NALSAR

Global Intangible Low Taxed Income (‘GILTI’)

Key highlights

December 2023

CONTENTS

Overview of US Tax Reforms

US Tax law reforms

- **Reduction in Corporate tax rate** - The Act reduces the corporate tax rate to a flat rate of 21% with effect from 1 January 2018, doing away with the graduated corporate structure.

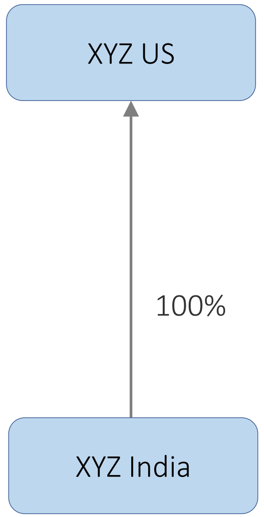
- **Elimination of Alternate Minimum Tax (AMT)** - The corporate AMT will be eliminated, with an expanded utilization (and potential refundability) of existing AMT credits for years beginning before 2021.

- **Modification of the net operating loss (NOL) deduction** - NOL carry back period is eliminated (as opposed to 2 years in the current law), and NOL carry forward period is extended indefinitely (as opposed to 20 years in the current law). However, the NOL deduction allowed would be limited to 80% of taxable income computed without regard to the NOL deduction.

- **Limitation on business interest** – The Act changes to the limitation on interest deductibility for taxpayers (barring certain small businesses), limiting the deduction to business interest income plus 30% of the taxpayer's EBITDA through 2021 and 30% of EBIT thereafter. In the case of a group of affiliated corporations that file a consolidated return, the Act clarifies that the limitation applies at the consolidated tax return filing level as opposed to an entity level.

- **Treatment of self-created property** - the gain or loss from the sale of a self-created patent, invention, model or design, or secret formula or process will not receive capital gain treatment. This provision is effective for disposition of such property after 2017.

Corporate tax rate @ 21%*
AMT @ Nil



* Section 199 manufacturing deduction is repealed (9% deduction for domestic US manufacturing income).

BEAT and GILTI

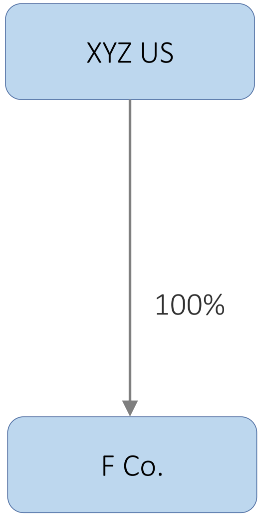
US Tax law reforms - BEAT

- **Base Erosion Anti-Abuse Tax (BEAT)** -
  - BEAT is imposed on certain corporations (“applicable taxpayer”) making payments to related foreign persons i.e., base erosion payment. The purpose of the BEAT is to identify and impose a special tax on entities that make payments to affiliates that substantially reduce U.S. taxable income
  - Such applicable taxpayer liable to Base Erosion Minimum Tax Amount (“BEMTA”) equal to the excess of **10%** of “Modified Taxable Income” (“MTI” i.e., Taxable income without the benefit of related-party tax deductions) over the Regular tax liability (“RTL”) reduced by certain credits

Financial Year	Taxpayers generally	Banks and securities dealers
2018	5%	6%
after 2018 before 2024	**10%**	11%
after 2025	12.5%	13.5%

  - Applicable taxpayer:
    - The taxpayer must be a corporation (that is not a regulated investment company, a real estate investment trust, or an S corporation) with an average annual gross receipts of at least $500 million over the three-year period ending with the preceding tax year
    - The taxpayer's "base erosion percentage" must be at least 3% (2% for certain banks and securities dealers) i.e., Ratio of deductible payments made to related parties and all deductible payments

Corporate tax rate @ 21%
AMT @ Nil



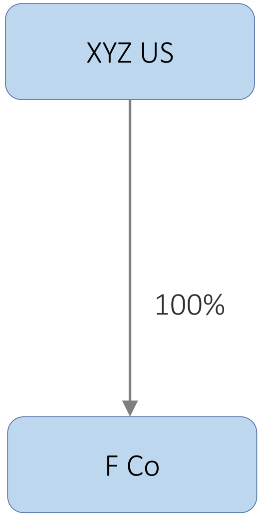
Refer Annexure 1 for Illustration on BEAT

US Tax law reforms - GILTI (Sec 951A)

