July 1, 2019

Treasury and IRS Release Regulations on the GILTI High Tax Exclusion

The Regulations Limit the GILTI High Tax Exclusion for Current and Prior Taxable Years, but Propose a Future Election to Exclude High-Taxed Foreign Income of Commonly Owned CFCs on a QBU-by-QBU Basis

SUMMARY

On June 14, the Internal Revenue Service (the "IRS") and the Treasury Department issued final and proposed regulations (the "Final Regulations" and the "New Proposed Regulations," respectively) addressing the exclusion of income subject to high foreign taxes from the "global intangible low taxed income" ("GILTI") tax introduced by the 2017 tax reform legislation (the "Act").

The Final Regulations adopt without change prior guidance that excluded high-taxed income from GILTI only if the income is excluded from subpart F income solely by reason of an election to apply the subpart F high tax exception. The New Proposed Regulations, however, would allow taxpayers to elect under the subpart F high tax exception to exclude from GILTI all income effectively taxed above 18.9% outside the United States (the "Proposed High Tax Election"). Significantly, the Proposed High Tax Election would calculate foreign tax rates separately with respect to each qualified business unit ("QBU") of a controlled foreign corporation ("CFC"), largely preventing taxpayers from "blending" high- and low-taxed income. In addition, taxpayers would be required to make or revoke Proposed High Tax Elections simultaneously with respect to all CFCs controlled in the same percentages by the same U.S. shareholders, with a five-year period required between making and revoking an election. The Proposed High Tax Election would not be available to taxpayers until the New Proposed Regulations are finalized.

The Final and New Proposed Regulations form part of a broader regulatory package that was issued by the Treasury Department and the IRS on June 14 and published in the Federal Register on June 18 and

June 21, which includes both temporary regulations on the new Section 245A "participation exemption" and additional guidance on GILTI.[1] We have prepared several publications addressing key features of the guidance.[2] This memorandum is limited to our observations on the new guidance for the treatment of high-taxed income under the GILTI rules.

BACKGROUND

A. GENERAL BACKGROUND ON GILTI

Under the GILTI statute as enacted by the Act, a 10% United States shareholder (a "U.S. shareholder")[3] of one or more CFCs is effectively taxed on the shareholder's pro rata share of CFC earnings in excess of a 10% "normal" return on the depreciable tangible assets of the CFCs (the "net deemed tangible income return"), calculated by reference to the shareholder's allocable share of the CFCs' adjusted tax basis of such assets. The U.S. shareholder's pro rata share of CFC earnings is determined by netting the shareholder's pro rata share of "tested income" and "tested loss" across CFCs. For these purposes, a pro rata share is determined under the same rules that apply to so-called "subpart F income."[4]

Tested income and tested loss are computed at the CFC level by including all of a CFC's gross income, less deductions (including taxes) properly allocable to such gross income and taking into account certain exceptions.[5] Under the GILTI statute, tested income and tested loss exclude, among other items of income, any income that is subpart F income or that is not subpart F income "by reason of" an election to apply the so-called "subpart F high tax exception" (the latter, the "GILTI high tax exclusion").[6] Under the subpart F high tax exception, a taxpayer may elect to exclude income from subpart F income if such income is subject

1 *See* 84 Fed. Reg. 28,398 (June 18, 2019) (245A guidance) and 84 Fed. Reg. 29,288 (June 21, 2019) (GILTI guidance).

2 *See* S&C publication of June 24, 2019, *Treasury and IRS Release Final and Proposed Regulations on the GILTI and Subpart F Treatment of Domestic Partnerships*; and S&C publication of June 28, 2019, *Treasury and IRS Release Temporary Regulations Limiting Section 245A Dividends Received Deduction*.

3 In general, a 10% U.S. Shareholder is a United States individual or entity that owns at least 10% (by vote or value) of a foreign corporation, after taking into account both indirect ownership and the "constructive" ownership rules of Section 958(b) of the Code. *See* Section 951(b).

