

Controlled Foreign Corporations

Individual Shareholders Try to Mitigate Impact of GILTI Tax

BNA Snapshot

- If shareholder is an individual, GILTI may apply to starting U.S. rate of 37 percent, not 21 percent corporate rate
- Individual shareholders of controlled foreign corporation could elect to get company treated as partnership

By Isabel Gottlieb

Individual shareholders of a controlled foreign corporation could have a lower effective tax rate in the U.S. by holding stock through a corporation rather than by holding it directly, practitioners said—a “somewhat peculiar outcome” of how the new U.S. international tax rules were drafted.

The tax on global intangible low-taxed income (GILTI) “really illustrates the disparate treatment of individuals and corporations” under the new U.S. tax law, practitioners said June 13 at an American Bar Association event in Miami.

The GILTI of a U.S. shareholder of a controlled foreign corporation (CFC) is generally the U.S. shareholder's net income from all CFCs, less a 10 percent deemed return on tangible property. If GILTI isn't already taxed at a rate of at least 13.125 percent overseas, it faces a 10.5 percent minimum tax.

But that's for a multinational, which also gets an 80 percent foreign tax credit. “You could have an effective tax rate down to the low single digits,” said Carl Merino, counsel at Day Pitney LLP in New York.

But if the shareholder is an individual, GILTI applies to a starting rate of 37 percent, not the new U.S. corporate rate of 21 percent. On top of that, add Medicare and potential state and local taxes, plus “no deemed credit, because generally individuals are not eligible for tax credits,” he said.

As a result, Merino said, “you have an odd situation where a U.S. citizen or resident, putting aside foreign taxes which are extremely important to take into account here, could actually have a lower effective tax rate in the U.S., if you count each level of tax, by holding stock through a U.S. corporation than by holding it directly.”

962 Election: The ‘Least Bad Option’

To try to improve their position with regards to the GILTI tax, individual shareholders of a CFC could try to do a “check the box” election, which gets the company treated as a partnership for U.S. tax purposes. They could also try to create a new company by contributing their shares to a commonly owned U.S. corporation.

Neither is a very good option, practitioners from several Latin American jurisdictions said, because they create unwanted tax and business implications under other jurisdictions' laws.

For example, if shareholders take the latter option in Colombia, they could trigger a 10 percent capital gains tax for both Colombian and non-Colombian tax residents, said Ignacio Velez-Vergara, a tax partner at Gomez-Pinzon Zuleta Abogados in Bogota.

And doing the same thing in Brazil would lead to a situation that is “very tax inefficient” because the shareholder will end up being taxed in Brazil on income that would otherwise not be taxed, said Ana Claudia Akie Utumi, a tax advisor at Utumi Advogados in Sao Paulo.

Perhaps the “least bad option” for individuals who are shareholders in a CFC to avoid being hit by the full brunt of GILTI is making a Section 962 election, Merino said. By making a 962 election, the shareholder elects to be taxed in the same manner as a CFC.

Section 962 is “a very old and dusty provision of the code, that is now being dusted off by a lot of practitioners,” Merino said.

The law seems to suggest that by making this election, the shareholder will be taxed at the U.S. corporate rate of 21 percent on the GILTI income from the CFC, Merino said. Tax advisers are waiting for IRS guidance to know whether the shareholder would also receive the same 50 percent deduction on GILTI that U.S. corporations receive, he said, but it appears they would not.

Nonetheless, this option may be the best for this group of taxpayers.

The 962 option “doesn't seem to have an effect for local purposes, because this is really solely for tax and solely at the level of shareholders, you're not changing entities or anything,” said Erika Litvak, a shareholder at Greenberg Traurig PA in Miami.

“It removes one layer of complexity, but there's still a lot of uncertainty.”

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