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A Mandatory High Tax Exclusion for GILTI

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A Mandatory High Tax Exclusion for GILTI

Kyle Pomerleau
February 5, 2025

Abstract

At the end of this year, the tax rate on Global Intangible Low-Tax Income (GILTI) is set to rise at the same time as the expiration of the individual provisions of the Tax Cuts and Jobs Act (TCJA). Lawmakers are unlikely to allow these changes to occur. However, simply canceling these scheduled changes would be fiscally irresponsible. The coming fiscal cliff provides an opportunity to evaluate and improve GILTI. One area that deserves close inspection is GILTI's structure as an overall minimum tax on foreign operations. This paper outlines a straightforward reform to GILTI: a mandatory high-tax exclusion. Under current law, corporations can elect to exclude the profits and related foreign taxes that face an effective tax rate above a certain threshold. This reform would make this election mandatory and, as a result, GILTI would only apply to income below the exclusion threshold. This reform would reduce opportunities for tax avoidance and reduce incentives to shift mobile assets to foreign jurisdictions while having a minimal impact on complexity. This reform would raise between \$68.5 and \$72.9 billion between 2026 and 2035, which could offset the revenue loss of other reforms to the taxation of multinational corporations.

Introduction

In 2017, the Tax Cuts and Jobs Act (TCJA) introduced reforms to the taxation of multinational corporations. These reforms introduced a quasi-territorial corporate tax system. In addition to eliminating the tax on foreign profits repatriated to the United States, it introduced a new minimum tax on foreign profits called Global Intangible Low-Tax Income (GILTI). GILTI is a minimum tax with an effective tax rate between 10.5 and 13.125 percent that applies to the deemed returns to intangible assets earned in foreign jurisdictions.

At the end of this year, GILTI's effective tax rate is scheduled to rise to between 13.125 percent and 16.4 percent. This will occur at the same time as the expiration of most individual income tax provisions. Lawmakers are unlikely to allow the TCJA provisions to expire. In addition, a GILTI rate that high could risk putting US-based corporations in an uncompetitive position. However, simply canceling these scheduled changes would be fiscally irresponsible.¹

The coming fiscal cliff provides an opportunity to evaluate and improve GILTI. One area that deserves close inspection is GILTI's structure as an overall minimum tax on foreign operations. Under GILTI, corporations blend all of their foreign profits, taxes, and tangible property to calculate their US tax liability. Although this approach is simpler than alternatives, it results in incentives that are counter to the goals of the provision.

This paper outlines a straightforward reform to GILTI: a mandatory high-tax exclusion. Under current law, corporations can elect to exclude the profits and related foreign taxes that face an effective tax rate above a certain threshold. This reform would make this election mandatory and, as a result, GILTI would only apply to income below the exclusion threshold. This reform would reduce opportunities for tax avoidance and reduce incentives to shift mobile assets to foreign jurisdictions while having a minimal impact on complexity. In addition, this reform would raise between \$68.5 and \$72.9 billion between 2026 and 2035, which could offset the revenue loss of other reforms to the taxation of multinational corporations.

Background

Prior to the passage of the TCJA, the United States had a worldwide or residence-based corporate income tax with deferral. Under this system, US-based multinational enterprises (MNEs) faced a 35 percent statutory tax rate on their worldwide profits but received a credit for any foreign income tax payments.

The additional US tax (and the accompanying credit for foreign taxes) could be deferred indefinitely if the income was reinvested in ongoing activities abroad. However, under Subpart F, passive income (interest, dividends, rents, and royalties) and certain income from related party sales was taxed on a current basis, meaning that it did not benefit from deferral. Subpart F was

¹ Pomerleau, Kyle, and Donald Schneider. "Making the Tax Cuts and Jobs Act Permanent." *American Enterprise Institute*, March 2024. <https://www.aei.org/research-products/report/making-the-tax-cuts-and-jobs-act-permanent-two-revenue-neutral-pro-growth-options-for-tax-reform/>.

meant to prevent companies from shifting highly mobile income into foreign jurisdictions and indefinitely avoid US tax liability on it.

