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Client Alert Commentary

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Treasury Department, IRS Issue Final GILTI High-Tax Exception Regulations (*Client Alert* With Illustrative Diagrams)

The final regulations addressing the GILTI high-tax exception retain the general approach of the proposed regulations with some simplifying changes.

Key Points:

- Taxpayers can elect on an annual basis whether to exclude income subject to high foreign taxes from the computation of GILTI minimum tax on foreign earnings.
- Taxpayers can make this election retroactively for tax years beginning on or after January 1, 2018.
- The election, if made, applies to all of the taxpayers' controlled foreign corporate subsidiaries.
- A complex process of matching items of income to foreign taxes paid hinders the ability to exclude low-taxed income by blending items of income subject to different foreign tax rates.
- Proposed regulations under the decades-old Subpart F rules would jettison Subpart F's historically more flexible high-tax exception and adopt the approach taken under the new GILTI rules.

On July 20, 2020, the US Treasury Department and the Internal Revenue Service (together, Treasury) issued final regulations on global intangible low-taxed income (the Final GILTI Regulations) concerning the application of the minimum tax imposed on foreign earnings of US-based multinational corporations, thus addressing important remaining questions about a fundamental feature of the Tax Cuts and Jobs Act of 2017 (the TCJA). Despite some concessions to the requests of the business community, the Final GILTI Regulations remain largely consistent with the proposed regulations and retain key features limiting the flexibility that multinationals might otherwise have used.

See the Appendix at pages 9-14 for a series of diagrams illustrating key aspects of the Final GILTI Regulations.

Executive Summary

The TCJA enacted provisions requiring that a 10% US shareholder of a controlled foreign corporation (CFC) include in income its share of the CFC's global intangible low-taxed income (GILTI). These provisions effectively impose a minimum tax on all foreign earnings in excess of a certain return on foreign tangible assets. There is an exception (the GILTI High-Tax Exception), however, for certain

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income of a CFC that is subject to foreign taxes in excess of a specified threshold (generally, 90% of the US corporate tax rate of 21%).

Under the Final GILTI Regulations, taxpayers (i) elect annually whether to apply the GILTI High-Tax Exception and (ii) may make the election retroactively to tax years beginning on or after January 1, 2018. If made, the election applies to all CFCs controlled by the taxpayer (the Consistency Requirement). In short, the election applies generally to a global multinational group, rather than on a CFC-by-CFC basis.

The Final GILTI Regulations set the high-tax threshold at 90% of the highest marginal US corporate income tax rate (18.9% based on the current 21% corporate tax rate). Some commenters had suggested that a threshold rate of between 13% and 14% better aligns with certain stated policy aspects of the GILTI regime and its application in the context of the foreign tax credit, but Treasury rejected such an approach.[1] Due to concerns that taxpayers could blend items of a CFC's income subject to different foreign tax rates and thus inappropriately exclude low-taxed foreign income from GILTI, the Final GILTI Regulations introduce complex rules for matching items of income with foreign taxes paid by separating CFCs, their branches, and hybrid entities into individually tested units (the Unit-by-Unit Approach).

As a reminder to taxpayers and commenters to be careful what you wish for, Treasury also issued proposed regulations under Subpart F (the Proposed Subpart F Regulations), an anti-deferral regime that has been in place since the 1960s and is discussed in more detail below. Subpart F has its own long-standing high-tax exception (the Subpart F High-Tax Exception). Several commenters suggested that the GILTI High-Tax Exception rules follow the relatively flexible rules in place under the Subpart F High-Tax Exception. Treasury agreed that the rules for the two exceptions should be aligned, but in fact took the *opposite* approach by proposing that the Subpart F High-Tax Exception be patterned after the more restrictive and rigid GILTI rules.

Background

Prior to the TCJA, US-based multinationals were subject to an international regime that generally allowed deferral of most foreign earnings until repatriated but taxed certain passive and highly mobile foreign earnings on a current basis under the Subpart F rules. The TCJA fundamentally changed this framework by expanding the types of foreign earnings subject to current taxation while generally allowing for the tax-free repatriation of non-previously taxed foreign earnings. The TCJA implemented these changes principally by (i) generally leaving in place the current taxation of passive and highly mobile income under the Subpart F rules, (ii) imposing a minimum tax on non-Subpart F income under the GILTI rules intended to address base erosion by reducing the benefits of shifting earnings to low-tax jurisdictions and (iii) providing for a participation exemption for foreign-source dividends received from foreign corporate subsidiaries for non-previously taxed earnings (*i.e.*, residual earnings after application of Subpart F and GILTI).

The Subpart F High-Tax Exception has been embedded in the law for decades and exempts from current US taxation foreign earnings that are subject to tax at a rate greater than 90% of the highest marginal US corporate income tax rate (currently 18.9% given the 21% corporate tax rate). The statutory language enacted in the TCJA created the GILTI High-Tax Exception. Some commentators interpreted that statutory language to apply only to what would otherwise be Subpart F income excepted under the Subpart F High-Tax Exception and not to non-Subpart F income (*i.e.*, active business earnings). For example, the GILTI High-Tax Exception clearly applied to high-taxed sales income that would otherwise be foreign base company income but eligible for the Subpart F High-Tax Exception, whereas it was questionable whether the GILTI High-Tax Exception applied to manufacturing income that was not of a character that would be Subpart F income.

