plante moran | Audit. Tax. Consulting. Wealth Management.

International Tax Alert

Provided by the National Tax Office

March 2019

IRS issues proposed regulations on Section 250

The IRS has released proposed regulations that clarify eligibility rules for individual taxpayers making a Section 962 election to claim the Section 250 deduction against their GILTI inclusion, ordinarily available only to C corporations.

What is GILTI?

The Tax Cuts and Jobs Act of 2017 (TCJA) established a foreign dividend exemption regime that allowed certain earnings of a foreign corporation to be repatriated to a U.S. corporate shareholder without being subject to U.S. taxation. The global intangible low-taxed income (GILTI) regime is intended to prevent corporations from taking advantage of this exemption for income deemed attributable to Intangible Assets located outside the United States. At a basic level, GILTI creates a current U.S. taxable inclusion for all current net income of a controlled foreign corporation (CFC) earned in excess of 10 percent of the net tax value of CFC depreciable assets.

Corporate taxpayers are eligible for a deduction under Sec. 250, which effectively exempts 50 percent of GILTI income from U.S. taxation. A GILTI foreign tax credit regime is available for corporate taxpayers to offset U.S. tax on the residual 50 percent of their GILTI income inclusion.

For information regarding proposed regulations issued for the GILTI calculation, please see the following article: [https://www.plantemoran.com/explore-our-thinking/insight/2018/10/irs-guidance-clarifies-gilti-calculation.](https://www.plantemoran.com/explore-our-thinking/insight/2018/10/irs-guidance-clarifies-gilti-calculation)

GILTI for individual taxpayers

Individuals with a greater than 10 percent interest in a CFC (by vote or value) and individuals with ownership in a pass-through entity distributing an allocation of GILTI or GILTI-tested items may have an annual GILTI inclusion.

The GILTI rules are particularly punitive to individuals, as the default individual taxpayer treatment for GILTI is an ordinary income inclusion with no 50 percent deduction allowable under Sec. 250 and no foreign tax credit. This can result in an individual global effective tax rate of over 50 percent in some instances.

Section 962 elections

A Sec. 962 election may result in tax savings for an individual with a GILTI inclusion. The Sec. 250 proposed regulations have further increased the potential benefit of Sec. 962 elections for individual shareholders of CFCs.

- **Who may make a Section 962 election:** A Sec. 962 election may only be made by an individual, including a trust or an estate, who owns a 10 percent or greater interest in a CFC, including a 10 percent or greater constructive ownership in a CFC through a domestic pass-through entity.
- **Individual taxation with a Section 962 election:** Sec. 962 provides an alternative tax regime for U.S. individuals recognizing Subpart F income, a category that includes GILTI. The election allows the individual to be taxed at the 21 percent corporate rates on his or her GILTI inclusion instead of ordinary rates, which are as high as 37 percent. In addition, the election entitles an individual to a deemed-paid foreign tax credit under Sec. 960, otherwise allowed only to C corporations. The downside is that by making a Sec. 962 election, actual cash distributions of income previously subject to tax as GILTI are taxable again as dividend income, as if the individual received a dividend from a foreign corporation. The dividend inclusion is reduced by taxes paid by the individual at the corporate tax rate.
- **New guidance on the Section 250 deduction:** The proposed regulations under Sec. 250 provide that an individual making a Sec. 962 election will be eligible to take the 50 percent GILTI deduction against his or her GILTI inclusion (limited to taxable income). This effectively exempts half of the GILTI inclusion from the first layer of tax and allows for greater likelihood that foreign tax credits may fully offset that inclusion. Following the proposed regulations, the Sec. 962 election will result in a lower global effective tax rate than the default treatment for GILTI in a much broader range of circumstances.
- **Other considerations on the Section 962 election:**
  - The Sec. 962 election is made on an annual basis by attaching a statement to the electing individual's tax return. Once made, the election is irrevocable for that tax year.
  - The 962 election applies to all CFCs of the U.S. shareholder making the election for the year.
  - Recent case law suggests the second-layer tax on distributions of GILTI income subject to the Sec. 962 election should receive qualified dividend treatment, if the underlying CFC is a resident of a country with a tax treaty with the United States.
  - For individual taxpayers with a previously taxed earnings pool from the Sec. 965 transition tax regime, distributions from a CFC are first deemed to come from the GILTI earnings pool before deemed distributed out of the previously taxed Sec. 965 pool. As a result, it may be difficult for

applicable taxpayers to defer the second-layer dividend tax on GILTI earnings subject to a Sec. 962 election.

When should an individual elect Section 962 on GILTI?

An annual analysis using taxpayer-specific facts should be done weighing the benefits of a Sec. 962 election against the cost of electing into a double tax regime. Factors impacting the relative benefit of a Sec. 962 include the jurisdiction and foreign tax rate of the CFC giving rise to GILTI, the expected timing of the cash distribution of the earnings subject to GILTI, the individual's personal tax situation, and other factors.

For many individual taxpayers impacted by GILTI, the combination of a low 21 percent corporate tax rate, the ability to utilize foreign tax credits, and the Sec. 250 deduction made available by the proposed regulations should result in significant tax savings from a Sec. 962 election.

If you have any questions about whether you may benefit by making a Sec. 962 election or your tax situation, please contact your international tax specialist.

If you have any questions, please contact:

Kellie Becker
Partner, International Tax Services Leader
586-416-4904
kellie.becker@plantemoran.com

Ben Cote
Senior Tax Manager, International Tax Services
303-846-3437
ben.cote@plantemoran.com

Arthur Ruple
Staff, International Tax Services
248-375-7390
arthur.ruple@plantemoran.com