

US Final and proposed GILTI regulations deliver few benefits and more than a few surprises

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United States (US) final regulations ([TD 9902](#)) and proposed regulations ([REG-127732-19](#)) released 20 July 2020, address the application of the high-tax exclusions from global intangible low-taxed income (GILTI) under Internal Revenue Code Section 951A(c)(2)(A)(i)(II) (the GILTI high-tax exclusion) and from subpart F income under Section 954(b)(4) (the proposed subpart F high-tax exception), respectively.

The elective GILTI high-tax exclusion allows taxpayers to exclude from their GILTI inclusion items of a controlled foreign corporation's (CFC) gross tested income subject to a high effective rate of foreign tax. The final regulations adopt the threshold rate of foreign tax of 18.9% (i.e., 90% of the highest domestic corporate tax rate under current law) to determine whether an item is subject to "high tax."

This exclusion applies at the level of each "tested unit" of a CFC, which will lower the amount of gross tested income excluded from a taxpayer's GILTI inclusion. The proposed subpart F income high-tax exception would conform that exception to the final GILTI high-tax exclusion. When finalized, a single election would be available to apply both the GILTI high-tax exclusion and the subpart F income high-tax exception.

A more detailed Tax Alert is forthcoming. In this Alert, EY shares its first impressions of the final and proposed regulations.

Final GILTI high-tax exclusion

The final GILTI high-tax exclusion generally has grown even less flexible, and more complex, than as proposed. Treasury retained the high threshold rate of foreign tax (under current law, 18.9%) and the election is “all or nothing” as it applies to all items of income of all CFCs in which a taxpayer holds (or is deemed to hold) a majority equity interest. Further, the final regulations require an even more precise association of foreign taxes and items of income. In particular, the final regulations apply the exclusion separately to each of a CFC’s “tested units” – with the effect that it is even less likely that many taxpayers will benefit from the final regulations. Among the few taxpayer-favorable modifications, however, a taxpayer may elect to apply the exclusion (or not) (i) annually and (ii) retroactively, to CFC tax years beginning after 31 December 2017.

Proposed Subpart F income high-tax exception

Under the current subpart F income high-tax exception, the effective foreign tax rate is determined separately for separate items of subpart F income determined at the CFC level (e.g., foreign base company sales income and foreign base company services income). Further, the current exception gives taxpayers considerable flexibility: The election is available annually as to each “item” of income and is decoupled from the GILTI high-tax exclusion.

The proposed regulations would generally conform the subpart F income high-tax exception to the GILTI high-tax exclusion, also reducing its application. The proposed

subpart F income exception, in other words, would apply separately to each tested unit of a CFC, rather than to separate items of subpart F income determined at the CFC level. The proposed regulations would combine, into a single “unitary” election, the subpart F income exception and the GILTI high-tax exclusion. That is, a taxpayer would be required to apply both of those regimes, or neither.

The proposed regulations would apply to CFC tax years beginning after the date on which final regulations are published.

Implications

Many taxpayers will be disappointed with the final GILTI high-tax exclusion, as the final rule is generally more burdensome, and even less advantageous, than the proposed version. Favorable to taxpayers, in contrast, is the ability to elect to apply the exclusion annually and retroactively. Many aspects of the proposed regulations modifying the subpart F income high-tax exception were foreseeable (e.g., “tested unit” conformity). Nonetheless, most taxpayers will be surprised that the proposed regulations jettison so many other features of the current regulations – leaving aside the combination of the subpart F income high-tax exception and GILTI high-tax exclusion into a single unitary election. Taxpayers – in particular those that have applied the current high-tax exception in recent years – should soon evaluate whether the exception is likely to be available, and advantageous, under the proposed regulations.

Endnotes

1. All “Section” references are to the Internal Revenue Code of 1986, and the regulations promulgated thereunder.

For additional information with respect to this Alert, please contact the following:

Ernst & Young LLP (United States), International Tax and Transaction Services

- ▶ Craig Hillier, *Boston* craig.hillier@ey.com
- ▶ Jose Murillo, *Washington, DC* jose.murillo@ey.com
- ▶ Allen Stenger, *Washington, DC* allen.stenger@ey.com
- ▶ Raymond Stahl, *Washington, DC* raymond.stahl@ey.com
- ▶ Carlos Vaca Valverde, *Washington, DC* carlos.j.vaca.valverde@ey.com

International Tax and Transaction Services

Global ITTS Leader, **Jeffrey Michalak**, *Detroit*

ITTS Director, Americas, **Craig Hillier**, *Boston*

ITTS Markets Leader, Americas, **Laynie Pavio**, *San Jose, CA*

ITTS NTD Leader, **Jose Murillo**, *Washington, DC*

ITTS Regional Contacts, Ernst & Young LLP (US)

West
Sadler Nelson, *San Jose*

East
Colleen O'Neill, *New York*

Central
Aaron Topol, *Atlanta*

Financial Services
Chris J Housman, *New York*

Canada - Ernst & Young LLP (Canada)
Warren Pashkowich, *Calgary*

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