There were several issues with the previous system.²

First, the high statutory tax rate, which was the highest among Organization for Economic Co-operation and Development (OECD) member nations, paired with the ability to defer the US tax on foreign profits, encouraged corporations to locate profits and mobile assets in low-tax jurisdictions.³

Second, the ability to defer the US tax on foreign profits indefinitely encouraged companies to accumulate cash overseas. This is because US corporations only faced the additional US tax on foreign profits when they repatriated those profits to the United States. Prior to the passage of the TCJA, estimates suggested that companies had deferred tax on at least \$2.6 trillion in foreign profits.⁴

Third, the US was also one of the last nations with a residence-based corporate income tax, which put corporations operating in foreign jurisdictions at a competitive disadvantage and encouraged corporations to relocate their headquarters to foreign jurisdictions for tax purposes. The previous system was one of the major drivers of corporate inversions over the last decade.⁵

To address these issues, the TCJA reduced the statutory corporate tax rate to 21 percent and reformed the tax treatment of multinational corporations. It introduced a quasi-territorial tax system. This new system includes two new definitions of income— Global Intangible Low-Tax Income (GILTI) and Foreign Derived Intangible Income (FDII), and a new minimum tax, the Base Erosion Anti-Abuse Tax (BEAT).⁶

Global Intangible Low-Tax Income (GILTI)

A central component of the TCJA's reforms to the tax treatment of multinational corporations is "Global Intangible Low-Tax Income" (GILTI), which is a definition of foreign profits.⁷ In principle, GILTI applies a minimum level of tax on the deemed returns to intangible assets in foreign jurisdictions.

² Pomerleau, Kyle, and Carol Wang. "Evaluating Three Minimum Taxes on The Foreign Profits of Multinationals." TAX NOTES FEDERAL 184 (September 2024):1879–1905.

³ Pomerleau, Kyle. "The Tax Burden on Corporations: A Comparison of Organisation for Economic Co-Operation and Development Countries and Proposals to Reform the US Tax System." American Enterprise Institute, October 13, 2021. <https://www.aei.org/research-products/report/the-tax-burden-on-corporations-a-comparison-of-organisation-for-economic-co-operation-and-development-countries-and-proposals-to-reform-the-us-tax-system/>.

⁴ Pomerleau, Kyle. "Biden's Reforms to the Tax Treatment of US Multinational Corporations: The Knowns and Unknowns." American Enterprise Institute, July 2021. <https://www.aei.org/research-products/report/bidens-reforms-to-the-tax-treatment-of-us-multinational-corporations-the-knowns-and-unknowns/>.

⁵ Ibid

⁶ Pomerleau, Kyle. "A Hybrid Approach: The Treatment of Foreign Profits under the Tax Cuts and Jobs Act." The Tax Foundation, no. 586 (May 2018), 1–13.

⁷ Pomerleau, Kyle, and Carol Wang. "Evaluating Three Minimum Taxes on The Foreign Profits of Multinationals." TAX NOTES FEDERAL 184 (September 2024):1879–1905.

The calculation of GILTI starts with “net tested income,” which is equal to after-tax foreign profits less foreign losses. Corporations then subtract from net tested income an amount equal to 10 percent of qualified business asset investment (QBAI) and some interest expense. QBAI is equal to the value of depreciable assets (machinery, buildings, plant, and equipment). Finally, net tested income, after exclusions and deductions, is then grossed up for any associated foreign taxes.

Once GILTI is determined, 50 percent of the GILTI amount is included in the US shareholder’s taxable income. A corporation then can offset the GILTI tax liability with a foreign tax credit (FTC), which is equal to 80 percent of foreign income taxes allocated to GILTI. Any excess FTC cannot be carried forward or back.

The effective tax rate on GILTI is generally between 10.5 percent and 13.125 percent.⁸

The GILTI regime, like subpart F, has a high-tax exclusion (HTE). It permits a corporation to elect, annually, to exclude high-taxed foreign income from the GILTI calculation. Introduced in 2020 through IRS regulations, income is considered subject to high foreign tax and excluded from tax as GILTI if it faces an effective tax rate (ETR) greater than or equal to 90 percent of the US statutory tax rate (18.9 percent). The exclusion is calculated on a business-unit-by-business-unit basis.

GILTI’s HTE was introduced in response to concerns about expense allocation rules. For corporations with certain domestic expenses, these rules resulted in a reduction in the FTC they would receive for foreign income taxes paid. As a result, these corporations could face GILTI liability even when foreign profits were taxed at rates above the GILTI rate of 13.125 percent. The HTE is meant to address this by removing high-taxed profits from GILTI.

In 2026, the section 250 deduction will fall from 50 percent to 37.5 percent, causing the ETR to rise to between 13.125 percent and 16.40625 (13.125 percent divided by 80 percent) percent.