4 *See* Section 951A. "Subpart F income" refers to income taxed under subpart F of subtitle A, chapter 1, subchapter N, part III of the Code. The subpart F provisions prevent deferral of U.S. tax on certain foreign income by taxing U.S. shareholders of CFCs currently on their pro rata share of such income. Generally, income taxed under subpart F consists of movable income, such as investment income in the form of dividends, interest, rent, and royalties and income from the sale of personal property to a related person. More specifically, the Code defines subpart F income as insurance income, foreign base company income, international boycott income, illegal bribes, and income derived from certain listed countries. *See* Sections 951 and 952.

5 *See* Section 951A(c)(2).

6 Section 951A(c)(2)(A)(i)(III).

to an effective foreign income tax rate greater than 90% of the maximum U.S. tax rate (18.9% for corporations under the current 21% U.S. corporate income tax rate).[7]

A U.S. shareholder that is a corporation is allowed both a 50% deduction with respect to GILTI inclusions for taxable years beginning before 2026 and a foreign tax credit for 80% of the foreign taxes related to that income.[8] As a result, a corporate U.S. shareholder is effectively taxed on GILTI inclusions at 10.5% and, absent the expense allocation rules described below, exempt from the GILTI tax on foreign income subject to a foreign tax rate of 13.125% or higher.

B. PRIOR PROPOSED REGULATIONS AND INTERACTION WITH EXPENSE ALLOCATION

On September 13, 2018, the IRS and Treasury issued proposed regulations (the "Prior Proposed Regulations") that would "clarify" the GILTI statute to exclude high-taxed income from tested income only if such high-taxed income were excluded from subpart F income solely by reason of an election to apply the subpart F high tax exception.[9] Thus, under the Prior Proposed Regulations, a CFC's tested income would include (and therefore a U.S. shareholder would be potentially subject to U.S. tax on) high-taxed income excluded from subpart F income by reason of other exceptions, such as active financing income, and high-taxed income that would not be subpart F income regardless of the subpart F high tax exception, such as active business income.

As discussed above, in some situations, high-taxed income included in a CFC's tested income could be effectively exempt from the GILTI tax as a result of the U.S. shareholder utilizing foreign tax credits against the tax on GILTI. However, layering on the expense allocation rules can significantly change the 13.125% GILTI threshold. The IRS and Treasury recently issued proposed regulations requiring that shareholder-level expenses, such as interest, be allocated to reduce GILTI "basket" income for purposes of computing a U.S. shareholder's foreign tax credit limitation with respect to such income (the "Proposed Foreign Tax Credit Regulations").[10] Since allocating deductions and expenses to a foreign tax credit basket reduces the foreign tax credits a taxpayer is allowed to use with respect to such basket, the higher the foreign taxes paid with respect to income included in GILTI, the more likely allocating deductions and expenses to that income prevents a U.S. shareholder from fully utilizing the foreign taxes paid. As a result, by reducing the amount of foreign taxes that can actually be credited, the allocation of deductions and expenses has the effect of causing foreign income subject to foreign taxes greater than 13.125% to still be taxed in the U.S. as GILTI under the Prior Proposed Regulations.

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[7] *See* Section 954(b)(4); Treas. Reg. § 1.954-1(d).

[8] Sections 250(a)(1)(B) and 960(d).

[9] Prop. Treas. Reg. § 1.951A-2(c)(1)(iii), published at 83 Fed. Reg. 51,072, 51,096 (Oct. 10, 2018).

[10] *See* S&C publication of February 11, 2019, *Proposed Foreign Tax Credit Regulations*, for a detailed description of the Proposed Foreign Tax Credit Regulations.

DISCUSSION

As discussed more fully below, the Final Regulations and the New Proposed Regulations take different approaches to the GILTI high tax exclusion. This memorandum first discusses the numerous comments received by the Treasury Department and the IRS regarding the GILTI high tax exclusion and various alternative approaches considered by the Treasury Department and the IRS. Next, this memorandum summarizes aspects of the GILTI high tax exclusion under the Final Regulations. Finally, this memorandum describes technical aspects of interest of the expanded, elective GILTI high tax exclusion proposed by the New Proposed Regulations.