- **Global Intangible Low-Taxed Income (GILTI) - Reason for Introduction**
  - Income earned by the foreign subsidiaries of U.S. corporations was subject to tax only when repatriated to the United States as dividends.
  - The Tax Cuts and Jobs Act (TCJA) changed the tax rules for multinational corporations by generally exempting the earnings of foreign subsidiaries' active businesses from U.S. corporate taxation, even if repatriated.
  - Although the TCJA lowered the top corporate income tax from a rate of 35% to a flat 21% effective in 2018, the U.S. corporate tax rate still exceeded the rate in some tax heaven countries (viz., Jersey, Guernsey, and the Isle of Man etc.)*
  - Situating ownership of a profitable patent, for example, in a foreign subsidiary in a lower-rate or no-tax jurisdiction instead of in the U.S. still could produce a substantial tax savings for MNEs.
  - Because of concerns that multinationals might seek to move profits abroad to escape the U.S. tax, the TCJA included provisions, particularly the tax on GILTI, to discourage such tax avoidance strategies.

* These countries generally impose no corporate tax at all with only a few low-rate exceptions for certain financial services, natural resource and real estate income.

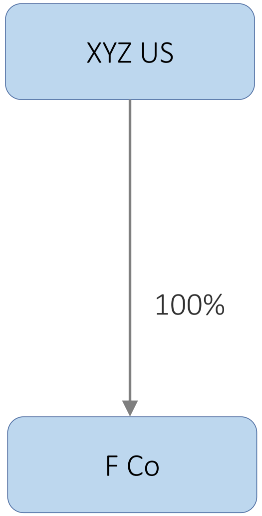
Corporate tax rate @ 21%
AMT @ Nil



US Tax law reforms - GILTI

- **Global Intangible Low-Taxed Income (GILTI) - How it works?**
  - A new basket of subpart F income that applies to all CFCs.
  - GILTI is income earned abroad by controlled CFCs (i.e., controlled subsidiaries of U.S. corporations) from easily movable intangible assets, such as IP rights.
  - CFCs are foreign corporations in which more than 50% of the vote or value is owned by U.S. shareholders who each own 10% or more of the CFC. In other words, CFC shareholders who own 10% or more of a CFC are liable for the tax on GILTI
  - GILTI = [CFC's total income - 10% of Depreciable assets of CFC* - interest expense]
  - GILTI Tax base = 50% of GILTI#; On which 21% tax rate would be applied
  - And credit for FTCs is available (at 80%).

Corporate tax rate @ 21%
AMT @ Nil



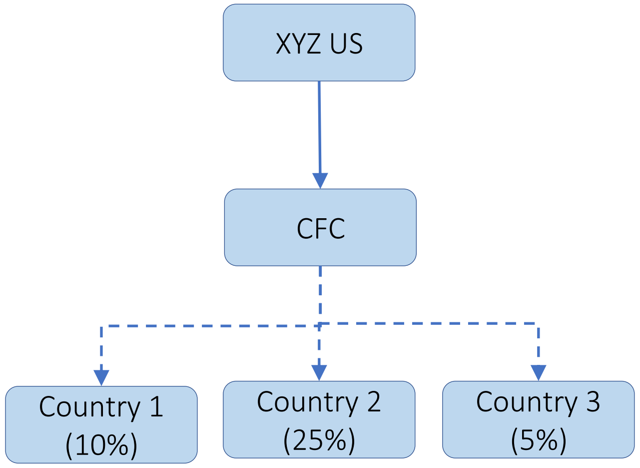
Refer Annexure 2 for Illustration on GILTI

* 10% of Depreciable assets is deemed to be tangible income return. In other words, The provision operates by attributing 90% return towards the intangible assets of the CFC and then taxing it in the hands of the US shareholder. GILTI is taxed on a shareholder-by-shareholder basis after aggregating the income of the CFCs owned by that shareholder

\# A deemed deduction of 50% is applied to GILTI limited to taxable income, from 2018 to 2025, and 37.5 percent starting in 2026.

