Implications of the International Tax Provision

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On March 2 and 27 Governor Deal signed House Bill 918 and Senate Bill 328, respectively. Together they comprise tax reform designed in part to exploit Georgia's potential tax "windfall." Some remember the Georgia tax debate as guns-versus-planes, others for lowering tax rates. As an international tax nerd, I'm focused on the Georgia/international tax items; 181,731 U.S. jobs were supported by goods exported from Georgia in 2016[1] so, as a state so focused on international trade, we need clarity on related taxation.

The following summary is an over-simplified review of the significant federal international tax changes for Georgia.

Participation Exemption moves us to a quasi-territorial system. New Internal Revenue Code Section ("§") 245A provides a U.S. corporation ("USCo") owning at least 10 percent of the vote or value of a foreign corporation ("ForCo") receives dividends from post 2017 earnings tax-free. Take care as there are exceptions and detailed rules. There's no free lunch, so who pays?

Payors are U.S. persons owning at least 10 percent of ForCo via a mandatory deemed distribution of untaxed post-1986 earnings under amended §965 as Subpart F income. This generally means a 2017 income inclusion (2018 for some) regardless of whether cash moved. Complicated? You tell me -- there have already been four notices and one formal Q&A issued.

§965 provides reduced tax rates and an eight-year payment timetable with no interest charge. The rates are 15.5 percent vs. eight percent for corporations depending on whether earnings are cash/equivalent vs. other assets, respectively, and 17.54 percent or 9.05 percent for individuals.[2] S Corporations and their shareholders get additional deferral.

GILTI (Global Intangible Low-Taxed Income) is not necessarily a tax on intangible nor low-taxed income. It's a new type of Subpart F income (§951A) based on foreign company returns exceeding a base investment threshold (essentially 10 percent of adjusted US tax basis in tangible business assets). The excess is GILTI. So what?

Corporations benefit via §250 providing a deduction leading to a 10.5 percent tax rate (13.125 percent after 2025 for calendar year filers), and they can potentially credit up to 80 percent of foreign taxes. At this low rate, contrary to popular belief, GILTI may encourage continued foreign investment. Individuals aren't so lucky and face normal tax rates.

FDII (Foreign Derived Intangible Income) doesn't only apply to intangible income. Under §250, FDII is income U.S. corporations earn over the same 10 percent threshold via exporting property and/or services, and they face a reduced tax rate of 13.125 percent (16.4 percent post 2025) instead of 21 percent. Non-corporations are again left out of the party.

BEAT (Base Erosion and Anti-Abuse tax) is an alternative minimum tax applicable to groups with more than $500M U.S. revenue where U.S. taxpayers make certain deductible payments to related foreign persons. Georgia reform does not comment on BEAT.

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1 https://www.trade.gov/mas/ian/statereports/states/ga.pdf, Georgia profile from International Trade Administration of the US Department of Commerce, courtesy of the GA Department of Economic Development.

2 Congress clearly didn't pay much attention to individuals, so these are our best estimates given the complexity. Separately, the 3.8% NIIT (net investment income tax) likely applies when the cash moves and not before.

What Does the Above Information Mean for Georgia Taxpayers?

Georgia historically allows corporate taxpayers to subtract certain items in determining taxable income, including actual and deemed dividends (including Subpart F).

The updated language for our focus:

The deduction provided by Section 250 shall apply to the extent the same income was included in Georgia taxable net income. The deduction, exclusion, or subtraction provided by Section 245A, Section 965, or any other section of the Internal Revenue Code of 1986 shall not apply to the extent income has been subtracted pursuant to this subparagraph.

It further confirms amounts to be subtracted *include Subpart F income, including income specified in Section 951A of the Internal Revenue Code of 1986*. Because of the changes by both new Georgia laws:

1. Georgia excludes GILTI as Subpart F income (although House Bill 918 would have taxed it). It's unclear why it was specifically listed in the new law, as opposed to simply being covered under the broad Subpart F exception. Corporations benefit, but what about the large number of non-corporate taxpayers? They seem to be stuck unless the legislature acts to share some of the "windfall" by expanding Georgia's definition of GILTI and FDII.

2. Given GILTI's exclusion under the general rule, presumably the new law's reference to §250 refers only to FDII. In such case:
   a. Since federal taxable income incorporates the FDII deduction, and that's the starting point for Georgia's tax calculation, what precisely does the change provide? Does it simply confirm that Georgia corporations enjoy the federal FDII benefit? If 'yes', does there even need to be a reference to §250?
   b. Or, is there an intent for the federal 37.5 percent FDII deduction to apply to the Georgia rate so Georgia corporations are taxed on FDII at 3.59 percent (5.75 percent x 62.5 percent)? This would provide a similar-type benefit as the federal one; however, the calculation could get complicated given the federal deduction is already included in Georgia's starting point. I'm guessing we're in 2a above, but clarity would be helpful.
   c. Ideally FDII incentives would apply to all taxpayers, not just corporations. So you know, there were 12,667 small/medium-sized goods exporters in Georgia in 2015 (the latest year data is available)[3]. I'm sure many of those are not corporations, so they wouldn't get the FDII federal benefit either.
   d. Again, as GILTI is excluded as Subpart F income and the GILTI deduction is also in §250, the §250 reference is potentially confusing.

3. The deduction, exclusion or subtraction provided by the Participation Exemption (§245A), §965, etc. shall not apply to the extent income has already been subtracted under the historical rule. Presumably this insertion prohibits a double deduction – once under the historical rule and once under the new one. What's still unclear:
   a. §965 is Subpart F income so, on a general reading of the Georgia law, wouldn't this income automatically be subtracted from the corporate tax base as Subpart F, period? Why is it separately addressed? That's also my thought for GILTI (§951A), yet the legislature saw fit to specifically include that § in the Subpart F subtraction line (see above). Does the lack of inclusion of §965 in the Subpart F subtraction line have a meaning, or am I tax-nerding this too much? I hope the intent is simply as stated above – to disallow a double deduction for both §965 and §245A items.

The Georgia Department of Revenue is still digesting the new law and its various complexities. We hope the legislature, or the Department of Revenue, will issue guidance soon. Let's not even get into whether a S corporation is a "corporation!"

3 See footnote 1.

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