Goals of GILTI

GILTI was introduced to address the concern that US-based multinational corporations were using intangible assets to shift profits from the United States to low- or no-tax jurisdictions.⁹

Profit shifting is the phenomenon by which firms locate deductions in high tax jurisdictions and revenue in low tax jurisdictions in ways in which that lower their worldwide effective tax burden. Corporations use a variety of ways to shift profits from one jurisdiction to another, including the location and pricing of intellectual property products, transfer pricing, and cross-border borrowing. Pure profit shifting is the relocation of profits, separate from real economic activity.¹⁰

Intangible assets are those that are not readily observable. These assets include things such as brand loyalty, goodwill, firm specific knowledge, and intellectual property. These assets are

⁸ The ETR may be higher because of the overall limitation on FTCs under section 904(d), which may require the US parent to allocate domestic expenses in a way that reduces the FTC limitation.

⁹ UF Tax Incubator. 2024. “Subpart F and GILTI Recommendations.” Tax Notes International 115 (5): 729–43.

¹⁰ Pomerleau, Kyle, and Carol Wang. “Evaluating Three Minimum Taxes on The Foreign Profits of Multinationals.” TAX NOTES FEDERAL 184 (September 2024):1879–1905.

viewed as highly mobile and susceptible to profit shifting because they do not have to be located where physical production is located and often do not have observable market prices.¹¹

The incentive to shift profits is driven by differences in statutory tax rates in the jurisdictions in which MNEs operate. For example, the value of shifting a dollar of profit from the United States (in the absence of GILTI and FDII) to a jurisdiction with a 5 percent tax rate is \$0.16: \$1 times the difference between the 21 percent US corporate tax rate and the 5 percent foreign corporate income tax rate.

In principle, the treatment of the foreign profits of MNEs under GILTI is a hybrid between two competing systems: a source-based or “territorial” tax system and a residence-based or “worldwide” system.¹² A territorial tax system generally only applies to profits reported in the United States while a worldwide system would tax profits wherever they arise at the US tax rate (minus a credit for foreign taxes already paid on foreign-source profits).

Under GILTI, MNEs that operate in high-tax jurisdictions and earn returns from foreign tangible assets (machinery, equipment, structures) face a source-based corporate tax system. Foreign Profits in high-tax jurisdictions, would face no US tax due to foreign tax credits reducing residual US tax to zero. The deemed return to tangible assets (10 percent of qualified business asset investment) is excluded from the base of GILTI and only faces foreign taxation.

At the same time, the deemed returns to intangible assets in low tax foreign jurisdictions (those with statutory rate under GILTI’s 13.125 percent tax rate) would face residual US tax without deferral, which is more consistent with a worldwide system.

The goal of this design is to preserve the competitiveness of US MNEs operating in foreign jurisdictions while protecting the US tax base. MNEs operating in high tax jurisdictions and those with tangible assets are less likely engaging in aggressive profit shifting. In contrast, intangible assets are viewed as more mobile, less subject to competition by foreign firms, and can be located in low-tax jurisdictions, allowing MNEs to potentially avoid US tax. Thus, placing a minimum tax on those returns can protect the US tax base.

GILTI’s application to low-taxed intangible income is meant to work alongside FDII.¹³ FDII has a similar tax base as GILTI. FDII is equal to foreign-derived profits in excess of a deemed return to tangible assets located in the United States. Foreign derived income is the share of “deduction eligible” income related to the exports of goods and services. Companies are allowed to deduct 37.5 percent of their FDII against their taxable income, resulting in an effective tax rate of 13.125 percent. Since the base and rates of each of the provisions are similar, firms are meant to face roughly the same effective tax rate on mobile, intangible assets that serve foreign markets, whether they are located in the US or low-tax jurisdictions. This is often called “GILTI-FDII parity.”¹⁴

¹¹ Ibid

¹² Pomerleau, Kyle. “A Hybrid Approach: The Treatment of Foreign Profits under the Tax Cuts and Jobs Act.” The Tax Foundation, no. 586 (May 2018), 1–13.

¹³ UF Tax Incubator. 2024. “Subpart F and GILTI Recommendations.” Tax Notes International 115 (5): 729–43.

¹⁴ UF Tax Incubator. 2024. “Taxation of Foreign Derived Intangible Income.” Tax Notes International 121 (5): 729–43.

To demonstrate how GILTI and FDII are meant to impact profit shifting incentives through the use of intangible assets, consider an example of a US-based multinational corporation that produces a product in Europe to sell to local consumers. This corporation has an related intangible asset, a brand, associated with this good that was developed in the United States. The corporation charges its European subsidiary for use of the branding on products sold in Europe.

In the absence of GILTI and FDII, the corporation has an incentive to locate this intangible asset, and potentially associated real economic activity, in a low or zero-tax foreign jurisdiction rather than the United States. This is because the royalty payments for the use of the brand in Europe would face a 21 percent corporate tax rate in the United States but could face a rate as low as zero in a foreign jurisdiction. If the corporation shifts the asset to a low-tax foreign jurisdiction they can reduce their tax liability and the US loses out on the tax revenue.

