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INTERNATIONAL TAX LANDSCAPE: U.S. AND GLOBAL (BEPS PILLAR 2) TAX UPDATE

By

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I. Introduction

In 2017, Congress enacted legislation formally titled "An Act To Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018," otherwise known as the "Tax Cuts and Jobs Act" or "TCJA".[1] Prior to, and at the time of its passage, the TCJA was touted as moving the United States from a global tax system to a territorial tax system (at least as it related to earnings of non-U.S. subsidiaries owned by U.S. companies), and incentivizing U.S. companies to move manufacturing and intangible property to the U.S. through a series of carrots and sticks (e.g., the Global Intangible Low Taxed Income ("GILTI") regime could be considered a stick, while Foreign Derived Intangible Income ("FDII") deduction could be considered the carrot). However, as we will see in the outline below, and even more so since the enactment of H.R. 1,otherwise known as the "One Big Beautiful Bill Act" or "OBBB",[2] the taxation of earnings of non-U.S. subsidiaries owned by U.S. shareholders has generally moved from a global taxation system of tax when dividends are paid, to a global taxation system of immediate taxation.

This outline generally focuses on the taxation of income earned by non-U.S. subsidiaries owned by U.S. persons, and the taxation of "foreign-derived" income earned by U.S. companies. The outline does not address the taxation of foreign branches of U.S. companies, although it should be noted that while branches have been taxed at the full U.S. corporate income tax rate pre-TCJA, post-TCJA, and post-OBBB, an additional basket of foreign source income was created in TCJA (and continues post-OBBB) which results in additional complexity, and potentially additional limits, in crediting foreign taxes paid by a foreign branch of a U.S. company.

Finally, many parts of this outline provide examples and commentary of tax changes that were made in the TCJA and the OBBB, as compared to the tax rules that applied pre-TCJA. However, the outline does not provide an exhaustive analysis of all changes, and any omission should not be interpreted as such changes not being meaningful, as any change could be meaningful depending on a taxpayer's facts.

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[1] Public Law 115-97. The House of Representatives originally named the bill the "Tax Cuts and Jobs Act". However, in the Senate, the Byrd Rule was invoked to strike the name from the bill on the grounds that the title was considered an "extraneous matter". As a result, when the bill was finally passed and signed into law, its official title became, "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018."

[2] Public Law 119-21. Similar to the TCJA, the OBBB also had its title removed as part of the Senate Amendment process, and thus its official name is H.R. 1 (Public Law 119-21), but it is commonly referred to as the OBBB.

II. U.S. Taxation of Income Earned by Non-U.S. Subsidiaries Owned by U.S. Persons

A. In General

It is likely that even some of the earliest U.S. citizens owned businesses and earned income from investments outside of the United States. We know there was a strong merchant class based in Boston, New York, Philadelphia and other Northeastern cities in the 1700's that were involved in shipping and trade, with operations in the Caribbean and Europe. Further, there have been U.S. corporations with foreign subsidiaries for almost 200 years.[3] These were established well before the United States taxed income, and while a historical analysis of how income has been taxed over time could be an interesting topic to discuss at cocktail parties, this outline is generally focused on more modern forms of taxing the earnings of non-U.S. subsidiaries owned by U.S. persons.

These days, the United States has a well-established, if ever changing, methodology of taxing the earnings of non-U.S. subsidiaries. Earnings of non-U.S. subsidiaries owned by U.S. persons will generally be taxed under the following four methods:[4]

- Immediate taxation of Subpart F income earned by the non-U.S. subsidiaries;
- Immediate taxation of tested income (under the GILTI[5] regime) earned by non-U.S. subsidiaries;
- Taxation of dividend income recognized by domestic corporations, but subject to a 100% dividend received deduction;[6] and
- Taxation of dividend income recognized by U.S. persons, but without a 100% dividend received deduction.

In some cases, earnings of non-U.S. subsidiaries will never be taxed under the four methods above because they did not qualify as Subpart F income or GILTI and were never paid out as a dividend, but in that case the earnings may have increased the value of the non-U.S. subsidiary and thus increased gain recognized by the owner of such non-U.S. subsidiary when the stock of the non-U.S. subsidiary is sold.

This part of the outline will cover the four methods of taxation detailed above. It will discuss changes made in the TCJA and OBBB, and the impact on U.S. persons from those changes.

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[3] The Singer Sewing Machine Company had foreign manufacturing and distribution businesses in Europe and Russia in the 1800s.

[4] The United States does tax the earnings of non-U.S. subsidiaries that are effectively connected with a U.S. trade or business; however, this outline is focused on earnings of non-U.S. subsidiaries that are not effectively connected with a U.S. trade or business. Additionally, earnings of non-U.S. subsidiaries could be taxed under the passive foreign investment company rules in Sections 1291 through 1298, but this outline conveniently ignores those rules.