A. COMMENTS

The preambles to the Final and New Proposed Regulations note that the Treasury Department and the IRS received numerous comments with respect to the GILTI high tax exclusion in response to the Prior Proposed Regulations. One comment agreed with the Prior Proposed Regulations' "clarification" of the GILTI high tax exclusion, but many other comments recommended expanding the GILTI high tax exclusion to exclude additional categories of high-taxed income.

Comments that recommended expanding the GILTI high tax exclusion pointed to the legislative history of the Act as evidence that Congress intended for both active and passive CFC income to be taxed as GILTI only if such income is taxed at a low rate outside of the U.S. Some comments stated that, contrary to the intended punitive nature of the subpart F regime, the Prior Proposed Regulations would incentivize taxpayers with high-taxed gross tested income to convert their high-taxed gross tested income into subpart F income, such as by restructuring their foreign operations to sell property from a CFC to a related person when the CFC has not substantially contributed to manufacturing the property.

Comments received by the Treasury Department and the IRS offered differing suggestions for how the GILTI high tax exclusion should be expanded, the appropriate threshold tax rate for an expanded GILTI high tax exclusion, and the regulatory authority that would allow the Treasury Department and the IRS to issue regulations providing for an expanded GILTI high tax exclusion.

1. Methods

Comments that recommended expanding the GILTI high tax exclusion generally recommended either expanding the scope of the GILTI high tax exclusion itself or expanding the scope of subpart F income such that the GILTI high tax exclusion would effectively be available for more types of income.

In the former category, some comments suggested that the GILTI high tax exclusion be expanded to apply to high-taxed income that is excluded from subpart F income by statutory exceptions other than the subpart F high tax exception, such as the active financing and active rent exceptions. Other comments in this category suggested that all high-taxed income should fall within the GILTI high tax exclusion.

The second category of comments suggested expanding the types of income treated as subpart F income. Some of these comments proposed allowing taxpayers to elect to treat a GILTI inclusion as subpart F income, which could then be eligible for a subpart F high tax exception election. Other comments suggested creating a rebuttable presumption that all CFC income (or more narrowly, all high-taxed CFC income) is subpart F income, such that taxpayers could essentially elect into or out of subpart F income treatment for all of their CFC income. If a taxpayer did not rebut the presumption, all of their CFC income would be excluded from GILTI, either as subpart F income or as high-taxed income subject to a subpart F high tax exception election. The preamble to the Final Regulations notes one comment analogized such a rule to taxpayers' historical ability to choose whether to subject their CFC income to the subpart F regime by choosing how to structure their transactions and operations.

2. Threshold Tax Rate

Comments received by the Treasury Department and the IRS suggested two different methods to determine the appropriate foreign tax rate threshold to apply to an expanded GILTI high tax exclusion. Some comments recommended applying the same threshold as the subpart F high tax exception, 90% of the maximum U.S. tax rate (18.9% under current rates). Other comments called for a lower threshold of 13.125%, consistent with the 50% corporate deduction for GILTI inclusions and the 80% GILTI foreign tax credit. Those comments cited the Conference Report accompanying the Act as indicating that, in general, no residual U.S. tax should be owed on GILTI when the foreign tax rate is greater than or equal to 13.125%.

The preamble to the New Proposed Regulations states that comments also differed on the calculation basis that should be used for determining the effective foreign tax rate. Some comments recommended that an expanded GILTI high tax exclusion be applied on a CFC-by-CFC basis, which would blend operations in high-tax and low-tax jurisdictions as long as they were held by the same CFC. Others recommended an income item-by-income item basis, which would not allow any blending of different foreign tax rates.