Treasury issued proposed regulations (the Proposed GILTI Regulations) on the GILTI High-Tax Exception in June 2019. Treasury adopted a taxpayer-favorable interpretation of the statute that made the GILTI High-Tax Exception elective and applicable to income that would not otherwise be Subpart F income, a reading that Treasury later acknowledged raised questions about the scope of its rulemaking authority.[2] The Proposed GILTI Regulations would have required that the applicable foreign tax rate be determined on a qualified business unit (QBU) basis and that the election be subject to a consistency requirement. The Proposed GILTI Regulations also required that the election, once made, could not be revoked for five years, and once revoked, could not be made again for another five years (the Five-Year Rule). In addition, the GILTI High-Tax Exception could not be applied retroactively under the Proposed GILTI Regulations.

The Proposed GILTI Regulations, like much of the TCJA, proved controversial. Some commenters viewed their approach as being too taxpayer-favorable.[3] Others viewed the rules — particularly the QBU-based foreign tax to income matching methodology, the Five-Year Rule, and the proposed consistency requirement — as creating unnecessary complexity, unwarranted restrictions on US-based multinationals, and a significant compliance burden. Also, because the rules currently applicable to the Subpart F High-Tax Exception are in many ways more flexible than those under the Proposed GILTI Regulations (in part because the Subpart F High-Tax Exception is available on an elective item-by-item basis with respect to each CFC), there was concern that taxpayers could restructure some GILTI income into Subpart F income in order to avail themselves of the Subpart F High-Tax Exception.

The Final GILTI Regulations

In General

The Final GILTI Regulations retain the basic framework of the Proposed GILTI Regulations with certain modifications. Under the Final GILTI Regulations, application of the GILTI High-Tax Exception remains elective and encompasses both income of a character that would otherwise be Subpart F income and income of a character that would be non-Subpart F income. The Final GILTI Regulations retain the 18.9% threshold for high-taxed income, a modified version of the foreign tax to income matching methodology, and the Consistency Requirement (that the election if made applies generally to the worldwide controlled group of a US-based multinational corporation). Notably, the Final GILTI Regulations abandon the Five-Year Rule and permit annual elections into or out of the GILTI High-Tax Exception. In addition, the Final GILTI Regulations allow for retroactive application of the GILTI High-Tax Exception to tax years beginning on or after January 1, 2018, which is the general effective date of much of the TCJA.

Mechanics of the GILTI High-Tax Exception

Unit-by-Unit Approach

In determining the applicability of the GILTI High-Tax Exception, there must first be a determination of whether income qualifies as “high-tax” income and thus is excludable from GILTI. Under the Final GILTI Regulations, high-tax income is determined on a “tested unit” basis that groups income items, deductions, and foreign taxes among tested units of a CFC. The Unit-by-Unit Approach differs from the QBU-based approach outlined in the Proposed GILTI Regulations by identifying separable foreign tax resident entities as opposed to trades or businesses with separate books and records. The Unit-by-Unit Approach, which is a new concept in the US international tax system, provides rules for taxpayers to use in identifying items of gross income, allocable deductions, and foreign income taxes of each tested unit through references to available books and records and the aggregation of certain tested units by tax residency.

- **Tested Units:**
  - The Final GILTI Regulations provide for three general categories of tested units intended to identify entities or business activities that are subject to foreign income tax different than those of a CFC. Once a tested unit is identified, items of gross income, deduction, and foreign taxes attributable to the tested unit are evaluated separately. Whether income meets the high-tax threshold is determined for each tested unit based only on the tested unit's items and its allocated and apportioned foreign taxes.
    - *CFC.* A CFC is itself a tested unit under the Unit-by-Unit Approach. If a CFC has no other tested units described below, all items of income, deduction, and foreign taxes are allocable to that CFC in determining the applicability of the GILTI High-Tax Exception.
    - *Interests in a Pass-Through Entity*. A tested unit includes an interest in a pass-through entity held by a CFC if the pass-through entity is either (i) a tax resident of a foreign country or (ii) fiscally opaque under the tax laws of the jurisdiction in which the owner of the pass-through entity is a tax resident. For purposes of identifying a tested unit, the Final GILTI Regulations primarily focus on whether an entity that is fiscally transparent for US federal income tax purposes is treated as a separate entity for foreign tax purposes. In addition, interests in such pass-through entities, not the entity itself, are treated as a tested unit to account for entities with multiple owners and different characterizations based on applicable foreign tax law or type of equity interest.
    - *Taxable Branch.* A tested unit includes a branch, or a portion of a branch, the activities of which are directly or indirectly carried on by a CFC, provided that the branch (or portion of such branch) either (i) gives rise to a taxable presence in the country in which the branch is located or (ii) gives rise to a taxable presence under the branch owner's tax law and such law provides an exclusion, exemption, or other similar relief (such as preferential tax rates) applicable to income attributable to the branch.
  - See Figure 1 in the Appendix for an illustration of identifying tested units in a multinational group and the application of the Combination Rule and the De Minimis Rule (each discussed below).

