September 9, 2019

The Honorable Richard Neal (D-MA)
Chairman
Ways and Means Committee
United States House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

The Honorable Kevin Brady (R-TX)
Ranking Minority Member
Ways and Means Committee
United States House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

The Honorable Chuck Grassley (R-IA)
Chairman
Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Ron Wyden (D-OR)
Ranking Member
Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, D.C. 20510

Re: Request for Guidance under Internal Revenue Code § 951A

Dear Chairman Grassley, Chairman Neal, Ranking Member Wyden, and Ranking Member Brady:

As part of the Tax Cuts and Jobs Act (TCJA), Congress created a new regime to tax income of a controlled foreign corporation (CFC) owned by one or more U.S. Shareholders (a U.S. person who owns 10% or more of the vote or value of a CFC). The “global intangible low-taxed income” (GILTI) provisions of section 951A of the Internal Revenue Code require a U.S. Shareholder of a CFC to pay a minimum tax on its CFC's earnings.

Treasury published proposed regulations on September 13, 2018, and final and proposed regulations on June 14, 2019. We are writing to raise two issues that were not corrected in the regulations published on June 14, 2019.

Foreign Subsidiary in a Loss Position or Expansion of Foreign Operations

Under both the proposed and final regulations, a U.S. Shareholder of a CFC is required to calculate income or losses for each of its CFCs (also known as tested income and tested loss). In the case of an overall loss at the CFC level, the U.S. Shareholder does not have a GILTI liability. However, the regulations do not provide for a carryforward of the loss. If the U.S. Shareholder has overall tested income at the CFC level in a future year, it cannot offset the income with previous tested losses, which can result in unfair taxation of start-up or expanding businesses. It can also hurt companies that are at the natural bottom of a business cycle.

The following example illustrates how the inability to carry forward tested losses can hurt such companies. X is a U.S. corporation. X owns all of the stock of FSub, a CFC. In year one, FSub has an economic loss of $100. In year two, FSub has economic income of $100. Under the proposed regulations, X does not have GILTI in year one, but will pay GILTI on $100 in year two, because X cannot offset the $100 of income in year two with the $100 of losses in year one. FSub does not have any net economic income over the two year period, and in many foreign countries, FSub can offset the income in year two with a net operating loss carryforward from year one. However, even in the absence of economic income over the two year period, X will be taxed on the full amount of income in year two.

Many stakeholders filed comments during the notice and comment period and recommended that Treasury revise the proposed regulations to permit a carryforward of tested losses to ensure that growing companies (and those branching out into new businesses or at a natural low in a business cycle) are not penalized. For example, the New York State Bar Association (NYSBA) stated that it "strongly believes that net operating losses should be allowed as a carryforward either at the CFC or shareholder levels."[1] Application of the loss carryforward at the U.S. shareholder level (with rules similar to the existing rules for domestic loss carryforwards) would be easiest, but either approach would prevent the unfair taxation of noneconomic profits.

In the preamble to the final regulations, Treasury noted that it does not believe it has authority to address the issue. We disagree and urge the Ways and Means Committee to direct Treasury to issue guidance providing for a carryforward of tested losses. One option to address the issue is to provide for an election to carry forward losses. Treasury exercised similar authority in Proposed Treasury Regulation § 1.951A–2(c)(6) in providing for an expanded high tax exception to GILTI. We also agree with the NYSBA that Treasury and the IRS could address this issue through guidance.[2]

US Parent In A Start-Up, Expansion Or Loss Position

A similar problem exists with GILTI inclusions in tax years where the U.S. Shareholder of the CFC uses net operating losses (NOLs) or current year losses to offset the GILTI inclusion. The GILTI provisions operate to ensure that U.S. Shareholders pay at least some minimum level of tax on income generated by CFCs. They accomplish this by providing a deduction and a foreign tax credit offset, which together can have the effect of exempting income that is subject to a foreign tax rate of 13.125% or higher (the GILTI rate) from any additional GILTI tax, setting aside such complications as expense apportionment.

However, the provisions do not operate correctly where a U.S. Shareholder has NOLs or current year losses that reduce the GILTI income before calculation of the GILTI deduction. Instead, the rules have the effect of eliminating the GILTI deduction for loss-making U.S. Shareholders that have a profitable foreign business. The result is especially punitive where the U.S. Shareholder uses such losses to offset GILTI income that is taxed at a rate as high or higher than the U.S. statutory corporate tax rate, because the foreign tax credits associated with this GILTI income do not carry forward and expire immediately if the credits cannot be used in the year of the GILTI inclusion (a harsh result that would be avoided by allowing unused foreign tax credits to carry forward).

[1] NYSBA Tax Section Report on Proposed GILTI Regulations (November 26, 2018), at 4 and 27-29.
[2] NYSBA Tax Section Report on the GILTI Provisions of the Code (May 4, 2018), at 34-44.

One solution to this issue is to offer a high tax exception from GILTI similar to the high tax exception for subpart F. The proposed GILTI regulations published on June 14, 2019 do provide for a high tax GILTI election where tested income is subject to a tax rate equal to 90% or more of 21%, the U.S. statutory corporate tax rate. However, because the proposed regulations measure the exception based on the U.S. statutory corporate tax rate instead of the GILTI rate, they do not effectively solve the punitive effect described above. Therefore, we urge the Ways and Means Committee to direct Treasury to modify the proposed regulations as follows. The high tax exception should exclude from the U.S. Shareholder's income GILTI tested income that has been subject to foreign tax at a rate equal to 90% or more of the GILTI rate (currently 13.125%). This modification is consistent with the policy behind the GILTI regulations as expressed in the TCJA Conference Report, which is that "the minimum foreign tax rate, with respect to GILTI, at which no U.S. residual tax is owed by a domestic corporation is 13.125 percent."

Thank you for your attention to this important issue to the digital economy.

Sincerely,

Michael Beckerman
President & CEO
Internet Association