[5] The GILTI regime was created under the TCJA. The OBBB modified the GILTI regime, including changing the name of the regime to Net CFC Tested Income, or "NCTI".

[6] Only domestic corporations that are U.S. shareholders of a foreign corporation are eligible for the 100% dividend received deduction for dividends of foreign earnings from non-U.S. subsidiaries under Section 245A.

B. Subpart F Income

Although the TCJA significantly changed the landscape of how income earned by non-U.S. subsidiaries owned by U.S. persons was taxed, one thing that did not change for U.S. shareholders of controlled foreign corporations was the immediate taxation of "Subpart F income" earned by such controlled foreign corporations. Subpart F was added to the Code by the Revenue Act of 1962,[7] and continues over 60 years later to be a key part of the taxation of income earned by non-U.S. subsidiaries.

Before exploring the definition of Subpart F income, it is important to understand that this taxation regime only applies to "U.S. shareholders" that own stock in "controlled foreign corporations". Thus, if a U.S. person owns stock in a foreign corporation, but the U.S. person is not a U.S. shareholder, or the foreign corporation is not a controlled foreign corporation, then these rules will not apply to such U.S. person.

A U.S. shareholder is a U.S. person who owns, or is considered to own, 10 percent or more of the total combined voting power of all classes of stock entitled to vote of a foreign corporation, or 10 percent or more of the total value of shares of all classes of stock of such foreign corporation.[8] A controlled foreign corporation is a foreign corporation whose stock is owned more than 50 percent by U.S. shareholders.[9]

If a controlled foreign corporation earns Subpart F income, then each U.S. shareholder that directly or indirectly owns stock in such controlled foreign corporation must include their pro-rata share of such Subpart F income in their taxable income.[10]

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[7] Revenue Act of 1962, Pub. L. No. 87-834, 76 Stat. 960 (1962).

[8] Section 951(b). A U.S. citizen and a domestic corporation are two examples of U.S. persons. *See* Section 957(c) and Section 7701(a)(3)(C).

In determining stock ownership for purposes of classifying a U.S. person as a U.S. shareholder, the rules of Section 958(a) and (b) apply. Section 958(a) is direct and indirect ownership. Section 958(b) is constructive ownership, which generally applies the ownership rules of Section 318 with modifications.

The TCJA did change the definition of U.S. shareholder. Prior to the TCJA, a U.S. shareholder required ownership of 10 percent or more of the combined voting power of all classes of stock entitled to vote. Post-TCJA, the test is both a vote or value test; meaning if either the 10 percent of vote, or the 10 percent of value test is met, a U.S. person will be a U.S. shareholder with respect to a foreign corporation.

[9] Section 957(a). Similar to ownership for determining whether a U.S. person is a U.S. shareholder, the rules of Section 958(a) and (b) apply to determine ownership by U.S. shareholders for purposes of determining if a foreign corporation is a controlled foreign corporation.

[10] A U.S. shareholder's pro-rata share of the Subpart F income of a controlled foreign corporation is generally equivalent to the share of earnings that would be realized by a U.S. shareholder if the controlled foreign corporation that earned such Subpart F income were to distribute earnings and profits equivalent to its Subpart F income to all of its shareholders. Treas. Reg. § 1.951-1(b)(1)(i). Only U.S. shareholders that own stock under the ownership rules of Section 958(a) (*i.e.,* direct or indirect ownership) will include their pro-rata share of Subpart F income as taxable income under Section 951(a). Special rules reduce a U.S. shareholder's pro rata share when current earnings were distributed to another person or when the U.S. shareholder acquired the foreign corporation during the taxable year and the foreign corporation was not a CFC before the acquisition.

Subpart F income is certain enumerated types of income earned by a controlled foreign corporation. Subpart F income includes:

- Insurance income (Section 953);
- Foreign Base Company Income (Section 954);
- Boycott Income (based on the International Boycott Factor provided in Section 999);
- Illegal bribes, kickbacks, or other payments paid by or on behalf of the controlled foreign corporation to an official, employee, or agent in fact of a government; and
- Income generated in any country from which the U.S. official designates as a country from which foreign tax credits are not available under Section 901(j).[11]

The most common type of Subpart F income earned by controlled foreign corporations is Foreign Base Company Income.[12] Foreign Base Company Income equals the sum of a controlled foreign corporation's:

- Foreign Personal Holding Company Income;
- Foreign Base Company Sales Income; and
- Foreign Base Company Services Income.[13]

Foreign Personal Holding Company Income is dividends, interest, rents, royalties, gains from certain property transactions, foreign currency gains under Section 988, and various other types of passive

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Pre-TCJA, only U.S. shareholders that owned stock in a controlled foreign corporation for an uninterrupted period of 30 days or more had to include their pro-rata share of Subpart F income earned by such controlled foreign corporation. TCJA eliminated the 30-day requirement.