3. Regulatory Authority

A number of comments advocating for expanding the GILTI high tax exclusion implicitly relied on the Treasury Department's general authority to write so-called "interpretive" regulations where Congress has not explicitly granted regulatory authority in a specific Code provision. In such situations, the Code grants Treasury broad authority to write "needful" regulations, including when "necessary by reason of any alteration of [tax] law."[11]

Some comments, however, focused on Section 951A(f)(1)(B) of the Code, which authorizes regulations treating GILTI inclusions in the same manner as subpart F inclusions for specific sections of the Code. These comments suggested that the Treasury Department and the IRS could exercise their authority under

[11] Section 7805(a). The preambles to the Final and New Proposed Regulations do not explicitly address Section 7805(a) regulatory authority in the context of the GILTI high tax exclusion.

Section 951A(f)(1)(B) to treat a GILTI inclusion as a subpart F inclusion, which could be eligible for a subpart F high tax exception election and would thereby be excluded from GILTI.

B. ALTERNATIVES CONSIDERED

The preamble to the New Proposed Regulations states that the Treasury Department and the IRS considered three options for the Proposed High Tax Election: (i) excluding from gross tested income only income that would be subpart F income but for the subpart F high tax exception (the approach taken by the Prior Proposed Regulations and the Final Regulations), (ii) allowing taxpayers to elect to exclude from gross tested income any high-taxed CFC income excluded from subpart F income by subpart F exceptions other than the subpart F high tax exception, and (iii) allowing taxpayers to elect to exclude from gross tested income any high-taxed CFC income (the approach taken by the New Proposed Regulations).

The preamble notes that, although the first two options are "reasonable" and "plausible" interpretations, respectively, of the statutory GILTI high tax exclusion, both of the first two options exclude some types of high-taxed income from the GILTI high tax exclusion. As a result, the first two options would both incentivize taxpayers to restructure their foreign operations in order to convert what would be high-taxed gross tested income into subpart F income eligible for those interpretations of the GILTI high tax exclusion. The preamble worries that any such restructuring could be "unduly costly and only available to certain taxpayers," and that the focus on tax considerations instead of business considerations when determining business structures could increase compliance costs and inefficient investment.

On the other hand, the third option, taken by the New Proposed Regulations, would reduce the incentive for taxpayers to restructure their operations for tax purposes because all high-taxed income would be eligible for an election to be excluded from GILTI under the subpart F high tax exception. There would be no need to restructure high-taxed gross tested income to qualify for subpart F treatment. The preamble notes this third approach could increase foreign investment by U.S.-parented firms by lowering the cost of capital and could change the incentives for the location of tangible assets.[12]

C. THE FINAL REGULATIONS

The Final Regulations adopt without change the Prior Proposed Regulations' "clarification" that tested income excludes high-taxed income only if such high-taxed income is excluded from subpart F income solely by reason of an election to apply the subpart F high tax exception.[13]

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12 The preamble to the New Proposed Regulations does not discuss what considerations led the Treasury Department and the IRS to provide for an elective, rather than mandatory, expansion of the GILTI high tax exclusion in the New Proposed Regulations.

13 Treas. Reg. § 1.951A-2(c)(1)(iii).

The Final Regulations apply to taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.[14]

The preamble discusses commentators' different recommendations for an expanded GILTI high tax exclusion and declines to adopt any in the Final Regulations. Instead, the preamble states that the Treasury Department and the IRS continue to believe the Prior Proposed Regulations reflect a "reasonable interpretation" of the GILTI high tax exclusion and subpart F high tax exception statutes.

The preamble explicitly rejects two suggestions made by the comments. First, the preamble declines to exercise Section 951A(f)(1)(B) authority for providing relief for high-taxed income from U.S. taxation because the subpart F high tax exception applies to items of income, while Section 951A(f)(1)(B) authority relates to GILTI inclusion amounts, not items of income. Second, the preamble rejects the idea of allowing taxpayers to elect subpart F income treatment for CFC income that would otherwise not be treated as subpart F income. The preamble states that there is no statutory or legislative history support for permitting taxpayers to treat income not described in the subpart F rules as subpart F income and worries that a rebuttable presumption could give rise to significant administrability concerns.