Under GILTI and FDII, this incentive to locate the IP in the foreign jurisdiction is reduced. In principle, GILTI places a floor on the tax rate on profits shifted to low-tax jurisdictions of 10.5 percent. In addition, the profits would face a tax rate of 13.125 percent under FDII if the asset were located in the United States. Thus, the potential tax savings of locating IP in a foreign jurisdiction dropped from \$0.21 per dollar of shifted profits to \$0.02625 per dollar of shifted profit. The corporation is more likely to hold the asset in the United States allowing the US to collect tax revenue on these profits.

GILTI's Aggregate Approach

In many ways, GILTI improved the tax treatment of multinational corporations. Previous research suggests that under certain circumstances, GILTI and FDII reduce distortions with respect to the location of mobile assets for US-based multinationals that serve foreign markets.¹⁵ However, this is not always the case..

One design choice that deserves closer inspection is GILTI's "one-cfc" or aggregate approach to calculating minimum tax liability. When US shareholders calculate GILTI, they add up all their foreign profits, losses, QBAI, and income taxes paid across all non-US jurisdictions of their CFCs.¹⁶ The result is that the GILTI regime can produce incentives counter to the goals of the provision's designers.

A notable feature of this approach is the ability to "blend" high- and low-tax income. This is also called "cross-crediting." Cross crediting is the ability for US multinational corporations to utilize unused foreign tax credits from high-tax jurisdictions (jurisdictions with tax rates higher than the US tax rate on foreign profits) to reduce US tax liability in low-tax jurisdictions. A corporation that operates in a single jurisdiction with a tax rate in excess of GILTI's rate of 13.125 will not be able to use the excess foreign tax credits. However, if this corporation also operates in a jurisdiction

¹⁵ Singh, Kartikeya, and Aparna Mathur. 2019. "THE IMPACT OF GILTI AND FDII ON THE INVESTMENT LOCATION CHOICE OF US MULTINATIONALS." *Columbia Journal of Tax Law*, 199-224. <https://doi.org/10.7916/CJTL.V10I2.3469>.

¹⁶ Pomerleau, Kyle, and Carol Wang. "Evaluating Three Minimum Taxes on The Foreign Profits of Multinationals." *TAX NOTES FEDERAL* 184 (September 2024):1879–1905.

with a statutory tax rate under GILTI, those unused tax credits can be used to offset US tax on GILTI earned in the low tax jurisdiction.

Take, for example, a corporation that operates in two jurisdictions: Country A and Country B. This MNE reports \$100 of profits in each jurisdiction. Country A levies a 5 percent income tax and Country B levies a 25 percent tax. For simplicity, assume the corporation has no tangible property in either jurisdiction.¹⁷

This corporation's GILTI is \$200. This is equal to net tested income of \$170, which is total foreign after-tax profits grossed up for foreign taxes of \$30. The initial tax on GILTI is \$21. The corporation receives an FTC of \$21, which is the lesser of 80 percent of foreign income taxes of \$24 (80 percent of \$30) or the domestic tax on GILTI of 21 percent. On net, this corporation pays no tax on GILTI even though half of foreign profits are taxed at an effective tax rate of 5 percent. This occurs because the excess foreign tax credits from Country B of \$9.50¹⁸ are effectively being used to offset the US tax of \$6.50 on profits located in Country A.

To demonstrate how this impacts the corporation's tax burden, consider an alternate which would calculate GILTI separately for each of the two jurisdictions. Under this approach, minimum tax liability is calculated within each country without the ability to blend foreign tax credits across countries. This method is utilized by the OECD's Pillar 2 minimum tax. Pillar 2 was proposed by the OECD as part of the two-pillar solution to the "tax challenges of the digital economy."¹⁹

If GILTI were calculated on a per-country basis, this same corporation would end up with a US tax liability of \$6.50. This is because the FTCs generated in the low-tax country (Country A) of \$4 would be insufficient to fully offset the US tax liability of \$10.50 on that income. The excess FTCs in Country B (\$9.50) would either be lost or would need to be carried forward (depending on how GILTI with country-by-country calculations were implemented).

¹⁷ Ibid

¹⁸ 80 percent of \$25 in foreign taxes (\$20) minus the US tax of \$10.5 (50% of 21%).

¹⁹ Pomerleau, Kyle, and Carol Wang. "Evaluating Three Minimum Taxes on The Foreign Profits of Multinationals." TAX NOTES FEDERAL 184 (September 2024):1879–1905.