US Tax law reforms - GILTI

- **GILTI high-tax exception rule**
  - Taxpayers to elect a "high-tax exception" that would exclude from a US shareholder's GILTI inclusion items of income of its CFCs that would otherwise be part of the GILTI inclusion.
  - The exception would apply if the items are subject to foreign income tax at an effective rate that is greater than 90% of the maximum income tax rate under Section 11 (currently 21%, so a foreign effective tax rate greater than **18.9%**).
  - This GILTI high-tax exception would apply to each item of income at the level of each qualified business unit (QBU) of a CFC (for this purpose, items of income within each Section 904(d) limitation at the QBU level would be treated as a single item of income).
  - For example, assume a CFC wholly owns three foreign disregarded entities: DRE1 is subject to a 10% local tax rate, DRE2 is subject to a 25% local tax rate, and DRE3 is subject to a 5% local tax rate. In this case, the CFC would have four QBUs, with the CFC being deemed a QBU under Section 989, and the GILTI high-tax exception would apply separately to each QBU (with only DRE2's items of income likely excluded from the relevant US shareholder's GILTI inclusion).
  - Further, any foreign income taxes paid or accrued with respect to a CFC's items of income that are excluded from a US shareholder's GILTI inclusion under the GILTI high-tax exception would not be deemed paid under Section 960(d).



Proposed Changes

Proposed changes - Build Back Better Act (BBBA)

- Changes proposed
  - The Budget would raise the corporate tax rate to 28%
  - The House bill would introduce a new 15% corporate alternative minimum tax (Corporate AMT) on the “adjusted financial statement income” of certain large corporations (very generally, and described in greater detail below, corporations reporting at least $1 billion average adjusted pre-tax net income on their consolidated financial statements), for tax years beginning after December 31, 2022. **[Refer Note 1]**
  - The House bill would reduce the amount of the section 250 deduction to 28.5% (from 50%) of GILTI which would make the effective tax rate on GILTI to 20%.[(100-28.50)*28%].
  - Create a new general business credit equal to 10% of eligible expenses incurred when onshoring a trade or business to the United States
  - Disallow deductions for expenses incurred when moving a US trade or business offshore
  - The Budget would repeal the BEAT and replace it with a UTPR that is consistent with the Pillar Two Model Rules, which include the UTPR. Refer **Annexure 3**

Notes:

1. The United States has not committed to Pillar 2.0 rules but has discussed several alternative approaches, such as aligning the U.S’s GILTI rules with Pillar 2 rules in a way that would make the resulting tax qualify as an IIR. The U.S. did institute its own 15% corporate minimum tax on companies with $1 billion or more in annual earnings through the Inflation Reduction Act. However, the tax does not comply with Pillar 2.0 rules.

Proposed changes - Build Back Better Act (BBBA)

Present:

- Under current law, a U.S. shareholder has a single GILTI inclusion computed on an aggregate basis across all of its CFCs. A US. shareholder's pro rata share of the aggregate of its CFCs' tested income is reduced by its pro rata share of the aggregate of its CFCs' tested losses to compute its net CFC tested income.
- Additionally, in determining its GILTI inclusion, the shareholder's net CFC tested income is reduced by its net deemed tangible income return. That net deemed tangible income return is 10% of a CFC's QBAI, reduced generally by the excess of certain interest expense over certain interest income taken into account in determining net CFC tested income.

Proposed:

- The proposal would require U.S. shareholders to compute GILTI inclusions and associated foreign tax credits on a country-by-country basis.
- To achieve this result, the proposal generally would determine tested income, tested loss, net deemed tangible income return, and foreign taxes for each "CFC taxable unit", and then aggregate these items for the CFC taxable units within the same country to determine separate GILTI inclusions for each country
- The proposal's country-by-country approach for determining GILTI would prevent tested losses incurred in one country from reducing tested income earned in another country.
- Consequently, taxpayers would benefit currently from a tested loss incurred within a particular country only to the extent a CFC taxable unit elsewhere in the structure has offsetting tested income earned within the same country.

Proposed changes - Pillar 2 vs GILTI vs BBBA

Table 2. Comparison of Basic Features of GLoBE and GILTI

	GLoBE	GILTI (Current Law)	GILTI as Proposed in the BBBA
Tax Rate	15.0%	10.5% (13.125% after 2025) with some tax applying to income earned in countries with tax rates of 13.125% or less (16.4% after 2025) if the foreign tax credit limit applies	15.015% with some tax applying to income earned in countries with tax rates of 15.8% or less if the foreign tax credit limit applies
How Tax is Applied	Per Country	Overall	Per Country
Tax Base	Financial Income	Taxable Income	Taxable Income
Substance Carve-Out (deduction)	5% of tangible assets, 5% of payroll costs after a10-year phase-down (rates start at 8% of tangible assets and 10% of payroll)	10% of tangible assets	5% of tangible assets
Avoiding Double Taxation	Add-on or top-up tax, applied based on priority	Foreign tax credit allowed, but limited to 80% of foreign taxes	Foreign tax credit allowed, but limited to 95% of foreign taxes
Losses	15% of losses carried forward as future credits	No loss carryforward	One-year loss carryforward
Other features	Credits for deferred income and deductions to address timing differences between tax and financial income		
Excluded Industries	International shipping income	International shipping income and foreign oil and gas extraction income	International shipping income

