

Key Elements of the U.S. Tax System

What is global intangible low-taxed income and how is it taxed under the TCJA?

TAXES AND MULTINATIONAL
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Q. What is global intangible low-taxed income and how is it taxed under the TCJA?

A. GILTI is the income earned by foreign affiliates of US companies from intangible assets such as patents, trademarks, and copyrights. The Tax Cuts and Jobs Act imposes a new minimum tax on GILTI.

Before the 2017 Tax Cuts and Jobs Act (TCJA), the United States generally taxed its firms and residents on their worldwide income. However, US firms could defer the tax on foreign subsidiaries' active business earnings until those earnings were repatriated to the United States as dividends. After the TCJA, the United States generally exempts earnings from active businesses of US firms' foreign subsidiaries, even if the earnings are repatriated. (The United States still taxes the income from passive investments of foreign subsidiaries.)

But Congress worried that completely exempting US multinationals' foreign earnings might exacerbate the incentive to shift profits to low-tax jurisdictions abroad. So, Congress added a new 10.5 percent minimum tax on global intangible low-taxed income (GILTI) to discourage such profit shifting. GILTI is intended to approximate the income from intangible assets (such as patents, trademarks, and copyrights) held abroad. Congress considered intangible assets highly mobile—and sought to discourage US firms from shifting these assets offshore.

More specifically, a US business must include GILTI in its gross income annually. GILTI is calculated as the total active income earned by a US firm's foreign affiliates that exceeds 10 percent of the firm's depreciable tangible property. A corporation (but not other businesses) can generally deduct 50 percent of the GILTI and claim a foreign tax credit for 80 percent of foreign taxes paid or accrued on GILTI. Thus, if the foreign tax rate is zero, the effective US tax rate on GILTI will be 10.5 percent (half of the regular 21 percent corporate rate because of the 50 percent deduction). If the foreign tax rate is 13.125 percent or higher, there will be no US tax after the 80 percent credit for foreign taxes.

For example, suppose a US corporation is the sole shareholder of a foreign corporation with a manufacturing plant in Ireland, which has a 12.5 percent tax rate. Suppose the plant cost \$100 million to construct, and the foreign income is \$30 million (after properly allocating expenses). The corporation would calculate GILTI of \$20 million (total foreign income minus 10 percent of \$100 million of depreciable assets). The US tax on GILTI would be \$2.1 million before credits for foreign taxes (half of the \$20 million of GILTI times the 21 percent corporate tax rate), and the net US tax after credits would be \$0.1 million (\$2.1 million—\$2 million credit for Irish taxes). In practice, the

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calculations are much more complicated, as US corporations may have multiple operations abroad—and how to properly allocate expenses among them is unclear.

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Further Reading

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Rosenthal, Steven M. 2017. [“Current Tax Reform Bills Could Encourage US Jobs, Factories, and Profits to Shift Overseas.”](#) *TaxVox* (blog). November 28.

Toder, Eric. 2018. [“Explaining the TCJA’s International Reforms.”](#) *TaxVox* (blog). February 2.

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