Table 1. Example of GILTI With and Without Blending

	With Blending			Without Blending		
	Country A	Country B	Total	Country A	Country B	Total
Foreign income	\$100	\$100	\$200	\$100	\$100	\$200
Foreign tax rate	5%	25%		5%	25%	
Foreign tax liability	\$5	\$25	\$30	\$5	\$25	\$30
Net tested income (<i>foreign income - foreign tax liability</i>)			\$170	\$95	\$75	\$170
QBAI			\$0	\$0	\$0	\$0
QBAI exemption			\$0	\$0	\$0	\$0
Total GILTI (<i>net tested income - QBAI exclusion + section 78 gross-up</i>)			\$200	\$100	\$100	\$200
Tax on GILTI			\$21	\$10.50	\$10.50	\$21
FTC			\$21	\$4	\$10.50	\$14.50
US tax on GILTI after FTC			\$0	\$6.50	\$0	\$6.50

Source: Pomerleau and Wang 2024.

Evaluating GILTI's Aggregate Approach

The result of GILTI's aggregate approach is that it does not always apply to shifted profits at the margin. Given the ability to cross credit, the tax savings from a dollar of shifted profit depends on a corporation's foreign tax credit position (Figure 1, below). A corporation can either be in "excess credit position" or "excess limitation position." If a corporation is in excess credit position, a corporation's total foreign tax credits generated with foreign taxes paid, exceed the US tax liability on foreign profits. In contrast, if a corporation is in excess limitation position, its total US tax liability on foreign profits exceeds the foreign tax credits it generates with foreign taxes paid.²⁰

If a corporation is in excess limitation position (top right quadrant of figure 1), the tax savings of shifting a dollar of profit from the United States to a low-tax jurisdiction is reduced by GILTI. Ignoring potential interaction with expense allocation rules, The value of shifting \$1 out of the United States to a low-tax jurisdiction (5 percent in this example) would be \$0.095: the US tax rate of 21 percent minus the net tax on foreign profits of 11.5 percent.²¹ The incentive to shift profits is even smaller, \$0.01625, if this dollar of profit qualifies for the FDII benefit in the United States and would be subject to a 13.125 percent statutory tax rate.

In contrast, if the above corporation were in excess credit position (top left quadrant of figure 1), the corporation would have the same incentive to shift profits to the low tax jurisdiction as if GILTI did not apply at all. This is because it has unused foreign tax credits from high-tax jurisdictions (those with tax rates in excess of the GILTI rate) on existing operations that can offset the US tax burden on the dollar of profit shifted from the United States to the low-tax jurisdiction. The corporation would be able to save \$0.16 by shifting that dollar to a tax

²⁰ Pomerleau, Kyle, and Carol Wang. "Evaluating Three Minimum Taxes on The Foreign Profits of Multinationals." TAX NOTES FEDERAL 184 (September 2024):1879–1905.

²¹ The tax on foreign profits is the sum of the foreign tax of the GILTI rate of 10.5 minus 80 percent of the foreign tax rate of 5 percent plus the foreign tax rate of 5 percent.

jurisdiction with a tax rate of 5 percent if it did not qualify for FDII.²² If the corporation did qualify for FDII, it would save \$0.08125.

Figure 1. Tax Savings from Shifting \$1 of Profit from the United States to a Foreign Jurisdiction, Current Policy

		US Corporation Foreign Tax Credit Position	
		Excess Credit	Excess Limitation
Foreign Jurisdiction Tax Rate	5%	\$0.16 (No FDII) \$0.08125 (FDII)	\$0.095 (No FDII) \$0.01625 (FDII)
	25%	-\$0.04 (No FDII) -\$0.11875 (FDII)	\$0.055 (No FDII) -\$0.0238 (FDII)

Source: Author's Calculations

Credit position also impacts the incentive to shift profits from the United States to high-tax jurisdictions. Suppose the above corporation has the ability to relocate a dollar of profit from the US to a high tax jurisdiction (a tax rate of 25 percent).

If the corporation is in excess limitation position (bottom right quadrant of figure 1), GILTI increases the incentive to locate US profits in the high tax jurisdiction. This is because a dollar of profits in the high-tax jurisdiction would generate \$0.20 in foreign tax credit,²³ of which \$0.095 is excess of what is needed to offset the \$0.105 US tax on those profits. Those excess credits could be used immediately to offset US GILTI liability that the corporation owes on other operations in low-tax jurisdictions in which it operates. Thus, the corporation would save \$0.055 per dollar shifted from the United States to the jurisdiction with a 25 percent corporate tax rate.²⁴ If the corporation qualifies for FDII, this incentive is less of a concern because the firm would pay an additional \$0.0238 shifting the profits from the United States to the high-tax jurisdiction.²⁵

This increased incentive to shift profits from the United States to a high-tax jurisdiction is inconsistent with incentives under a territorial tax system. Under such as system, corporations would be less likely to locate profits in high-tax jurisdictions because those profits would face higher tax than if they were located in the United States.