Source: https://crsreports.congress.gov/product/pdf/R/R47174/18

Notes:

1. An important difference between current-law GILTI and GLoBE is the overall treatment of foreign income and foreign credits. Income, losses and foreign tax credits are measured on overall basis for all foreign countries under GILTI. As a result, losses in one jurisdiction can offset the income in another, and credits in excess of US taxes in a high-tax jurisdiction can offset US taxes in low tax jurisdiction. GLoBE would apply separately to each country, and the BBBA would apply this per-country treatment under GILTI

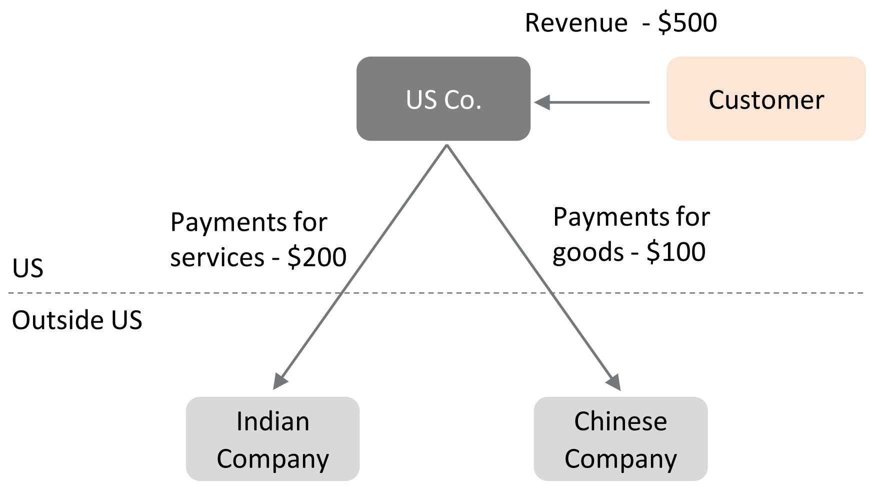
Annexures

Annexure 1 - Illustration on BEAT

- Base erosion payments can be deductible payments such as interest, royalties, or service payments. In this case, payments to Indian Company (USD 200)
- Base erosion percentage = 200/350*100 = 57.1% (i.e., >3%)
- Base Erosion Minimum Tax Amount (BEMTA) = 10% of Modified Taxable Income (MTI) - Regular Tax Liability (RTL)

#	Computation of RTL (Regular Tax Liability)	Amount (USD)
A	Gross Income	500
B	Deductions (200+100+50)	350
C	Taxable Income	150
D	Corporate Tax @ 21%	31.50

#	Computation of Modified Taxable Income	Amount (USD)
A	Gross Income	500
B	Deductions (100+50)	150
C	Modified Taxable Income	350
D	BEMTA = 10%(350)-31.50	3.50



For purposes of the BEAT computation, assume that:

1. US Co has $50 of other deductible costs with 3rd parties;
2. US Co qualifies as an Applicable Taxpayer; and
3. The $200 payment for services by US Co to Indian CFC is a payment for which a deduction is allowed in the taxable year.

Annexure 1 - Impact of BEAT on Indian entities

- This could have a significant impact for US companies which have set-up GIC’s/captives/ back-offices in India (depending on their structure) since these companies will now have to pay an additional tax on the US income
- This could also result in an overall increase in the group tax costs and dilute some of the cost benefits which these US companies obtain by setting-up India GIC’s/captives/ back-offices
- More relevant for Indian MNCs with US businesses, which pay back most of the income to India in the form of royalties / fees
- Risk of economic double taxation, FTCs cannot shelter BEAT liability