Pre-OBBB, only U.S. shareholders who owned stock in a controlled foreign corporation on the last day of the tax year of such controlled foreign corporation (or on the last day such foreign corporation was a controlled foreign corporation) included their pro-rata share of such controlled foreign corporation's Subpart F income in their taxable income. The OBBB changed the pro-rata share rules to require a U.S. shareholder that owns stock in a controlled foreign corporation on *any* day of such controlled foreign corporation's tax year to include in its taxable income its pro-rata share of Subpart F income. Such change is effective for tax years of controlled foreign corporations beginning after December 31, 2025.

[11] Section 952(a).

[12] While this may be accurate, this is 100% based on my experience as an international tax professional, and was also the answer provided by ChatGPT to the query, "Section 952(a) provides the definition of Subpart F income. Of the types of income designated by Section 952(a), which type is the most commonly earned by controlled foreign corporations." As ChatGPT agreed with me, I have decided to include a reference to ChatGPT in this outline.

[13] Section 954(a). The type of income included in Foreign Base Company Income has changed over the prior 60+ years, but the types of income discussed in this outline have been consistent since the enactment of the Subpart F income rules in 1962.

income. There are exceptions that cause certain types of income to no longer be considered Foreign Personal Holding Company Income, including dividends, interest, rents and royalties earned from related controlled foreign corporations.[14]

Foreign Base Company Sales Income and Foreign Base Company Services income generally are active types of income, but are considered Subpart F income because there is not a good enough reason for the controlled foreign corporation to be earning such income. Foreign Base Company Sales Income is generated from the qualifying sale of personal property, and Foreign Base Company Services Income is generated by recognizing qualifying income from services. Examples of activities that give rise to both types of Foreign Base Company income are provided below.

Example of Foreign Base Company Sales Income

A U.S. corporation ("USCO") wholly owns a controlled foreign corporation in the Cayman Islands ("Cayman CFC"). USCO also wholly owns a controlled foreign corporation in the United Kingdom ("UK CFC"). USCO manufactures widgets and sells such widgets to Cayman CFC for $100. Cayman CFC, through employees located in the Cayman Island performing distribution services, sells such widget to UK CFC and to third parties outside of the Cayman Islands for $120. Cayman CFC incurs $5 of expenses on such sales and thus earns $15 of net income on each sale.

Cayman CFC's $15 earned on each sale would be Foreign Base Company Sales Income as there is not a good enough reason for the Cayman CFC to be earning such income.

Example of Foreign Base Company Services Income

Assume the same ownership as the example above. USCO signs a contract with a customer ("U.S. Customer") to provide tax services in exchange for $100. USCO contracts with Cayman CFC to provide the tax services to the U.S. Customer and pays Cayman CFC $40 for such services. Cayman CFC's employees do provide the tax services in Cayman, but provide the services in Canada as Cayman is too hot in the summer. It costs Cayman CFC $10 in compensation and other costs to provide such tax services.

Cayman CFC's $30 of net services income would be Foreign Base Company Services Income as there is not a good enough reason for Cayman CFC to be earning such income.

In the case of Foreign Base Company Sales Income, in the example above, Cayman CFC would either have had to (i) manufacture the widgets, (ii) purchase the widgets from a person who manufactured such widgets in the Cayman Islands, or (iii) sell the widgets to persons located in the Cayman Islands

[14] Section 954(c)(6) provides the exception from the definition of Foreign Personal Holding Company Income for dividend, interest, rent and royalty income earned by a controlled foreign corporation from related controlled foreign corporations (referred to as the CFC to CFC Look-Thru Rule). Prior to the OBBB, tax practitioners had to remember when the CFC to CFC Look Thru rule expired, as it originally expired for tax years beginning after December 31, 2008, and was extended in various acts after its original enactment. The OBBB made Section 954(c)(6) permanent (thankfully).

(related or unrelated) in order to have a good enough reason to earn the income in the Cayman Islands (and thus for the income to not be Foreign Base Company Sales Income).[15]

In the case of Foreign Base Company Services Income, in the example above, the Cayman CFC would have had to perform the services in the Cayman Islands in order to have a good enough reason to earn the income in the Cayman Islands (and thus for the income to not be Foreign Base Company Services Income).[16]

As discussed above, when a controlled foreign corporation earns Subpart F income, U.S. shareholders that directly or indirectly own stock in such controlled foreign corporation (as determined under Section 958(a)) must include in their taxable income their pro-rata share of such Subpart F income. While this regime can give rise to double taxation (*i.e.*, the income is taxed both in the country of the controlled foreign corporation and in the United States), the foreign tax credit regime is intended to limit the double taxation by allowing a credit for foreign income taxes paid by the controlled foreign corporation that are properly attributable to such Subpart F income.[17]

The rest of this outline discusses other types of income earned by non-U.S. subsidiaries and describes how such income will be taxed by the United States.