²² US tax of \$0.21 the foreign tax rate of \$0.05 plus US tax of \$0.105 minus a foreign tax credit for \$0.105

²³ 80 percent of \$0.25

²⁴ US tax of \$0.21 minus the foreign tax rate of \$0.25 plus the US tax on GILTI of \$0.105 minus the \$0.20 foreign tax credit.

²⁵ US tax of \$0.13125 minus the foreign tax rate of \$0.25 plus the US tax on GILTI of \$0.105 minus the \$0.20 foreign tax credit.

The profit shifting incentives to high-tax jurisdiction are more aligned with what one expects under a territorial corporate tax if the corporation is in excess credit position (bottom left quadrant of figure 1). In this case, the corporation would end up losing out if they shifted profits to a jurisdiction with a higher corporate tax rate (\$0.04 with no FDII, \$0.11875 with FDII) than the US

The net result of blending is that GILTI can produce incentives counter to its goals. In the case of low-taxed GILTI, the tax system does not necessarily protect the US tax base as it would under a pure minimum tax. Corporations in excess credit position have similar incentives as if the US had no minimum tax at all. In the case of a high-tax jurisdiction, the tax system does not necessarily operate like a territorial tax system, providing, in effect, a full foreign tax credit on profits located in these jurisdictions, making locating profits there more attractive than otherwise.

Reforming GILTI: A Mandatory High-Tax Exclusion

Under this proposal, the existing high-tax exclusion would be mandatory. Each year, corporations would be required to remove foreign income, taxes, and associated QBAI from the calculations of GILTI if that income faces an effective tax rate higher than a specified effective tax rate test. Consistent with the current exclusion, the effective tax rate calculation would be done on a CFC-by-CFC basis.

The effective rate test for the mandatory high-tax exclusion, which is currently 18.9 percent (90 percent of the statutory tax rate of 21 percent), should be set at GILTI's effective tax rate. For example, if the corporate tax rate is 21 percent and the GILTI effective tax rate is 13.125 percent, the high tax exclusion effective tax rate test should be set at 62.5 percent of the domestic tax rate or 13.125 percent.

GILTI would continue to use an aggregate approach. As such, all items of GILTI not removed due to the mandatory exclusion across all jurisdictions in which an MNE operates would be added together. GILTI would continue to have a single, separate foreign tax credit basket that only includes foreign taxes associated with unexcluded income.²⁶

To demonstrate how this would operate, consider the simple example from above where a US multinational corporation operates in two foreign jurisdictions (Table 2).

As discussed, current law allows this corporation to “blend” high-tax and low-tax income in a way that eliminates tax on the low-tax income. Although the effective tax rate on foreign profits is 5 percent in Country A and below GILTI's rate of 13.125 percent, the corporation does not pay tax on its foreign profits. This is because the excess credits generated in Country B, where the effective tax rate is higher than the GILTI rate (25 percent vs 13.125 percent), are used to offset tax generated in Country A.

Under the mandatory HTE, the corporation would be required to remove Country B's net tested income, QBAI, and foreign taxes because the associated profits face an effective tax rate over 13.125 percent. As a result, the corporation's GILTI calculation would only include profits from Country A: \$95 in net tested income and \$100 in GILTI, which generates a US tax liability of

²⁶ This is in contrast with a similar proposal to create two foreign tax credit baskets under GILTI: one for high-tax income and one with low-tax income. See: UF Tax Incubator. 2024. Tax Notes International 115 (5).

\$10.50. With \$4 of FTC (80 percent of the \$5 in taxes paid to Country A), the corporation's net GILTI liability would be \$6.50.

Table 2. Example of GILTI With and Without Mandatory High Tax Exclusion

	With Blending (Current Policy)			Mandatory HTE (Proposal)		
	Country A	Country B	Total	Country A	Country B	Total
Foreign income	\$100	\$100	\$200	\$100	\$100	\$200
Foreign tax rate	5%	25%		5%	25%	
Foreign tax liability	\$5	\$25	\$30	\$5	\$25	\$30
Net tested income (<i>foreign income - foreign tax liability</i>)			\$170			\$95
QBAI			\$0			\$0
QBAI exemption			\$0			\$0
Total GILTI (<i>net tested income - QBAI exclusion + section 78 gross-up</i>)			\$200			\$100
Tax on GILTI			\$21			\$10.50
FTC			\$21			\$4.00
US tax on GILTI after FTC			\$0			\$6.50

Source: Author's calculations

Evaluation of the Proposal

The goal of this reform is for GILTI to operate like a true minimum tax on low-tax intangible income and for the broader tax treatment of high-tax and tangible assets to be more consistent with a territorial tax system.