Annexure 2 - Illustration on GILTI

- **Global Intangible Low-Taxed Income (GILTI) - Illustration**

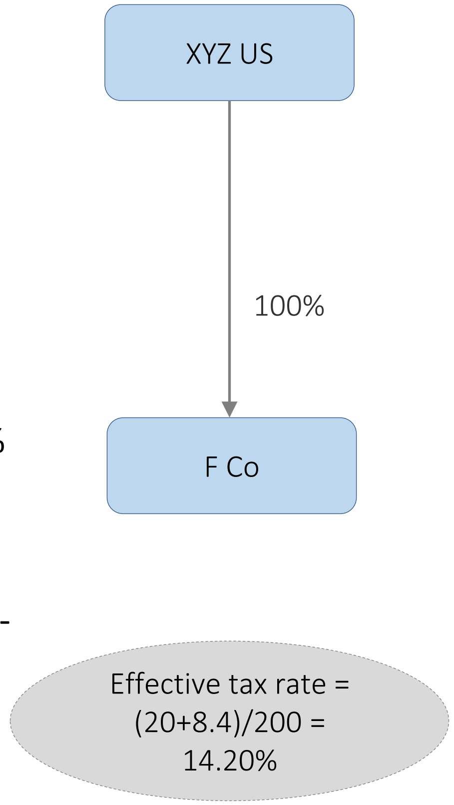
#	Particulars	Description	Amount (USD)
A	GILTI	USD 200 - 10% of 100 - Nil	190.00
B	GILTI Tax base	50% of USD 190	95.00
C	US Tax payable on GILTI Tax base	21% of USD 95	19.95

#	Particulars	Description	Amount (USD)
D	GILTI Tax base	50% of USD 190	95.00
E	Expense allocation for FTC*		40.00
F	Deemed foreign income		55.00
G	Deemed paid FTC	80% of USD 20	16.00
H	FTC Limitation	21% of USD 55	11.55
I	Eligible FTC	Min of G and H	11.55
J	**Residual US tax payable**	**C-I**	**8.40**

Corporate tax rate @ 21%
AMT @ Nil

Corporate tax rate @ 10%
Income earned - USD 200
Tax paid @10% - USD 20

Note: Depreciable assets - USD 100



* The FTC rules require some US expenses to be allocated to the foreign income. Let’s say USD 40 in this Illustration

Annexure 2 - CFCs

- Controlled foreign corporations, or CFCs, are entities that are directly or indirectly more than 50% controlled by a U.S. parent but organized under foreign law. For U.S. income tax purposes, they are treated as corporations. CFCs typically do not have U.S. operations.
- Since the Revenue Act of 1962, which refined the definition of a CFC, Subpart F of the Tax Code has required Subpart F income (made up of mainly passive income) to be included in the current-year taxable income of a CFC’s United States shareholder, whether or not the CFC distributes that income to the shareholder in the current year.
- The dividends received deduction (DRD) under Sec. 245A offsets the U.S. impact of any foreign dividends from CFCs. This DRD is sometimes referred to as the “exempt basket.”
- Today, CFCs are still subject to the Subpart F rules, but the global intangible low-taxed income (GILTI) and the Base Erosion and Anti-abuse Tax (BEAT) regimes expand the range of situations where U.S. tax may be imposed on some or all of the earnings of a U.S. corporation’s CFC’s operations.

Annexure 3 - BEPS 2.0 - Pillar 1

October 8, 2021 - The G20 Inclusive Framework (IF) released an updated statement setting forth key components for an agreement on a two-pillar solution to address tax challenges arising from the digitalization of the economy.

Pillar One: Profit allocation and nexus

- On 11 October 2023, the Organisation for Economic Co-operation and Development (OECD)/G20 Inclusive Framework on BEPS released a text of the 'Amount A' MLC along with an 'Explanatory statement' and 'Understanding on the Application of Certainty'. This reflects the current consensus among Inclusive Framework member jurisdictions on the design of Amount A. The text of the MLC as released is not yet open for signature, and the Inclusive Framework did not make any announcement regarding the same.
- Applies to groups with an adjusted revenues greater than €20 billion worldwide and a pretax profit margin greater than 10% (PBT/Revenue) for the preceding two years. Also, refer Note 1& 2
- The initial objective was to tax highly digitalized business models. However, the scope covers all business models except few regulated financial services (viz., governmental entities, international organizations, investment funds, not-for-profit organizations, pension funds and pension services entities)
- MLC would require the countries to repeal existing unilateral Digital services taxes or similar levies. To the extent of conflict with provisions of an existing tax treaty, the provisions of the MLC are to prevail.