- **Combination Rule:**
  - The Final GILTI Regulations provide that tested units of a single CFC (including the CFC tested unit) will be treated as a single tested unit for purposes of the Unit-by-Unit Approach if the tested units are either tax residents of, or in the case of a branch with a taxable physical presence, located in, the same foreign country (the Combination Rule). If the Combination Rule applies, items of income and deduction and allocable foreign taxes are aggregated for purposes of determining if an item of income is subject to tax in excess of the high-tax threshold. See Figure 1 in the Appendix for an illustration of the Combination Rule.

- **De Minimis Rule:**
  - The Proposed Subpart F Regulations would also aggregate tested units, subject to certain anti-abuse provisions and regardless of tax residency, the gross income of which is less than the lesser of (i) 1% of gross income of the CFC or (ii) $250,000[4] (the De Minimis Rule).

- **Books and Records:**
  - Consistent with the Proposed GILTI Regulations, the Final GILTI Regulations provide that items of gross income will be attributable to a tested unit to the extent such items are reflected on the separate books and records of the tested unit (as adjusted for any items that would be taken into account for US federal income tax purposes).[5]

- The Proposed Subpart F Regulations, however, adopt a narrower documentation standard, attributing items of gross income and requiring the allocation of deductions to a tested unit to the extent they are reflected on its "applicable financial statements."

Consistency Requirement: All-or-Nothing Election Applies to Entire Worldwide Group

The Final GILTI Regulations require that either all or none of the members of a "CFC group" elect to apply the GILTI High-Tax Exception. A CFC group consists of CFCs that are directly, indirectly, or constructively connected through stock ownership of more than 50% (by vote or value) with a common parent.

The election must be made by a CFC's "controlling domestic shareholders," which are generally the 10% US shareholders (including domestic partnerships) that, in the aggregate, own more than 50% of the total combined voting power of all classes of stock of the CFC and that undertake to act on its behalf. If the 10% US shareholders do not, in the aggregate, own 50% of the total combined voting power of all classes of stock of the CFC, then the CFC's controlling domestic shareholders are all of the CFC's 10% US shareholders. Controlling domestic shareholders must notify other 10% US shareholders of elections and revocations thereof. And the election may be made or revoked on an amended income tax return for a tax year only if all 10% US shareholders file amended income tax returns for such year (and for any other tax year in which their tax liabilities would be increased by such election or revocation).

The Proposed Subpart F Regulations also provide for a unitary election for both the GILTI High-Tax Exception and the Subpart F High-Tax Exception. Taxpayers would thus be required to elect to apply both regimes or neither, each subject to the Consistency Requirement.

Calculations

Determining whether CFC tested income is eligible for the high-tax exception requires multiple steps with respect to allocating income, deductions, and foreign taxes among applicable tested units. If the GILTI High-Tax Exception applies, items of gross income that are determined to be subject to an effective foreign tax rate above the 18.9% threshold are excluded from GILTI tested income.

See Figure 2 in the Appendix for applicable quantitative steps required for determining eligibility for the GILTI High-Tax Exception.

In addition, due to the Unit-by-Unit Approach adopted by the Final GILTI Regulations, adjustments to allocable items of income and foreign taxes are required to take into account transactions that are disregarded for US federal income tax purposes. These adjustments can sometimes lead to surprising results at the CFC level.

See Figure 3 in the Appendix for an illustrative example of the effect of disregarded payments on GILTI High-Tax Exception eligibility.

Annual Election: Final GILTI Regulations Drop Five-Year Rule

Subject to the Consistency Requirement, the Final GILTI Regulations permit an annual election of the GILTI High-Tax Exception and abandon the five-year lock on elections and revocations.

Retroactive Application

The Final GILTI Regulations permit application of the GILTI High-Tax Exception to tax years beginning on or after January 1, 2018. The election must be made on an amended return within 24 months of the unextended due date of the original tax return of the controlling domestic shareholder for which the

election is made. See Figure 4 in the Appendix for a timeline illustrating the retroactive application of the Final GILTI Regulations.

Observations

General

While the Final GILTI Regulations provide welcome certainty for taxpayers regarding the application of an important aspect of the TCJA, election mechanics and the interaction with other parts of the international tax system add further complexity. Many decisions that could be made intuitively by a tax director pre-TCJA now require significant multi-factor US and foreign tax modeling and quantitative analysis.