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[15] Foreign Base Company Sales Income shall, unless an exception is met, consist of gross income (whether in the form of profits, commissions, fees or otherwise) derived in connection with the purchase of personal property from a related person and its sale to any person, the sale of personal property to any person on behalf of a related person, the purchase of personal property from any person and its sale to a related person, or the purchase of personal property from any person on behalf of a related person. Foreign Base Company Sales Income does not include income derived in connection with the purchase and sale of personal property (or purchase or sale of personal property on behalf of a related person) if the property is manufactured, produced, constructed, grown, or extracted in the country under the laws of which the controlled foreign corporation which purchases and sells the property (or acts on behalf of a related person) is created or organized. Foreign Base Company Sales Income also does not include income derived in connection with the purchase and sale of personal property (or purchase or sale of personal property on behalf of a related person), (a) if the property is sold for use, consumption, or disposition in the country under the laws of which the controlled foreign corporation which purchases and sells the property (or sells on behalf of a related person) is created or organized, or (b) where the property is purchased by the controlled foreign corporation on behalf of a related person, if such property is purchased for use, consumption, or disposition in the country under the laws of which such controlled foreign corporation is created or organized. Finally, Foreign Base Company Sales Income does not include income of a controlled foreign corporation derived in connection with the sale of personal property manufactured, produced, or constructed by such corporation. Section 954(d) and Treas. Reg. § 1.954-3.

[16] Foreign Base Company Services Income means income of a controlled foreign corporation, whether in the form of compensation, commissions, fees, or otherwise, derived in connection with the performance of technical, managerial, engineering, architectural, scientific, skilled, industrial, commercial, or like services which, (i) are performed for, or on behalf of a related person, and (ii) are performed outside the country under the laws of which the controlled foreign corporation is created or organized. Section 954(e) and Treas. Reg. § 1.954-4

[17] Post-TCJA, foreign income taxes "properly attributable" to Subpart F income included in the taxable income of a domestic corporation are allowed as a foreign tax credit against the U.S. federal income tax paid by such domestic corporation. Prior to the TCJA, a foreign tax credit was allowed for foreign taxes paid by a controlled foreign corporation, but the determination of the amount of foreign taxes eligible as a foreign tax credit to be used against U.S. federal income tax was based on a pooling method and not the "properly attributable" method.

C. Global Intangible Low Taxed Income (GILTI) / Net CFC Tested Income (NCTI)

From 1962 until 2018, Subpart F income was (predominately) the only type of income earned by non-U.S. subsidiaries that was immediately subject to taxation by U.S. persons who owned stock in such non-U.S. subsidiaries.[18] As discussed above, Subpart F income was limited to only certain types of income earned by controlled foreign corporations and was only included in the taxable income of U.S. shareholders. Outside of Subpart F, earnings of non-U.S. subsidiaries were generally only taxed when repatriated as dividends to U.S. persons who owned stock in the non-U.S. subsidiary.

The TCJA changed that by both (i) generally eliminating tax on dividend income received by domestic corporations from non-U.S. subsidiaries through a 100% dividend received deduction, and (ii) requiring U.S. shareholders to immediately recognize their pro-rata share of GILTI as taxable income at the time that a controlled foreign corporation earns income (in addition to requiring U.S. shareholders to continue to recognize as taxable income their share of Subpart F income). Shifting away from a taxation of dividends system was intentional as Congress did not want to continue to discourage repatriation of cash to the United States.[19] However, Congress believed that some amount of tax was required on the earnings of non-U.S. subsidiaries in order to discourage U.S. multinationals from shifting profits to low-taxed jurisdictions.[20] Thus, GILTI was created in order to have a minimum level of tax on the earnings of non-U.S. subsidiaries.

The following discusses the GILTI regime which had a good seven-year run until modified and renamed to NCTI under OBBB.

1. TCJA

For tax years of a controlled foreign corporation beginning after December 31, 2017, U.S. shareholders that own stock in such controlled foreign corporation on the last day of the controlled foreign corporation's tax year are required to determine the amount of such controlled foreign corporation's earnings that must be included as GILTI in such U.S. shareholders' taxable income.

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[18] The passive foreign investment company rules in Sections 1291 through 1298 could also require the immediate taxation of income of non-U.S. subsidiaries, but this outline conveniently ignores those rules.

Additionally, transition rules under Section 965 required certain U.S. persons to include in income their pro-rata share of deferred foreign income and subjected such amount to immediate taxation, but allowed a partial participation exemption against such income, with the amount of the exemption being based upon what share of the foreign deferred income was held in cash and cash equivalents versus the amount held in all other assets. This was a one-time inclusion so it is also ignored for purposes of this outline.