Notes:

1. Also, a Group would be considered as Qualified Group if the Group has a pretax profit margin greater than 10% in at least two out of the four Periods immediately preceding the Period and (ii) the average of the pretax profit margin for the five-year Period ending with the Period is greater than 10%.

2. Turnover threshold to be reduced to 10 billion euros, contingent on successful implementation including of tax certainty on Amount A, with the relevant review beginning 7 years after the agreement comes into force

Annexure 3 - BEPS 2.0 - Pillar 1

Pillar One: Profit allocation and nexus (Contd..)

- Allocation of profits to market jurisdictions irrespective of any physical presence in those jurisdictions. Amount to be taxed in the market jurisdictions = Amount A + Amount B.

- **Amount A** - Profits to be allocated to market jurisdictions.

  For in-scope MNEs (that derives at least 1 million euros in revenue from that jurisdiction), 25% of residual profit (defined as profit in excess of 10% of revenue) will be allocated to market jurisdictions with nexus using a revenue-based allocation key.

  The excess profits allocated to a market jurisdiction are capped when the market jurisdiction already taxes those profits. This adjustment is referred to as the Marketing and Distribution Safe Harbour Adjustment (MDSH). The MDSH operates generally as a multi-step calculation that identifies the excess profits with reference to a minimum level of profit calculated as the greater of a local jurisdiction RODP based on in-scope MNEs RODP or 3% of the revenue sourced to market jurisdiction.

- **Amount B** - Remuneration for baseline marketing and distribution activities.

  The development of standard remuneration for in-county “baseline” marketing and distribution activities has been deferred pending further technical work.

Note: Determination of Tax base - The relevant measure of profit or loss of the in-scope MNE will be determined by reference to financial accounting income, with a small number of adjustments. Losses will be carried forward.

Annexure 3 - BEPS 2.0 - Pillar 2

Pillar Two: Global Anti-Base Erosion Rules ('Globe Rules')

- Taxpayers that either have no foreign presence or that have less than EUR 750 million in consolidated revenues are not in scope of the Model Rules. Also, do not apply to government entities, international organisations and non-profit organisations, pension, investment or real estate funds
- Taxpayers in scope of the rules calculate their effective tax rate for each jurisdiction where they operate, and pay top-up tax for the difference between their effective tax rate per jurisdiction and the 15% minimum rate. Any resulting top-up tax is generally charged in the jurisdiction of the ultimate parent of the MNE. A de-minimis exclusion applies where there is a relatively small amount of revenue and income in a jurisdiction.
- The Pillar Two Model Rules also contemplate the possibility that jurisdictions introduce their own domestic minimum top-up tax based on the GloBE mechanics, which is then fully creditable against any liability under GloBE, thereby preserving a jurisdiction's primary right of taxation over its own income.
- Though more than 140 countries have announced their intent to adopt Pillar 2.0, their timelines for implementation vary

Annexure 3 - BEPS 2.0 - Pillar 2 (Four measures for global minimum taxation)

The OECD's Model Rules for the GMT include three main rules and a fourth "subject to tax rule" that countries can use when developing tax treaties.

US GILTI is similar to the IIR

Domestic legislation

Income Inclusion Rule (IIR) & Domestic Minimum Tax (DMT)

IIR (Rule 1): Inclusion of the income of a low-taxed constituent entity in the tax base of the ultimate parent entity if that income is not taxed at the minimum 15% ETR.
DMT (Rule 3): Also known as the Qualified Domestic Minimum Top-up Tax (QDMTT). the DMT gives countries the option of collecting and keeping any top-up taxes that would otherwise flow overseas. Countries that implement a DMT are not subject to the measures imposed by the IIR and UTPR.

Undertaxed Payments Rule (UTPR)

UTPR (Rule 2): Secondary rule which is meant as a backstop in case the minimum taxation is not achieved through the IIR. The UTPR is applied by the jurisdiction of the payer. UTPR gives governments the power to deny deductions (for payments to group companies or third parties on items viz., depreciation, interest etc.) or take similar actions to collect taxes that otherwise would not be collected under the IIR.

Tax treaties

Switch-over Rule (SOR)

Ensuring proper application of IIR by allowing a switch from the exemption method to the credit method.

Subject to Tax Rule (STTR)

Rule 4: STTR enables countries to impose additional WHT on certain cross-border payments (viz interest, royalties, services) that are otherwise fully or partially exempt under a tax treaty to bring the total tax cost up to 9%. STTR taxes can be offset against the rest of the Pillar 2 taxes.

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