Nevertheless, the preamble states that the Treasury Department and the IRS are studying whether taxpayers should be permitted to make a subpart F high tax exception election for additional types of income. The preamble notes that the existing subpart F high tax exception election regulations do not provide the necessary framework for expanding the GILTI high tax exclusion and points to the New Proposed Regulations for a potential framework.

D. THE NEW PROPOSED REGULATIONS

1. The Proposed High Tax Election

Unlike the Prior Proposed Regulations and the Final Regulations, the New Proposed Regulations would exercise the Treasury Department's general regulatory authority to expand the GILTI high tax exclusion to high-taxed income for which the subpart F exception is one of the reasons, but not the sole reason, for excluding such income from subpart F income. The preamble to the New Proposed Regulations agrees with several comments that the legislative history of the GILTI statute "evidences an intent to exclude high-taxed income from gross tested income." As support, the preamble points to the Senate Explanation for the Act, which stated that "income subject to high levels of foreign tax" falls within "[i]items of income excluded from GILTI because they are exempt from U.S. tax under the bill" and "generally not the type of income that is the source of base erosion concerns."

[14] Treas. Reg. § 1.951A-7.

The preamble explains that the subpart F high tax exception, by its statutory text, applies to "any item of income received by a [CFC]." Thus, as long as the subpart F high tax exception is one of the reasons for exclusion from subpart F treatment, any high-taxed income could be excluded from subpart F income "by reason of" the subpart F high tax exception, as required by the statutory text of the GILTI high tax exclusion.[15] Adopting this reading, the New Proposed Regulations would allow U.S. shareholders of CFCs to elect under the subpart F high tax exception to exclude all high-taxed CFC income from tested income, whether or not the high-taxed income would otherwise be subpart F income.[16] Consistent with the subpart F high tax exception, the Proposed High Tax Election would apply to CFC income effectively taxed outside the United States at greater than 90% of the maximum U.S. tax rate (18.9% for corporations under the current 21% U.S. corporate income tax rate).[17]

Income excluded from gross tested income under the Proposed High Tax Election would not otherwise contribute to a taxpayer's GILTI inclusion. Any property used to produce the excluded income would not be treated as property used in the production of gross tested income, and any basis in such property would not be taken into account when calculating a U.S. shareholder's net deemed tangible income return.[18] Thus, if a CFC had a sufficiently high adjusted basis in property used to produce high-taxed income, a U.S. shareholder that made a Proposed High Tax Election could wind up with a higher GILTI inclusion than if the shareholder had not made the election. In addition, under the Proposed Foreign Tax Credit Regulations, a U.S. shareholder would not receive a deemed paid credit for any foreign income taxes allocated and apportioned to income excluded from GILTI by a Proposed High Tax Election.[19]

2. QBU Grouping and Disregarded Payments

The Proposed High Tax Election would aggregate CFC income by a CFC's QBUs, where a QBU would generally be any separate and clearly identified unit of a taxpayer's trade or business that maintains separate books and records.[20] The gross tested income of each QBU with an effective foreign tax rate higher than the threshold rate would be excluded from the CFC's tested income.[21] To arrive at a QBU's

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15 The preamble notes that, before the Act, the subpart F high tax exception would have had no effect with respect to items of income that were excluded from subpart F income for other reasons.

16 Prop. Treas. Reg. § 1.951A-2(c)(6).

17 Prop. Treas. Reg. § 1.951A-2(c)(6)(i)(B).

18 Treas. Reg. § 1.951A-3(b) and (c)(1).

19 Prop. Treas. Reg. § 1.960-1(e).

20 The New Proposed Regulations would apply to QBUs as such term is defined by the foreign currency rules. *See* Prop. Treas. Reg. § 1.951A-2(c)(6)(ii)(A)(1). A QBU can be a disregarded entity for U.S. federal income tax purposes. Thus, as the preamble notes, a CFC with a disregarded entity subsidiary that qualifies as a QBU can have multiple items of income for purposes of applying a Proposed High Tax Election, one with respect to the QBU subsidiary and another with respect to the CFC itself.