- The threshold effective foreign tax rate for applying the GILTI High-Tax Exception is directly affected by the applicable statutory US federal corporate rate. For example, if proposals to raise the US federal corporate tax rate to 28%[6] are enacted, this would further limit the GILTI High-Tax Exception by increasing the high-tax income threshold to 25.2%.
- The Unit-by-Unit Approach is the touchstone of the Final GILTI Regulations and the starting point for taxpayers to analyze whether they are eligible to elect the GILTI High-Tax Exception. The Final GILTI Regulations are likely to cause multinationals, financial institutions, and investment funds to reexamine their international organizational structures and internal accounting systems to account for the new tested unit concept.
- Like nearly all aspects of the TCJA's international tax provisions, the GILTI High-Tax Exception has increased the need for financial and tax sensitivity modeling. Complex determinations such as the allocation of deductions, the impact of disregarded transactions on effective foreign tax rates, and the effect on foregoing foreign tax credits in the case of an election (taking into account the fact that GILTI basket foreign tax credits are limited to 80% and not carried forward), for instance, will require detailed quantitative analysis in most cases.
- The Proposed Subpart F Regulations would replace the current flexibility of the Subpart F High-Tax Exception with the more narrow and rigid GILTI High-Tax Exception mechanics. This would require some taxpayers to restructure current internal systems that analyze and apply the Subpart F High-Tax Exception in its current form.
- If the GILTI High-Tax Exception applies, foreign taxes allocable to exempt GILTI tested income are not eligible to be claimed as a foreign tax credit. The reduction in available foreign tax credits may affect a taxpayer's profile under the base erosion and anti-abuse tax (BEAT) regime. Because foreign tax credits are not allowed under the BEAT, decreasing the regular tax liability by excluding GILTI income rather than by using foreign tax credits against it may in some cases allow taxpayers to minimize the BEAT and thereby reduce their overall US federal income tax burden. Determining how the GILTI High-Tax Exception affects the BEAT will require sophisticated financial modeling.

Implications for US-based multinationals

- As of 2019, member states of the Organisation for Economic Co-operation and Development have an average statutory corporate tax rate of 23.59%.[7] US-based multinationals today likely stand to benefit from the GILTI High-Tax Exception and the retroactive applicability of the Final GILTI Regulations, though, as noted above, the eligibility of the GILTI High-Tax Exception is highly fact-specific and requires quantitative analysis.
- US-based multinationals must weigh the benefit of the GILTI High-Tax Exception against the loss of foreign tax credits, particularly if there is both high- and low-taxed income in the corporate group. Because excess foreign tax credits allocable to the GILTI limitation basket are not eligible to be

carried back or forward to other taxable years, the loss of foreign tax credits may not have a material impact on a US-based multinational's foreign tax credit profile in some cases.

- The allocation of deductions to income items attributable to tested units for purposes of the GILTI High-Tax Exception calculation may create incentives to affirmatively structure deductions to be allocable to foreign source income in order to increase effective foreign tax rates for GILTI gross income items. This incentive is contrary to well-worn foreign tax credit planning given that deductions allocable to foreign source income generally have the effect of reducing the foreign tax credit limitation for foreign tax credit purposes. At the same time, the potential availability of the GILTI High-Tax Exception on an annual basis adds another dimension to local foreign tax planning, including timing of foreign tax deductions, income inclusions, and attribute utilization.
- A multinational that could effectively utilize the GILTI High-Tax Exception together with the foreign participation exemption may be able to permanently shield a larger portion of its foreign earnings from US tax, rather than merely achieving a deferral of US tax as was the case under the pre-TCJA rules.
- The impact of the Consistency Requirement and the GILTI High-Tax Exception's unitary election with the Subpart F High-Tax Exception requires careful review of a multinational corporate group's entire foreign tax profile. Quantitative analysis applying the GILTI and Subpart F High-Tax Exceptions will likely affect US-based multinationals' decisions on debt placement, intercompany transactions, and organizational structure.

Implications for multinational financial groups

- US-parented multinational financial groups may significantly benefit from the availability of the GILTI High-Tax Exception due to the fact that they are often subject to high rates of tax in jurisdictions where they operate. In particular, such taxpayers are now able to apply the GILTI High-Tax Exception to income that is not treated as Subpart F income due to the active financing exception, without being subject to the statutory interpretation uncertainty under the TCJA.
- US-parented multinational financial groups also stand to be most affected by the complexity of the rules that require matching of the foreign taxes to the tested units. The reason is that such groups are frequently required to operate through branches due to foreign country regulatory regimes or due to passporting rules. Disregarded payments between such branches are commonplace and numerous, which significantly complicate the application of the Unit-by-Unit Approach.
- The interaction between the foreign tax credit rules applicable to GILTI and the foreign branch income categories, including interest expense apportionment, and the GILTI High-Tax Exception will likely require annual multi-factor financial modeling to determine whether a US-parented multinational financial group would benefit from making an election to apply the GILTI High-Tax Exception in any particular year.

Implications for private equity funds

- Private equity sponsors of CFCs should consider including GILTI High-Tax Exception provisions in shareholders agreements. 10% US shareholders (including domestic partnerships) owning more than 50% of the total combined voting power of all classes of stock of a CFC decide whether to elect application of the GILTI High-Tax Exception each year and will bind all other 10% US shareholders to that election. The election may be made or revoked for prior taxable years on an amended income tax return only if all 10% US shareholders file amended income tax returns. Shareholders agreements are likely to be an important aspect in determining decision rights regarding the GILTI High-Tax Exception election. In particular, if a CFC does not have a single controlling domestic shareholder, a shareholders agreement should be considered to specifically address election rights and mechanics. Even if there is a single controlling domestic shareholder, a shareholders agreement could address hold-outs and require non-controlling domestic shareholders to file amended returns if the controlling

