GILTI

Key Points

- Global Intangible Low Tax Income (GILTI) defines taxable foreign earnings for U.S. multinationals and functions as a minimum tax.
- Calculating GILTI involves determining net income, isolating "supernormal" returns, and taking the appropriate deductions.
- The GILTI regime was created on top of the old international tax code, so it broadened the U.S. tax base and created issues for some taxpayers.
- The GILTI tax rate is tied to the U.S. corporate tax rate and would automatically rise if the corporate tax rate is increased.

Introduced as a part of the Tax Cuts and Jobs Act (TCJA), GILTI is a definition of foreign earnings designed to operate as a minimum tax on the profits of U.S. multinationals. It serves as one of the guardrails enacted by the TCJA to prevent highly mobile income from intellectual property (IP) escaping taxation, a key feature of a territorial tax system.

The four terms below are key components of the GILTI regime:

1. Net tested income
2. Qualified Business Asset Investment (QBAI) exemption
3. The 50 percent deduction
4. Foreign tax credit limitation

Net tested income determines the income of a U.S. company's foreign affiliates. It is calculated by adding up the net income and losses of foreign affiliates and is the first step in calculating a company's GILTI tax liability. In this example, the net tested income is $200 for Company A.

GILTI's formulaic approach taxes most active foreign earnings if they are "supernormal" profits. The QBAI exemption defines these types of returns by allowing a deduction of 10 percent from the company's foreign depreciable

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assets, like factories, R&D facilities, and other facilities. If Company A has $100 of foreign assets, it can deduct $10 from its net tested income of $200 to exempt returns from these assets under 10 percent. Company A is left with $190 of income after taking the QBAI exemption.

Corporations can deduct 50 percent of the income remaining, which effectively lowers the tax rate on this income from 21 percent to 10.5 percent. For Company A, the 50 percent deduction leaves us with $95 ($200*10.5%=$95*21%), which forms the GILTI tax base subject to the 21 percent corporate tax rate.

Before final tax liability is calculated, foreign tax credits for foreign taxes paid must be incorporated into the GILTI calculation. However, the TCJA's limitation on foreign tax credits throws yet another wrinkle in this determination. Under the GILTI rules, foreign tax credits are limited to 80 percent of their value. For many firms, the effect of this limitation is to raise the GILTI tax rate from 10.5 percent to a "maximum rate" of 13.125 percent. See the graphic for a simplified calculation of GILTI.

The tax on GILTI is tied to the U.S. corporate tax rate. This means that increases in the corporate tax rate would not only increase the tax burden on domestic income, it would also increase the tax burden on the foreign income of U.S. companies.

Before GILTI, only foreign passive income (think royalties, dividends, and interest income) was actively taxed; other forms of income, including most active income, were not taxed until repatriation. However, GILTI was built mostly *on top of* rather than *in replacement* of the old system, having the effect of broadening the tax base. This contributes to key issues some taxpayers experience with the GILTI regime.

For an in-depth explanation of these issues, including the high-tax exception, expense allocation issues, and incentives related to the QBAI exemption, please see Daniel Bunn's research U.S. Cross-border Tax Reform and the Cautionary Tale of GILTI or contact him at dbunn@taxfoundation.org.

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An Example for Calculating GILTI

	The calculations start with some assumptions about the foreign subsidiary.		
A	Foreign tax rate	10%	The foreign tax rate where the subsidiary is located (an assumption for the sake of this example).
B	Foreign income	$200.00	The foreign income of the subsidiary (an assumption for the sake of this example), in technical terms this is "Net Tested Income."
C	Taxes paid to the foreign jurisdiction (**A** x **B** = **C**)	$20.00	This is the income tax paid by the subsidiary to the foreign jurisdiction.
	Now the U.S. parent company must calculate its GILTI liability.		
D	QBAI deduction (10% x $100 = **D**)	$10.00	First, it deducts 10% of the value of depreciable assets of the foreign subsidiary from the foreign income. In this example, it is assumed that those assets are worth $100.
E	GILTI (**B** - **D** = **E**)	$190.00	"GILTI" income is foreign income minus the 10% QBAI deduction (D).
F	GILTI tax base [50% x **E** = **F**]	$95.00	Second, the U.S. parent company applies a general deduction of 50% from GILTI. The GILTI tax base is half of "GILTI" income.
G	U.S. tax on GILTI before applying foreign tax credits (21% x **F** = **G**)	$19.95	The GILTI liability is the U.S. corporate tax rate (21%) multiplied by the GILTI tax base (F).
	Now the U.S. parent company must calculate its foreign tax credits that would offset its tax liability on GILTI.		
H	Expense allocation for FTC	$40.00	The foreign tax credit rules require some U.S. expenses to be allocated to foreign income. In this example, it is assumed that $40 of U.S. expenses are allocable to the foreign subsidiary.
I	Deemed foreign income (**F** - **H** = **I**)	$55.00	The allocated expenses are then deducted from the GILTI tax base to arrive at deemed foreign income.
J	Deemed paid foreign taxes (80% x **C** = **J**)	$16.00	Foreign tax credits to offset GILTI liability are limited to 80% of foreign taxes paid (C).
K	FTC limitation (21% x **I** = **K**)	$11.55	The potential foreign tax credit is also limited by the deemed amount of U.S. tax on foreign income. This step applies the U.S. corporate tax rate (21%) to deemed foreign income.
L	FTC amount (the lesser of **J** and **K** = **L**)	$11.55	The foreign tax credit amount to offset GILTI liability is the lesser of the deemed paid foreign taxes (J) or the amount of the foreign tax credit limitation (K).
	The U.S. parent company can now apply the tax credit to its GILTI liability.		
M	Residual U.S. Tax (**G** - **L** = **M**)	$8.40	This is the additional tax the U.S. parent company pays on top of the foreign taxes already paid by the subsidiary.
N	Total Global Tax on Foreign Income [(**C** + **M**)/ **B**] = **N**	14.2%	The overall tax rate including both U.S. and foreign taxes on the subsidiary's income.

Source: Author's calculations based on a similar example provided in Michael J Caballero and Isaac Wood, "Restoring a 'Not GILTI' Verdict for High-Taxed Income," Tax Notes, Oct. 8, 2018.