21 Prop. Treas. Reg. § 1.951A-2(c)(1)(iii) and (c)(6).

effective foreign tax rate, the Proposed High Tax Election would require each QBU to separately take into account income, deductions and CFC taxes allocated to it.[22] Notably, each QBU's income and deductions would be adjusted to regard certain otherwise disregarded payments in the same manner as disregarded payments are regarded for foreign branches under the Proposed Foreign Tax Credit Regulations.[23] Regarding these otherwise disregarded transactions would generally lead to increasing a U.S. shareholder's GILTI inclusion, decreasing the amount of gross tested income excluded by the Proposed High Tax Exception and decreasing the proportion of creditable foreign taxes in respect of the increased GILTI inclusion. For example, consider a CFC in a high-tax jurisdiction that makes a payment to its disregarded entity subsidiary, which is in a low-tax jurisdiction and qualifies as a separate QBU. Regarding the payment would decrease the amount of income eligible for the Proposed High Tax Election (by decreasing the tested income of the high-taxed CFC QBU) and increase the GILTI inclusion of the CFC's U.S. shareholders (by increasing the tested income of the low-taxed subsidiary QBU). Because the excluded income is subject to a higher rate of tax and therefore more tax is attributable to the excluded high-taxed QBU's income, the amount of creditable foreign taxes available for use in respect of the amounts included in GILTI is disproportionately decreased.

The preamble explains that the Treasury Department and the IRS also considered applying the Proposed High Tax Election on an income item-by-income item basis and on a CFC-by-CFC basis. The Treasury Department and the IRS rejected an income item-by-income item basis calculation as too complex and difficult to administer. The preamble states that while a CFC-by-CFC basis calculation would minimize complexity and would be relatively easy to administer, a CFC-by-CFC basis calculation would permit "inappropriate" tax motivated planning to blend high- and low-taxed income, with the economically inefficient result that low-taxed base erosion-type income could escape the GILTI tax.

By aggregating income on a QBU-by-QBU basis, the New Proposed Regulations would effectively prevent most blending of high- and low-taxed income. The preamble acknowledges that a QBU-by-QBU basis calculation could be more complex and administratively burdensome than a CFC-by-CFC basis calculation. However, the preamble states that compared to a CFC-by-CFC basis calculation, a QBU-by-QBU basis calculation (coupled with regarding disregarded payments) would "more accurately pinpoint[] income subject to a high rate of foreign tax" and thus would better ensure that the GILTI tax applied to the low-taxed base erosion-type income Congress intended to tax as GILTI.

Practically, the QBU-by-QBU basis calculation used in the New Proposed Regulations would require significant time and effort to implement for taxpayers with complex corporate structures. Taxpayers would be required to analyze each of their QBUs and each disregarded payment made by or to each of their

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22 Prop. Treas. Reg. § 1.951A-2(c)(6).

23 Prop. Treas. Reg. § 1.951A-2(c)(6)(ii)(A)(2).

QBUs. Significantly, because the GILTI rules (and the single GILTI foreign tax credit basket) otherwise allow a blending of high- and low-taxed GILTI income outside of the Proposed High Tax Election, a taxpayer considering a Proposed High Tax Election would need to carefully account for every payment made to and from its QBUs in order to determine whether its overall U.S. tax liability would be decreased by making such an election.

The New Proposed Regulations do not include rules targeting many situations where a QBU's books and records do not match the foreign income tax base, such as partnerships, hybrid entities, and combined foreign income tax groups. The preamble requests comments, for purposes of the GILTI high tax exclusion, on whether additional rules should be implemented to more accurately capture the income base upon which foreign tax is imposed, whether CFCs should be allowed to aggregate some QBUs, and whether the definition of QBU should be modified for purposes of the GILTI high tax exclusion.