Corporations would be less likely to be in excess credit position and are less likely to benefit from larger tax savings from shifting profits to foreign jurisdictions (Figure 2). With no foreign tax credits from high-tax jurisdictions, corporations will always face US tax on marginal dollars shifted to low-tax jurisdictions and, thus, a reduced incentive to shift profits out of the United States. Likewise, profits and assets located in high-tax jurisdictions would be excluded from GILTI and face only the foreign tax and, in this case, a reduced incentive to locate profits in that jurisdiction relative to current law.

Figure 2. Tax Savings from Shifting \$1 of Profit from the United States to a Foreign Jurisdiction, Mandatory HTE

		US Corporation Foreign Tax Credit Position	
		Excess Credit	Excess Limitation
Foreign Jurisdiction Tax Rate	5%	N/A	\$0.095 (No FDII) \$0.01625 (FDII)
	25%	-\$0.04 (No FDII) -\$0.11875 (FDII)	N/A

Source: Author's Calculations

A mandatory HTE would have a limited impact on complexity for corporations. GILTI's choice to calculate GILTI liability for overall foreign activity reduces complexity and eases administrative burdens to some extent. Corporations are only required to calculate GILTI one time for their entire operations. This limits the complexity for corporations that may operate across dozens of jurisdictions. Contrast this with Pillar 2's Income Inclusion Rule (IIR), which requires calculating tax liability separately for each jurisdiction in which corporations operate.²⁷

However, GILTI is not entirely devoid of more detailed calculations under current law. As discussed above, corporations can elect to use a high-tax exclusion, which allows corporations to remove certain profits from their GILTI calculation. This exclusion is calculated on a "tested unit" basis or controlled foreign corporation (CFC) by CFC. As such, corporations, if they elect, need to calculate the effective tax rate for each controlled foreign corporation. This election can be made each year. As such, many corporations may find it necessary to do this calculation each and every year even if they do not choose to elect into the exclusion.

Corporations that have already elected to use the HTE would face no additional complexity. Only corporations that do not use or consider using the HTE would face increased compliance burden from needing to perform a new calculation for GILTI. In fact, a mandatory HTE could reduce compliance burdens with respect to tax planning. Under current law, there is an incentive for corporations to plan around the HTE elections in ways that reduce their tax burden. As such, corporation may performing multiple tax calculations each year to determine whether the HTE is optimal. Making it mandatory removes the option and those costs associated with planning.

There may be concern that the higher tax burden on the foreign operations would impact the competitiveness of US-based multinational corporations, but this reform should have a limited

²⁷ Pomerleau, Kyle, and Carol Wang. "Evaluating Three Minimum Taxes on The Foreign Profits of Multinationals." TAX NOTES FEDERAL 184 (September 2024):1879–1905.

impact. It is true that a mandatory HTE will raise the effective tax burden on the operations of some multinational corporations. Corporations that currently invest in low-tax jurisdictions would no longer be able to offset US tax with excess foreign tax credits from high-tax jurisdictions. Likewise, investments in high-tax jurisdictions that generate tax credits will not be able to use them to offset existing US tax liability. Additional US taxation on foreign profits can mean that US firms may earn a lower rate of return on a given project than a foreign competitor. As a result, US firms may lose out on projects and market share to foreign competitors.

However, other features of GILTI minimize the competitiveness implications of taxing foreign profits. As discussed above, GILTI provides a substance-based carve out equal to 10 percent of the adjusted basis of tangible assets. The 10 percent exemption for the deemed return on tangible investment effectively exempts the “normal” return on tangible investment from US taxation assuming that a firm expects a new tangible investment to earn a 10 percent return. Thus, US corporations would not expect to face any additional US tax on new investments in tangible assets and face the same tax burden as their foreign competitors on a given project in a foreign jurisdiction.

Intangible assets, of course, do not qualify for the QBAI exemption. However, there is less of a competitiveness concern as these high-return assets are less likely to face competitive pressure.²⁸ In contrast, taxation is much more likely to impact whether a US or foreign corporation acquires a manufacturing plant in Europe.

