Cuts Act).

Foreign tax credit. Foreign tax credits are allowed for foreign income taxes paid on GILTI included in the gross income of a domestic corporation but the provision restricts this to 80 percent of the foreign income taxes paid. Under the provision, these are considered deemed-paid credits for taxes properly attributed to tested income and a separate foreign tax credit basket is created for GILTI (see¶725). No carryforward or carryback of excess taxes paid or accrued is permitted (Code Sec. 960(d), as added by the 2017 Tax Cuts Act).

Deduction for FDII and GILTI. The provision provides domestic corporations with reduced rates of U.S. tax on foreign-derived intangible income (FDII) and global intangible low-taxed income (GILTI). For tax years beginning after December 31, 2017 and before January 1, 2026, the provision allows, as a deduction, generally, an amount equal to the sum of 37.5 percent of its FDII plus 50 percent of its GILTI, if any (Code Sec. 250(a)(1), as added by the 2017 Tax Cuts Act). For tax years beginning after December 31, 2025, the deduction for FDII is 21.875 percent and 37.5 percent for GILTI (Code Sec. 250(a)(3), as added by the 2017 Tax Cuts Act). The amount of the deduction is limited based on taxable income. If the

sum of a domestic corporation's FDII and GILTI amounts exceeds its taxable income, then the amount of the FDII and GILTI deduction is similarly reduced by an amount determined by the excess (Code Sec. 250(b)(2), as added by the 2017 Tax Cuts Act).

FDII defined. A domestic corporation's foreign-derived intangible income (FDII) is the portion of its intangible income, determined according to a codified formula, that is derived from serving foreign markets, meaning, income derived in connection with property that is sold by the taxpayer to any person who is not a U.S. person and that such property is for foreign use, consumption or disposition that is not within the United States (Code Sec. 250(b), as added by the 2017 Tax Cuts Act).

A domestic corporation's FDII is generally its deemed intangible income multiplied by the percentage of its deduction-eligible income that is foreign derived: FDII = Deemed Intangible Income x Foreign-Derived Deduction Eligible Income over Deduction Eligible Income, where deduction eligible income means the excess of the gross income of the domestic corporation over deductions (including taxes) properly allocated to gross income (Code Sec. 250(b)(3), as added by the 2017 Tax Cuts Act). This is determined without taking into account certain exceptions to deduction eligible income. These exceptions include:

- Subpart F income of the corporation determined under Code Sec. 951;
- GILTI of the corporation;
- Financial services income of the corporation;
- Dividends received from a CFC with respect to which the corporation is a U.S. shareholder;
- Domestic oil and gas extraction income of the corporation; and
- Foreign branch income of the corporation.

Foreign-derived deduction eligible income means deduction eligible income derived in connection with (1) property sold by the taxpayer to any person who is not a U.S. person if the taxpayer satisfies the IRS that the property was for foreign use, and (2) services provided by the taxpayer if the taxpayer satisfies the IRS that the services are provided to any person or with respect to any property not located in the United States (Code Sec. 250(b)(4), as added by the 2017 Tax Cuts Act). Special rules apply for purposes of determining foreign use, including rules for related parties (Code Sec. 250(b)(5), as added by the 2017 Tax Cuts Act).

Deemed intangible income is the excess of the deduction eligible income over the deemed tangible income return of the corporation (Code Sec. 250(b)(2), as added by the 2017 Tax Cuts Act).

The Treasury may issue regulations or other guidance as necessary (Code Sec. 250(c), as added by the 2017 Tax Cuts Act) (Code Sec. 250(c), as added by the 2017 Tax Cuts Act).

COMMENT

According to clarifications and modifications provided in the Conference Agreement, the deduction for FDII and GILTI is only available to C corporations that are not RICs or REITs. Further, the deduction for GILTI applies to the amount treated as a dividend received by a domestic corporation under Code Sec. 78 that is attributable to the corporation's GILTI amount under new Code Sec. 951A (Conference Report on H.R. 1, Tax Cuts and Jobs Act (H. Rept. 115-466)).

Effective date. The GILTI provisions apply to tax years of foreign corporations beginning after December 31, 2017, and to tax years of U.S. shareholders in which or with which such tax years of foreign corporations end (Act Sec. 14201(d) of the Tax Cuts and Jobs Act). The deduction for foreign-derived intangible income and GILTI provisions apply to tax years beginning after December 31, 2017 (Act Sec. 14202(c) of the 2017 Tax Cuts Act).