3. Making and Revoking the Proposed High Tax Election

The Proposed High Tax Election would be made by U.S. shareholders of a CFC who, in the aggregate, own more than 50% by vote of the CFC (the CFC's "controlling domestic shareholders").[24] For this purpose, the Proposed High Tax Election would take into account direct and indirect ownership, but not constructive ownership resulting from so-called "downward attribution."[25] If a CFC's U.S. shareholders do not, in the aggregate, directly or indirectly own more than 50% by vote of the CFC, all of the CFC's direct and indirect U.S. shareholders would be treated as the CFC's controlling domestic shareholders.[26] For example, if one U.S. shareholder directly owns 20% by vote of a CFC while a non-U.S. joint venture partner (with its own separate U.S. subsidiary) owns the remaining 80% by vote, the 20% U.S. shareholder would be treated as the controlling domestic shareholder of the CFC.

The New Proposed Regulations would allow a CFC's controlling domestic shareholders to make or revoke a Proposed High Tax Election for a CFC's taxable year either by attaching statements to filed or amended income tax returns for the shareholders' taxable years in which or with which the CFC's taxable year ends, or in accordance with rules provided in forms or instructions.[27] A Proposed High Tax Election would be

24 Prop. Treas. Reg. § 1.951A-2(c)(6)(v)(A) (referencing Treas. Reg. § 1.964-1(c)(5)). The New Proposed Regulations would apply the same definition for controlling domestic shareholders that is used for purposes of determining a CFC's earnings and profits.

25 Only ownership under Section 958(a), and not constructive ownership under Section 958(b), would be taken into account. *See id.* After the enactment of the Act, corporations, partnerships, and trusts and estates are treated as constructively owning stock owned directly or indirectly by their foreign owners ("downward attribution") for purposes of determining CFC status. However, downward attribution does not apply for purposes of determining whether a U.S. shareholder has a subpart F or GILTI inclusion. As a result, a foreign corporation can be treated as a CFC, yet have no controlling domestic shareholders or even no U.S. shareholders that are required to make inclusions.

26 *See* Treas. Reg. § 1.964-1(c)(5).

27 Prop. Treas. Reg. § 1.951A-2(c)(6)(v)(A) and (D)(1).

effective for the CFC's taxable year of election and all subsequent CFC inclusion years until the election was revoked.[28] A Proposed High Tax Election would be binding on all U.S. shareholders of the CFC for which the election was made.[29] Thus, it would appear that a single U.S. shareholder owning more than 50% by vote of a CFC would be able to make a binding Proposed High Tax Election for all of the CFC's U.S. shareholders (including unrelated joint venturers). It would also appear that, where no single U.S. shareholder owns more than 50% of the CFC's voting power, U.S. shareholders owning less than 50% by vote of a CFC would need to agree to make a Proposed High Tax Election together, unless forms or instructions were to allow a single U.S. shareholder owning less than 50% by vote of a CFC to make a binding Proposed High Tax Election for all of the CFC's U.S. shareholders.

Once a Proposed High Tax Election had been revoked with respect to a CFC, a new Proposed High Tax Election could not be made with respect to the same CFC for five years following the end of the CFC's taxable year for which the previous election was revoked. Similarly, a Proposed High Tax Election, other than the first such election made with respect to a CFC, could not be revoked for five years following the end of the CFC's taxable year for which the election was made.[30] However, the New Proposed Regulations would allow a change of control exception to both five-year periods. Making or revoking a Proposed High Tax Election would be allowed once more than 50% by vote of the CFC was owned by persons that did not own any interests in the CFC when the prior Proposed High Tax Election was revoked or made, respectively.[31]