[19] Comm. on Ways and Means, *House Rep. No. 115-409 (Committee Report)*, Tax Cuts and Jobs Act, 115th Cong., 1st Sess., p. 382 (Nov. 13, 2017) ("The worldwide system of taxation with deferral provides perverse incentives to keep funds offshore because dividends from foreign subsidiaries are not taxed until repatriated to the United States. The Committee believes that a territorial system with appropriate anti-base erosion safeguards, combined with a lower corporate tax rate, will make American workers and companies competitive again, and also will remove tax-driven incentives to keep funds offshore.").

[20] *See* Conference Report on H.R. 1 (H.R. Rep. No. 115-466, December 15, 2017).

Calculation of GILTI

GILTI means, with respect to any U.S. shareholder for any taxable year of such U.S. shareholder, the excess (if any) of (i) such U.S. shareholder's "net CFC tested income" for such year, over (ii) such U.S. shareholder's net deemed tangible income return for such taxable year.

In determining the amount of GILTI to be included in income by a U.S. shareholder, a controlled foreign corporation must first identify its amount of tested income or tested loss. Tested income and tested loss are new terms created under the TCJA, and are defined as the gross income (or loss)[21] of such controlled foreign corporation determined without regard to:

- Any U.S. source income effectively connected with a U.S. trade or business (unless such item is exempt from U.S. taxation, or subject to a reduced rate of tax);
- Any gross income taken into account in determining the Subpart F income of such controlled foreign corporation;
- Any gross income excluded as Foreign Base Company Income or Insurance Income as a result of the exception that applies for high taxed income under Section 954(b)(4);[22]
- Any dividend received from a related person;
- Any foreign oil and gas extraction income defined under Section 907(c)(1); over
- Deductions (including taxes) properly allocable to such gross income.[23]

Determining each controlled foreign corporation's tested income or tested loss is only the beginning of computing a U.S. shareholder's GILTI inclusion. After determining tested income and tested loss, each U.S. shareholder must determine their "net CFC tested income", their "qualified business asset investment" ("QBAI"), and their "specified interest expense".

To determine the net CFC tested income, a U.S. shareholder will net their aggregate pro-rata share of the tested income of each controlled foreign corporation with respect to which such shareholder is a U.S. shareholder for such taxable year of such U.S. shareholder (determined for each taxable year of such controlled foreign corporation which ends in or with such taxable year of such U.S. shareholder), over the aggregate of such U.S. shareholder's pro-rata share of the tested loss of each controlled foreign corporation with respect to which such shareholder is a U.S. shareholder for such taxable year of such U.S. shareholder (determined for each taxable year of such controlled foreign corporation which ends in or with such taxable year of such U.S. shareholder).[24] Once the net CFC tested income is determined, a

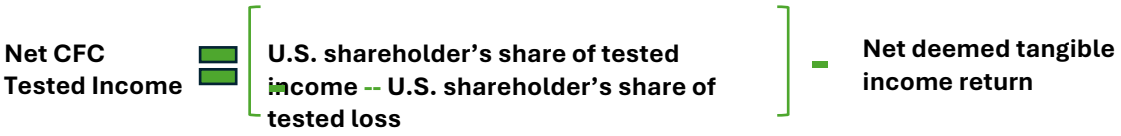
[21] For purposes of determining tested income and tested loss (other than for controlled foreign corporations in the insurance business), the gross income and allowable deductions of a controlled foreign corporation are determined by treating such foreign corporation as a domestic corporation taxable under Section 11 and by applying the principles of Section 61 and the regulations thereunder.

[22] Treasury regulations extended this high tax exclusion to make it available for certain tested income of a controlled foreign corporation that was subject to a high enough rate of foreign income tax. Treas. Reg. § 1.951A-2(c)(7).

[23] Section 951A(c)(2)(A).

[24] Section 951A(c)(1).

U.S. shareholder will subtract from that amount its "net deemed tangible income return".[25] Net CFC tested income is illustrated by the following equation:



The net deemed tangible income return is defined as 10% of the aggregate of such U.S. shareholder's pro-rata share of the QBAI of each controlled foreign corporation with respect to which such shareholder is a U.S. shareholder for such taxable year (determined for each taxable year of each such controlled foreign corporation which ends in or with such taxable year of such U.S. shareholder), over the U.S. shareholder's specified interest expense. QBAI means, with respect to any controlled foreign corporation for any taxable year, the average of such corporation's aggregate adjusted tax bases[26] as of the close of each quarter of such taxable year in specified tangible property that is (i) used in a trade or business, and (ii) of a type with respect to which a deduction is allowable under Section 167. Specified tangible property means any tangible property used in the production of tested income.[27] Specified interest is the amount of interest expense that reduced a U.S. shareholder's net CFC tested income, and for which the interest income attributable to such interest expense is not taken into account in determining such U.S. shareholder's net CFC tested income.[28] Net deemed tangible income return is illustrated by the following equation:

For purposes of determining the net deemed tangible income return, only the QBAI of controlled foreign corporations with tested income is taken into account.[29] Thus, in computing a U.S. shareholder's GILTI, not all tangible assets of controlled foreign corporations owned by such U.S. shareholder may be taken into account.