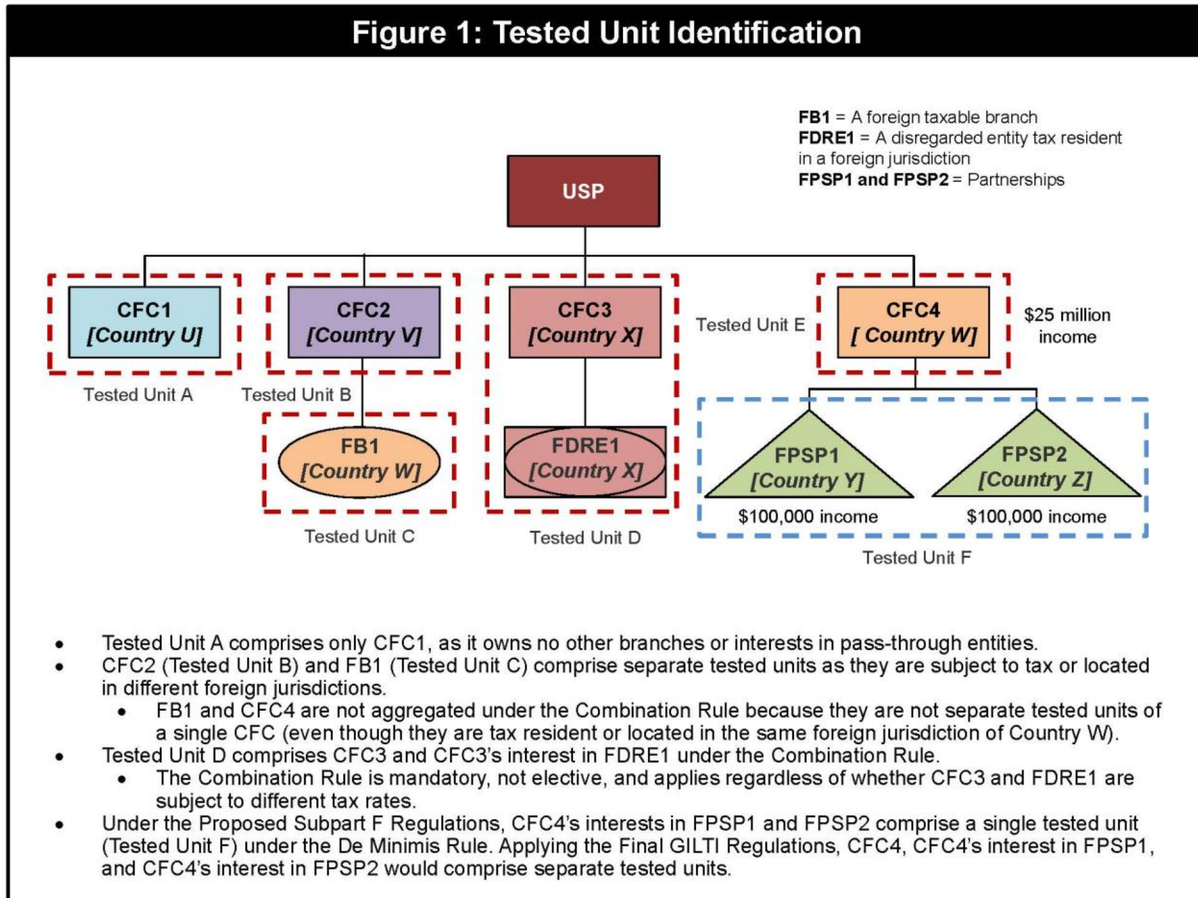
domestic shareholder chooses to make or revoke the election by an amended return. See Figure 5 in the Appendix.

- Treasury previously promulgated final regulations under GILTI that generally treat a domestic partnership as an aggregate of its partners for purposes of determining GILTI inclusions. The Final GILTI Regulations provide that a domestic partnership can be a controlling domestic shareholder of a CFC regardless of whether any of its partners are 10% US shareholders of the CFC under this aggregate approach. This creates the potential for the domestic partnership to control the GILTI High-Tax Exception even though neither it nor any of its partners would be subject to GILTI inclusions under the aggregate approach. See Figure 6 in the Appendix. Treasury is still considering the treatment of domestic partnerships as controlling domestic shareholders.
- Proposed regulations that would treat a domestic partnership as an aggregate of its partners for purposes of determining Subpart F inclusions generally permit domestic partnerships to apply this proposed Subpart F aggregate approach for taxable years beginning on or after January 1, 2018 so long as the electing taxpayer treats all "related" domestic partnerships consistently. However, because these proposed regulations expressly do not affect the treatment of a domestic partnership as a 10% US shareholder for purposes of determining CFC status, electing to treat a domestic partnership as an aggregate under these proposed regulations should not affect the applicability of the Consistency Requirement and other aspects of the Final GILTI Regulations.

Conclusion

Taxpayers are likely to benefit from the certainty provided in the Final GILTI Regulations, particularly given the prior lack of clarity as to the scope of the GILTI High-Tax Exception, the appropriate allocation of foreign tax to income methodology, and election mechanics and applicability periods. The Final GILTI Regulations, however, add new complexities, and US-based multinationals, financial institutions, and investment funds will likely have to conduct detailed quantitative modeling along yet another dimension to determine eligibility for, and the benefits and drawbacks of, electing the GILTI High-Tax Exception.