4. Controlling Domestic Shareholder Groups: All or Nothing

The New Proposed Regulations include special rules for any group of two or more CFCs owned more than 50% by vote and in the same percentages by the same controlling domestic shareholders or related persons (such a group of CFCs, a "controlling domestic shareholder group").[32] Under the New Proposed Regulations, a Proposed High Tax Election made or revoked with respect to any one CFC would also be treated as made or revoked with respect to all other CFCs in the same controlling domestic shareholder group, including any CFCs that joined the controlling domestic shareholder group at a later time.[33] In other words, if two or more CFCs are commonly controlled by the same U.S. shareholders, a Proposed High Tax Election could be made or revoked with respect to only either all of the CFCs or none of the CFCs. In

28 Prop. Treas. Reg. § 1.951A-2(c)(6)(v)(B).

29 *Id.*

30 Prop. Treas. Reg. § 1.951A-2(c)(6)(v)(D)(2)(i).

31 Prop. Treas. Reg. § 1.951A-2(c)(6)(v)(D)(2)(ii).

32 Prop. Treas. Reg. § 1.951A-2(c)(6)(v)(E)(2). As with determining a CFC's controlling domestic shareholders, only direct and indirect ownership would be taken into account when determining a controlling domestic shareholder group.

33 Prop. Treas. Reg. § 1.951A-2(c)(6)(v)(E)(1).

addition, the rules discussed above with respect to when Proposed High Tax Elections could be made or revoked would apply by reference to the entire controlling domestic shareholder group.[34]

For many taxpayers, the controlling domestic shareholder group rule would effectively require that any Proposed High Tax Election be simultaneously made (or revoked) for most or all of their CFCs. For example, a taxpayer that owns all of its CFCs through a single non-U.S. holding company would have one controlling domestic shareholder group including all of its CFCs, such that the taxpayer could make (or revoke) a Proposed High Tax Election for only either all of its CFCs or none at all. All CFC property used to produce high-taxed income would be excluded from the taxpayer's net deemed intangible return when calculating the taxpayer's GILTI inclusion, and the taxpayer would not receive any deemed paid credits for high foreign income taxes. Thus, the New Proposed Regulations would severely restrict the ability of taxpayers to maximize the use of foreign tax credits and QBAI by selectively including certain high-taxed GILTI to reduce the overall U.S. tax on GILTI.

In addition, as a result of the five-year-limitation rules on making and revoking Proposed High Tax Elections, taxpayers considering a Proposed High Tax Election would need to evaluate the impact of an election on multiple CFCs together for multiple years into the future. For taxpayers with large controlling domestic shareholder groups, deciding whether to make Proposed High Tax Elections would require careful modeling and tracking of numerous inputs over time to ensure elections would not be ultimately harmful to their U.S. tax liability profile.

5. Effective Date

Under the New Proposed Regulations, the Proposed High Tax Election would be available to taxable years of foreign corporations beginning on or after the date the New Proposed Regulations are finalized and to taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.[35] Taxpayers may not rely on the New Proposed Regulations for or apply the Proposed High Tax Election to current or past taxable years. In fact, the preamble to the Final Regulations explicitly prohibits taxpayers from excluding from tested income any item of income unless such income would be subpart F income but for the subpart F high tax exception until the New Proposed Regulations are effective.[36] However, in a public statement, a Treasury Department official recently indicated that it is "still on the table" for the Proposed High Tax Election to be made retroactive when finalized.[37]

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34 *Id.*

35 Prop. Treas. Reg. § 1.951A-7(b).

36 *See* 84 Fed. Reg. 29,294.

37 *See* Siri Bulusu, *GILTI Exclusion Could Still Be Made Retroactive*, 122 Bloomberg DTR 6 (June 26, 2019) (quoting Gary Scanlon, an attorney-adviser in the Treasury Department's Office of International Tax Counsel at a June 25 event as saying, "It's still on the table to go change our minds on [applying

* * *

the Proposed High Tax Election prospectively only], but we'll listen to comments and make that decision.").

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