Once a U.S. shareholder has determined its GILTI inclusion for its taxable year, then such U.S. shareholder must determine whether they are eligible for a deduction against their GILTI, and must determine whether foreign tax credits are available to reduce U.S. federal income tax.

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[25] Section 951A(b)(1).

[26] For this purpose, the adjusted tax bases of any property shall be determined by using the alternative depreciation system under Section 168(g). Section 951A(d)(3).

[27] If a tangible property is dual use property, then a portion of the tangible property will be considered specified tangible property. Section 951A(d)(2)(B).

[28] Treas. Reg. § 1.951A-1(c)(3)(iii).

[29] Treas. Reg. § 1.951A-1(c)(3)(ii).

Section 250 Deduction and Foreign Tax Credits

Subjecting non-U.S. earnings to full U.S. taxation was considered to be anti-competitive as compared to other countries.[30] Thus, a deduction was allowed against GILTI equal to up to 50% of the GILTI inclusion recognized by a domestic corporation that is a U.S. shareholder.[31] When allowed in full, the deduction was intended to cause GILTI to be taxed at an effective rate of 10.5% (or half of the U.S. federal income tax rate) for domestic corporations.[32]

The deduction, however, is limited by taxable income. Meaning if a domestic corporation's aggregate amount of GILTI and FDII (discussed below) exceeds such domestic corporation's taxable income, the Section 250 deduction will be limited and thus the effective tax rate applied to such domestic corporation's GILTI inclusion will exceed 10.5%.

Additionally, domestic corporations that are U.S. shareholders are allowed a foreign tax credit for foreign taxes "properly attributable" to tested income.[33] In determining the foreign taxes that could be eligible as a foreign tax credit against U.S. federal income tax paid by a domestic corporation on GILTI inclusions (referred to herein as the "initial GILTI eligible foreign taxes"), a controlled foreign corporation's inclusion percentage must be determined, and that percentage is applied against the controlled foreign corporation's foreign taxes properly attributable to its tested income.[34] The term inclusion percentage, with respect to a domestic corporation that is a U.S. shareholder of one or more controlled foreign corporations, is the domestic corporation's GILTI inclusion amount divided by the aggregate pro-rata share of the tested income of each controlled foreign corporation with respect to which such shareholder is a U.S. shareholder for such taxable year of such U.S. shareholder (determined for

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[30] *See* Conference Report H.R. 1 (H.R. Rep No. 115-466, December 15, 2017), "The provision [*GILTI*] is intended to reduce the incentive for U.S. companies to shift profits to low- or no-tax jurisdictions, while at the same time maintaining the competitiveness of U.S. companies relative to foreign companies." *See also* Joint Committee on Taxation, General Explanation of Public Law 115-97 (JCS 1-18, December 2018, the TCJA Blue Book), "To mitigate the potential competitive disadvantage to U.S. corporations, the deduction allowed under Section 250 results in a lower effective U.S. tax rate on GILTI."

[31] Section 250(a)(1)(B). The 50% deduction also applies to any gross-ups required under Section 78 for foreign taxes that will be claimed as a foreign tax credit against U.S. federal income tax that are properly attributable to tested income.

Only domestic corporations are allowed a deduction under Section 250. Thus, U.S. shareholders that are not domestic corporations are required to include their GILTI as taxable income without the benefit of a deduction against such inclusion.

[32] The 50% deduction against GILTI allowed under Section 250 was intended to apply for tax years beginning after December 31, 2017 and before January 1, 2026. For tax years beginning on or after January 1, 2026, the deduction allowed under Section 250 was to be reduced to 37.5%; however, under the OBBB, the Section 250 deduction was modified again and made permanent (discussed further below in this outline).

[33] Section 960(d). Only domestic corporations are allowed a foreign tax credit for taxes properly attributable to tested income. Thus, U.S. shareholders that are not domestic corporations may be double taxed on the earnings of their non-U.S. subsidiaries if (i) such earnings are taxed in a foreign country, and (ii) such earnings are taxed in the U.S. as a result of the GILTI regime. Some U.S. individuals may consider an election under Section 962 to be taxed on the earnings of their non-U.S. subsidiaries as if they were a domestic corporation, but such election does have downsides and requires modelling by the U.S. individual.