APPENDIX: Tested Units, Eligibility for the GILTI High-Tax Exception, and Applicability Timeline



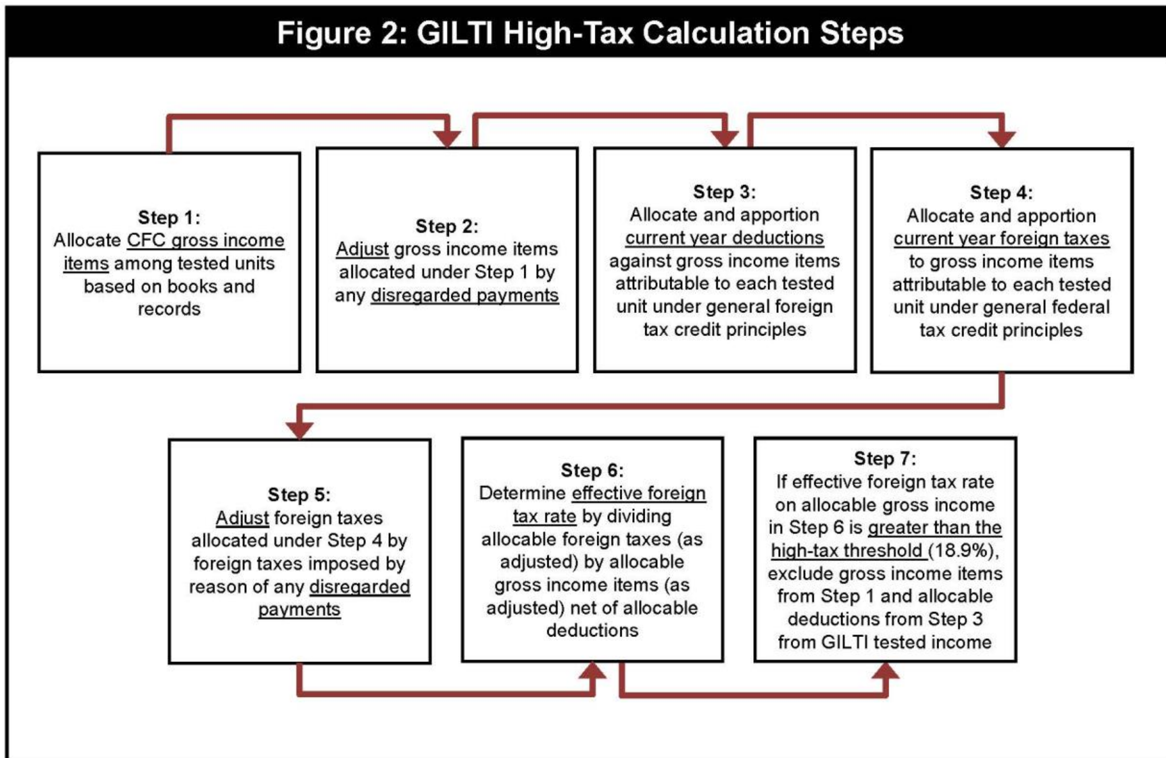
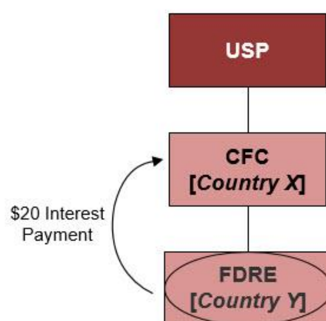


Figure 2: GILTI High-Tax Calculation Steps
Step 1:
Allocate CFC gross income items among tested units based on books and records
Step 2:
Adjust gross income items allocated under Step 1 by any disregarded payments
Step 3:
Allocate and apportion current year deductions against gross income items attributable to each tested unit under general foreign tax credit principles
Step 4:
Allocate and apportion current year foreign taxes to gross income items attributable to each tested unit under general federal tax credit principles
Step 5:
Adjust foreign taxes allocated under Step 4 by foreign taxes imposed by reason of any disregarded payments
Step 6:
Determine effective foreign tax rate by dividing allocable foreign taxes (as adjusted) by allocable gross income items (as adjusted) net of allocable deductions
Step 7:
If effective foreign tax rate on allocable gross income in Step 6 is greater than the high-tax threshold (18.9%), exclude gross income items from Step 1 and allocable deductions from Step 3 from GILTI tested income

Figure 3: GILTI High-Tax Calculation Example – Disregarded Payment



- CFC generates $100 of gross income from services to unrelated parties and is reflected on FDRE's books and records. CFC generates no other income.
- FDRE accrues and pays $20 of interest expense to CFC.
- The $20 interest payment is deductible for Country Y purposes, but disregarded for US federal income tax purposes.
- Country X imposes no tax on net income.
- Country Y imposes a 25% tax on net income.
- FDRE has a foreign tax expense of $20 on $80 of net income.
- Each of CFC and FDRE comprise a separate tested unit.