A mandatory HTE would also enhance “GILTI-FDII parity.” As discussed above, GILTI’s one-cfc structure is one way in which GILTI deviates from the base of FDII by allowing excess credits to potentially shield profits from taxation if located in a foreign jurisdiction. This can tilt the tax treatment in favor of foreign locations. A mandatory high-tax exclusion would bring the tax rate that US-based multinationals expect to pay under GILTI and FDII more in line.

A mandatory high tax exclusion would raise federal revenue. It would raise revenue directly by reducing the ability to offset low-tax income with excess foreign tax credits. In addition, this proposal would reduce the incentive to shift profits from the United States to foreign jurisdictions, which would also increase federal revenue. According to the Tax Foundation, a mandatory HTE would raise \$72.9 billion between 2026 and 2035 relative to current law, which assumes the GILTI rate would rise to 16.4 percent. A mandatory HTE would raise \$68.4 billion over the same period under current policy, which assumes the GILTI rate remains at 13.125 percent.

²⁸ Grubert, Harry, and Rosanne Altshuler. 2013. “FIXING THE SYSTEM: AN ANALYSIS OF ALTERNATIVE PROPOSALS FOR THE REFORM OF INTERNATIONAL TAX.” *National Tax Journal* 66 (3): 671–711. <https://doi.org/10.17310/ntj.2013.3.06>.

Table 3. Revenue Effect of a Mandatory High Tax Exclusion Equal to GILTI Effective Rate, Billions of Dollars.

	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2026 - 2035
Current Law Baseline (GILTI Rate of 16.4 percent)	5.9	6.1	7.0	7.1	7.0	7.3	7.3	7.4	8.8	9.1	72.9
Current Policy Baseline (GILTI Rate of 13.125 percent)	5.5	5.3	6.8	6.6	6.6	6.7	6.6	6.8	8.6	8.9	68.5

Source: Tax Foundation

This reform could be paired with other changes to GILTI that rationalize the taxation of foreign profits of US-based multinational corporations and hold the overall tax burden on MNEs constant. Lawmakers should consider reforms that introduce timing adjustments, including carryforwards and carrybacks backs losses and foreign tax credits. Timing adjustments should also be used for purposes of calculating a CFC's effective tax rate for purposes of the high tax exclusion. Further, lawmakers should consider whether it is still necessary to require corporations to allocate certain domestic expenses to foreign operations for purposes of calculating the foreign tax credit limitation. Lawmakers could also use this additional revenue to simplify international taxation by eliminating other base erosion provisions such as Subpart F that may be unnecessary under a more robust GILTI.²⁹

This proposal could also be used to help finance maintaining the current policy GILTI rate. In fact, this proposal, alone, would cover more than half the revenue loss from extending current policy GILTI. According to the Tax Foundation, extending the 50 percent deduction for GILTI (the 13.125 percent effective rate) would reduce federal revenue by \$118.2 billion over the next decade. Pairing it with a mandatory high tax exclusion at 13.125 percent would reduce the revenue loss to \$49.7 billion over the same period.

Table 4. Revenue Effect of Extending 13.125 percent GILTI Rate Paired with a Mandatory High Tax Exclusion, Billions of Dollars.

	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2026 - 2035
Maintain GILTI Section 250 Deduction at 50 percent	-10.3	-10.7	-10.5	-10.9	-11.6	-12.1	-12.7	-13.2	-12.9	-13.4	-118.2
Mandatory GILTI high tax exclusion above 13.125%	5.5	5.3	6.8	6.6	6.6	6.7	6.6	6.8	8.6	8.9	68.5
Total	-4.8	-5.4	-3.7	-4.3	-5.0	-5.3	-6.0	-6.5	-4.3	-4.4	-49.7

Source: Tax Foundation

Note that this revenue estimate is based on current projections of foreign taxes paid by US MNEs. Several countries have begun enacting the OECD's minimum tax, Pillar 2, which will raise the effective tax rate on US MNEs. To the extent that countries continue to raise their taxes on corporations, proposals such as a mandatory high tax exclusion would raise less revenue in the future.

²⁹ For more reform ideas see: UF Tax Incubator. 2024. Tax Notes International 115 (5).

Conclusion

This year, lawmakers will consider a bill to address the expiring provisions of the TCJA. This is an opportunity to assess the tax treatment of multinational corporations and in particular GILTI. GILTI, along with other provisions, were a big improvement over prior law, but there is room for improvement. One such reform lawmakers should consider is a mandatory high-tax exclusion. This reform could improve both GILTI's robustness to avoidance and its economic efficiency while having a minimal impact on complexity. It would also raise revenue that could pay for other important reforms to that tax treatment of multinational corporations.

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