[34] Section 960(d) and Treas. Reg. § 1.960-2(c)

each taxable year of such controlled foreign corporation which ends in or with such taxable year of such U.S. shareholder). To say it another way, the inclusion percentage is the actual ratio of tested income included in the domestic corporation's GILTI inclusion after taking into account offsets for tested losses of other controlled foreign corporations and the net deemed tangible income return. Thus, if 60% of a controlled foreign corporation's tested income is ultimately included in a domestic corporation's GILTI inclusion, then 60% of such controlled foreign corporation's taxes properly attributable to its tested income are eligible to be considered for a foreign tax credit by the domestic corporation U.S. shareholder.

Once the initial GILTI eligible foreign taxes are determined, such amount is multiplied by 80% for purposes of determining the final amount of foreign taxes eligible to be used as a foreign tax credit against U.S. federal income tax paid by domestic corporations on GILTI inclusions (referred to herein as the "final GILTI eligible foreign taxes").[35] The impact of the 50% deduction allowed under Section 250, and the 20% haircut applied to initial GILTI eligible foreign taxes, is that generally GILTI subject to a combined foreign tax rate of 13.125% or higher should not be subject to any additional U.S. federal income tax as the foreign tax credit should completely offset the U.S. federal income tax.[36] However, this ignores expense allocation and apportionment which is required in determining limits applicable to the amount of foreign tax credit allowable to a domestic corporation.

In addition to introducing the GILTI regime, the TCJA also introduced a new category of income for purposes of determining foreign tax credit limits. The foreign tax credit allowed to a domestic corporation as an offset to U.S. federal income tax on its GILTI inclusion is required to be computed under its own separate limitation.[37] In computing its separate limitation, a domestic corporation must first determine its GILTI inclusion, must then allocate its Section 250 deduction against that amount, and then must allocate and apportion other deductions as required under Sections 861 through 865. The net amount computed (referred to herein as the "income in the GILTI FTC basket") is then used to compute the domestic corporation's foreign tax credit limitation (the "GILTI FTC limit"). A domestic corporation is a allowed a foreign tax credit for the lesser of the final GILTI eligible foreign taxes or the GILTI FTC limit. Thus, the allocation and apportionment of expenses could result in a reduction of the amount of foreign tax credit recognized by domestic corporations.

[35] Section 960(d).

[36] Staff of the Joint Comm. on Tax'n, *General Explanation of Public Law 115-97*, JCS-1-18, at 371 (Comm. Print 2018) ("To the extent that the effective foreign tax rate on a CFC's tested income equals or exceeds 13.125 percent, the deemed paid credit generally eliminates U.S. residual tax liability with respect to such income.").

[37] Section 904(d)(1)(A).

This is illustrated in the examples below:[38]

Example 1: GILTI Inclusion and Foreign Tax Credits - No Expense Apportionment

A U.S. corporation ("USCO") wholly owns a controlled foreign corporation in the United Kingdom ("UK CFC"). UK CFC earns $750 of tested income and paid $250 of UK tax. UK CFC earns no other income.

USCO is required to include $750 of UK CFC's earnings as GILTI, and increases that amount by the $250 of taxes paid by UK CFC under Section 78. USCO is allowed a 50% deduction against its GILTI (including its Section 78 gross up) under Section 250. Thus, USCO recognizes $1,000 of GILTI inclusion, $500 of a deduction under Section 250, and owes $105 of U.S. federal income tax on such income (U.S. federal income tax rate of 21% multiplied by $500), before foreign tax credits.

USCO's initial GILTI eligible foreign taxes are $250, which is reduced by a 20% haircut such that USCO's final GILTI eligible foreign taxes are $200. USCO's foreign tax credit is limited to $105. This is computed by taking USCO's GILTI plus Section 78 gross up of $1,000 and subtracting the $500 Section 250 deduction, resulting in $500 of income in the GILTI FTC basket. That amount is then multiplied by 21%, resulting in a GILTI FTC limit of $105. USCO is a allowed a foreign tax credit for the lesser of the final eligible GILTI foreign taxes ($200) or the GILTI FTC limit ($105), and thus is allowed a foreign tax credit of $105.[39]

Thus, USCO's final U.S. federal income tax on GILTI is $0 after taking into account its $105 foreign tax credit.

Example 2: GILTI Inclusion and Foreign Tax Credits - Expense Apportionment

Same facts as the example above, except that USCO also has $200 of interest expense, of which $100 is apportioned against USCO's income in the GILTI FTC basket for foreign tax credit limitation purposes.

USCO is required to include $750 of UK CFC's earnings as GILTI, and increases that amount by the $250 of taxes paid by UK CFC under Section 78. USCO is allowed a 50% deduction against its GILTI (including its Section 78 gross up) under Section 250. Thus, USCO recognizes $1,000 of GILTI inclusion, $500 of a deduction under Section 250, and owes $105 of U.S. federal income tax on such income (U.S. federal income tax rate of 21% multiplied by $500), before foreign tax credits.