- **Gross Income Allocation**
  - CFC is allocated $20 of gross income ($0 of attributable income items plus $20 of disregarded interest).
  - FDRE is allocated $80 of gross income ($100 of attributable income minus the $20 of reallocated disregarded interest).
- **Foreign Tax Allocation**
  - FDRE is allocated $20 of foreign tax expenses.
  - CFC is not allocated any foreign tax expense, as no foreign taxes are imposed by reason of the disregarded interest payment.
- **Effective Foreign Tax Rate**
  - FDRE has an effective foreign tax rate of 25% ($20 of Country Y tax divided by $80 of gross income).
  - CFC has an effective foreign tax rate of 0% ($0 of Country X tax divided by $20 of gross income).
- **GILTI High-Tax Exception Application**
  - $80 of CFC's tested income qualifies for the GILTI High-Tax Exception and will be excluded if election is made.
  - $20 of CFC's tested income does not qualify for the GILTI High-Tax Exception and must be included in CFC's GILTI tested income.

Figure 4: Timeline of GILTI and Subpart F High-Tax Exceptions

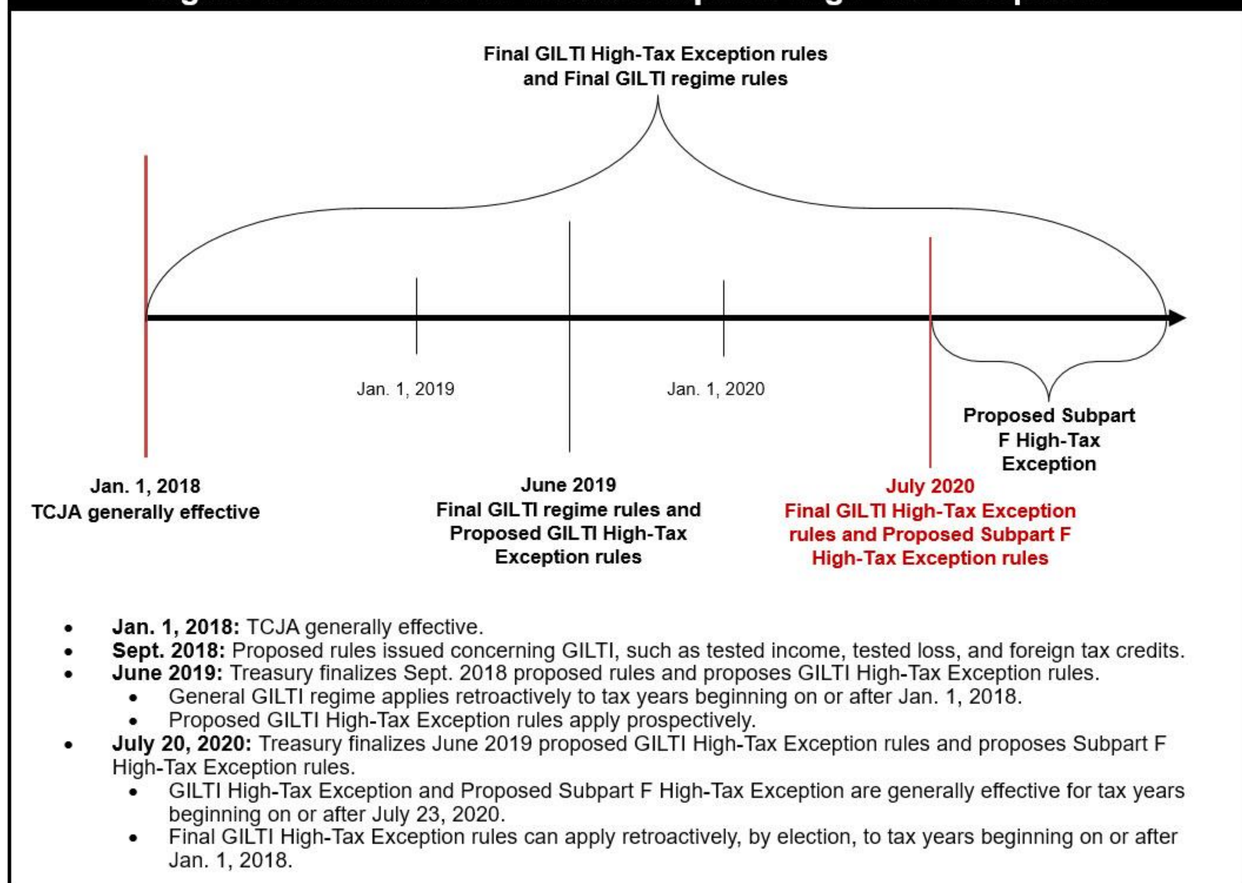
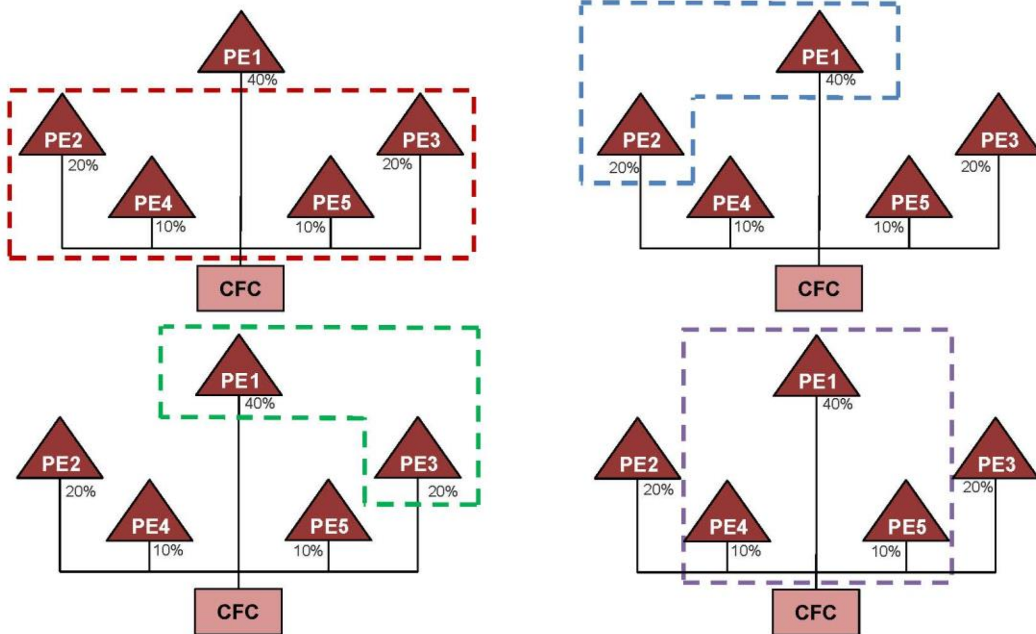
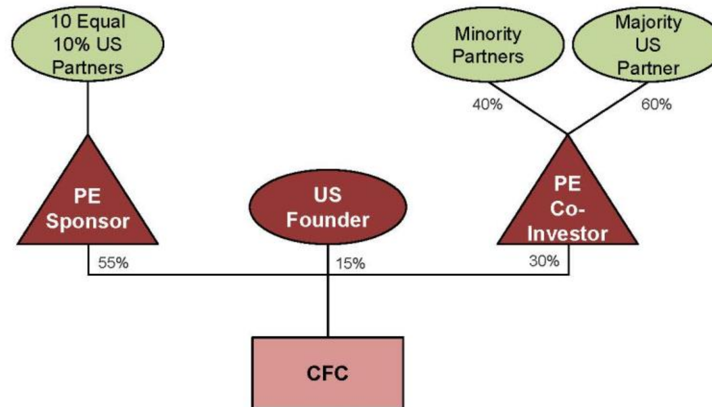


