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GILTI: Proposed Changes in the Taxation of Global Intangible Low-Taxed Income

The treatment of income earned abroad in U.S.-controlled foreign corporations (CFCs) has been extensively debated over the years. In the 2017 Tax Cuts and Jobs Act (P.L. 115-97), the tax treatment of foreign-source income was altered. The prior system imposed taxes on CFCs' income only when they paid dividends to their U.S. owners. The system taxed in full income earned in branches and certain types of easily shifted income of CFCs, referred to as Subpart F income. CFCs are foreign incorporated firms at least 50% owned by U.S. shareholders who hold at least 10% of the share by value or vote.

Current Treatment

The Tax Cuts and Jobs Act eliminated the tax on dividends and instead imposed a lower tax on CFCs aimed at intangible income, the tax on global intangible low-taxed income, or GILTI. GILTI targeted intangible income due to concerns about profit shifting (i.e., moving income to low-tax countries), because intellectual property is more easily moved than tangible property.

In calculating income for GILTI, CFCs are allowed two deductions. One is a deemed deduction of 10% of tangible assets (buildings and equipment, called qualified business asset investment, or QBAI). The deduction is intended to offset the normal return from tangible investments, such as factories, leaving GILTI to largely reflect the return from intangible assets, such as drug formulas, computer programs, technology, and brand names. The other is a deduction of 50% on the remaining amount, so that, with the corporate tax rate of 21%, the effective tax rate is 10.5% (21% times 50%). This deduction is scheduled to fall to 37.5% after 2025, leading to an effective tax rate of 11.8125% (21% times 56.25%).

Taxpayers can credit foreign taxes paid, limited to the amount of U.S. tax due. The limit is on an overall basis so that foreign taxes in excess of the U.S. tax in a high-tax country can be used to offset U.S. tax due in a low-tax country. For GILTI, 80% of foreign taxes can be credited to offset GILTI tax. Unused foreign tax credits can be carried back 1 year and carried forward 10 years.

Changes in the Reconciliation Bill

The Build Back Better Act, H.R. 5376 (released November 3, 2021) considered under reconciliation, would have made several changes affecting GILTI. It would have reduced the deduction for tangible investment to 5% and the GILTI deduction to 28.5%. With the new corporate tax rate, that would have led to an effective tax rate of 15.051% (71.5% times 21%). It would have applied the foreign tax credit on a country-by-country (or per-country) basis and would have allowed unused excess credits to be carried forward for 5 years through 2030, and for 10 years after that (with no carryback). This version of H.R. 5376 was not adopted and the final legislation did not include the changes in GILTI or the increase in the corporate tax rate.

Example of Tax Computation

Table 1 provides an example of the calculation of the initial GILTI tax before foreign tax credits for current law and under H.R. 5376. **Table 2** provides the calculation of the foreign tax credit and final tax liability.

Table 1. Calculation of GILTI Before Foreign Tax Credits, Assuming QBAI of $200 million
(dollars in millions)

	Current Law	H.R. 5376
Income	$100	$100
QBAI Deduction	$20	$10
Income after QBAI Deduction	$80	$90
GILTI Deduction	$40	$33.75
Income After GILTI Deduction	$40	$56.25
Tax on GILTI	$8.4	$14.91

Source: CRS calculation.

Notes: QBAI deduction is 10% under current law and 5% under H.R. 5376. The GILTI deduction is 50% under current law and 37.5% under H.R. 5376. The corporate tax rate is 21% under current law and 26.5% under H.R. 5376.

As can be seen in **Table 1**, all three revisions in H.R. 5376 relating to GILTI tax before foreign tax credits increase the GILTI tax. The smaller tangible deduction in H.R. 5376 leaves a larger amount of GILTI. The smaller GILTI deduction in H.R. 5376 leaves a larger amount of income subject to the statutory rate, and the higher statutory rate increases the tax.

Calculation of final tax liability taking into account the foreign tax credit, as illustrated in **Table 2**, assumes a U.S. parent has identical operations in a high-tax and a low-tax country. The calculation requires several steps. First, only a proportional share of foreign taxes is eligible, as no foreign tax credits are allowed for the excluded income under the QBAI deduction. Out of the remainder, the percentage allowed (80% under current law and 95% under H.R. 5376) is calculated. The table also illustrates the effects of eliminating the per-country limit.