Figure 5: Controlling Domestic Shareholders



- Consider a CFC owned by five domestic private equity funds.
- Each of the groupings shown above could be the controlling domestic shareholders of CFC and elect to apply the GILTI High-Tax Exception, which would be binding on all 10% US shareholders of CFC.
- Shareholders agreements will be important to govern decision rights with respect to these annual elections.

Figure 6: Partnerships as Controlling Domestic Shareholders of CFC



- PE Sponsor is CFC's sole controlling domestic shareholder and can therefore annually unilaterally decide whether to apply the GILTI High-Tax Exception. This election is binding on all 10% US shareholders of CFC.
- As none of PE Sponsor's partners are 10% US shareholders of CFC, none of them will be subject to tax on CFC's GILTI and the GILTI High-Tax Exception is therefore largely irrelevant to PE Sponsor and its partners.
- US Founder and the Majority US Partner of PE Co-Investor are both 10% US shareholders of CFC and therefore are affected by PE Sponsor's decisions regarding application of the GILTI High-Tax Exception to CFC.

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Endnotes

[1] The GILTI regime is commonly cited as applying to foreign earnings that are taxed at less than a 13.125% rate. While inclusions by a corporate US shareholder from a CFC under GILTI, or Section 951A of the Internal Revenue Code of 1986, as amended

(the Code), are generally taxed at regular corporate tax rates of 21%, corporate US shareholders are subject to an effective rate of 10.5% on GILTI inclusions as a 50% deduction under Section 250 of the Code for all GILTI inclusions is generally available for taxable years beginning on or before December 31, 2025 (reduced to 37.5% for taxable years beginning after December 31, 2025). However, Section 960(d) of the Code limits a corporate US shareholder's foreign tax credit against GILTI inclusions to 80% of the foreign taxes paid by a CFC allocable to the GILTI limitation category. Assuming no foreign tax credit limitation, GILTI is thus often cited as imposing US federal income tax based on foreign earnings subject to a foreign tax rate of 13.125% or below for US corporate taxpayers.

[2] 85 Fed. Reg. 44620, 44631 (July 23, 2020) ("The Treasury Department and the IRS are aware that questions have been raised regarding the statutory authority for the GILTI high-tax exclusion.").

[3] *See, e.g.*, Stephen E. Shay, *A GILTI High-Tax Exclusion Election Would Erode the U.S. Tax Base*, 165 Tax Notes Fed. 1129 (2019).

[4] All values are in US$.

[5] Books and records are determined by reference to the "qualified business unit" rules under Treasury Regulations Section 1.989-1(d).

[6] Richard Rubin, Joe Biden Proposes $1 Trillion in New Corporate Taxes, The Wall Street Journal (Dec. 4, 2019).

[7] Tax Foundation, *Corporate Tax Rates around the World, 2019* (Dec. 10, 2019).