Table 2. Foreign Tax Credits and U.S. Final Tax Assuming Identical Operations in a High-Tax and Low-Tax Country

(dollars in millions)

	Current Law		H.R. 5376	
	High Tax	Low Tax	High Tax	Low Tax
Foreign Taxes	$20	$5	$20	$5
Foreign Taxes, Net of QBAI	$16	$4	$18	$4.5
Share of Taxes for GILTI Credited	$12.8	$3.2	$17.1	$4.275
U.S. Tax (from **Table 1**)	$8.4	$8.4	$14.91	$14.91
Residual U.S. Tax	$0	$5.2	$0	$10.635
Excess Foreign Tax Credit	$4.4	$0	$2.19	$0
Final Tax	$0.8		$10.635	
Excess Foreign Tax Credits Carried Forward	—		$2.19	

Source: CRS Calculations and **Table 1**.

Notes: The share of taxes associated with GILTI that can be credited is 80% for current law and 95% for H.R. 5376. The U.S. parent has a firm in each country with $100 million of income and $200 million of QBAI.

As shown in **Table 2**, the creditable foreign taxes are reduced by the share of income associated with the tangible (QBAI) deduction, and then further reduced by the limits on the amount of foreign taxes associated with GILTI. The available foreign tax credits are higher for H.R. 5376 because the tangible deduction is lower and percentage of foreign taxes associated with GILTI that can be credited is higher. For current law, there is a residual tax in the low-tax country that is offset by the unused credit in the high-tax country leaving a net liability of $0.8 million ($5.2 million minus $4.4 million) and no unused excess credits (which could not have been carried forward in any case). For the proposal in H.R. 5376, there is a larger tax in the low-tax country and no offset from excess credits in the high-tax country. The firm has an excess credit that can be carried forward for five years but only to offset tax in the high-tax country (which it might not ever be able to use).

Other Provisions in the Reconciliation Bill Affecting GILTI

Under current law, a share of U.S. interest and head office expenses (which are deducted against all income) is allocated to foreign-source income for the foreign tax credit limit. H.R. 5376 would have limited interest deducted to the share of interest that is 110% of the share of worldwide income. Consistent with that change, U.S. interest would no longer be allocated to foreign-source income. The bill also provided that no head office expenses would be allocated.

Currently, losses in one country can be used to offset income in another country. H.R. 5376 would have provided a per-country treatment for losses, and only allowed losses to offset income in another operation in the same country. GILTI losses cannot be carried forward; the proposal would have allowed a one-year carryforward.

Current law limits the deduction for GILTI and another provision providing benefits for foreign-derived tangible income, or FDII (i.e., a deduction aimed at providing lower taxes on export income reflecting intangible income by U.S. firms), to taxable income, with no carryover for excess deductions. Under the proposed revision, these excess deductions could have been carried forward indefinitely.

Under current law, oil and gas extraction income is excluded from GILTI. The proposal included extraction income, including production from tar sands and oil shale. (A special rule prevents foreign credits on oil and gas income to offset other income; that rule would have remained unchanged.)

The revisions in 2017 provided “downward attribution” rules in which ownership by U.S. interests in a foreign subsidiary for purposes of determining CFC status could be attributed through a foreign parent of a U.S. subsidiary. The scope of this provision would have been reduced by applying only to firms that are 50% owned by the foreign parent rather than 10%.

The proposal would have moved certain income items called foreign base company sales and services from Subpart F to GILTI. As noted earlier, Subpart F applies full taxation (with foreign tax credits) to certain easily shifted income. Foreign base company income is income where neither the customers nor the producers are located in the country. Income that involves transactions with related U.S. firms would be retained in Subpart F, whereas transactions with foreign-related firms would be in GILTI. Although tax rates are higher in Subpart F, GILTI would have been more restrictive because of the limits on losses and foreign tax credits, and the revision was expected to raise revenue.

For a discussion of the overall international tax regime, see CRS Report R45186, *Issues in International Corporate Taxation: The 2017 Revision (P.L. 115-97)*, by Jane G. Gravelle and Donald J. Marples.

Jane G. Gravelle, Senior Specialist in Economic Policy

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