USCO's initial GILTI eligible foreign taxes is $250, which is reduced by a 20% haircut such that USCO's final GILTI eligible foreign taxes is $200. USCO's foreign tax credit is limited to $84. This is computed by taking USCO's GILTI

[38] The examples are simplified and take liberties with how the foreign tax credit limit is computed (including ignoring Section 904(b)(4)).

[39] Excess foreign taxes in the GILTI FTC basket are not permitted to be carried forward.

plus Section 78 gross up of $1,000, subtracting the $500 Section 250 deduction, and subtracting the $100 of interest expense apportioned to USCO's income in the GILTI FTC basket, resulting in $400 of income in the GILTI FTC basket. That amount is then multiplied by 21%, resulting in a GILTI FTC limit of $84. USCO is a allowed a foreign tax credit for the lesser of the final eligible GILTI foreign taxes ($200) or the GILTI FTC limit ($84), and thus is allowed a foreign tax credit of $84.

Thus, USCO's final U.S. federal income tax on GILTI is $21 after taking into account its $105 of U.S. federal income tax before credit, less $84 of foreign tax credit.

Thus, as you can see from example 2, domestic corporations may still be required to pay U.S. federal income tax even if the effective foreign tax rate on the earnings of a controlled foreign corporation for which it owns stock exceeds 13.125%.

Final Thoughts on GILTI

As discussed at the very beginning of this outline, the TCJA was touted as moving the U.S. from a global tax system to a territorial tax system (at least as it related to earnings of non-U.S. subsidiaries owned by U.S. companies), and incentivizing U.S. companies to move manufacturing and intangible property to the United States. GILTI potentially does neither of these things.

First of all, GILTI had the potential to subject more earnings of non-U.S. subsidiaries to U.S. federal income tax as compared to pre-TCJA. Pre-TCJA, U.S. shareholders were generally only subject to immediate tax on the earnings of controlled foreign corporations when such controlled foreign corporations earned very specific enumerated income. Post-TCJA, almost all income of a controlled foreign corporation could be subject to U.S. federal income tax, even if the income is generated through active operations that occur in the country of incorporation of the controlled foreign corporation through the actions of the controlled foreign corporation's employees.

Second of all, a controlled foreign corporation's earnings can be excluded from GILTI if it is offset by the deemed tangible income return. The greater a controlled foreign corporation's investment is in tangible property (*e.g.*, investments in manufacturing sites, etc.) the greater the deemed tangible income return will be. Thus, potentially causing U.S. multinationals to be incentivized to invest in manufacturing or other facilities outside of the U.S. in order to reduce their U.S. federal income tax on GILTI.

Additionally, GILTI was sold to U.S. multinationals as only applying a U.S. top up tax on low-taxed earnings of controlled foreign corporations.[40] However, as demonstrated in the examples above, domestic corporations can still pay a U.S. federal income tax on GILTI even if the effective foreign tax on such income exceeds 13.125% and, in fact, even if such foreign effective tax rate exceeds the U.S. federal income tax rate of 21%.

Thus, there were a number of areas that Congress could focus on for improvement in their next Big Beautiful Bill.

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[40] Staff of the Joint Comm. on Tax'n, *General Explanation of Public Law 115-97*, JCS-1-18, at 371 (Comm. Print 2018) ("To the extent that the effective foreign tax rate on a CFC's tested income equals or exceeds 13.125 percent, the deemed paid credit generally eliminates U.S. residual tax liability with respect to such income.").

2. OBBB

The OBBB kept the GILTI framework generally in place, but made the following significant changes that we will discuss further in this section of the outline:

- The reduction for the net deemed tangible income return was eliminated;
- The Section 250 deduction was reduced from 50% of GILTI to 40% of GILTI (now called NCTI);
- The foreign tax disallowance was reduced from 20% of the initial GILTI eligible foreign taxes to 10% of the initial GILTI eligible foreign taxes; and
- Only the Section 250 deduction and directly allocable expenses, which does not include interest expense, are required to be allocated and apportioned to income in the GILTI FTC basket for purposes of computing the foreign tax credit limit.

Additionally, now that the deemed tangible income return was eliminated, the regime is no longer referred to as the GILTI regime, but is now referred to as the Net CFC Tested Income regime ("NCTI").

Using the same format as the TCJA section above, we will discuss the impact of these changes.

Calculation of NCTI

The only significant change to the calculation of a U.S. shareholders GILTI (now NCTI) is the elimination of the net deemed tangible income return.[41] Using the equations provided above, the NCTI inclusion can be computed as:

NCTI = **U.S. shareholder's pro-rata share of tested income** − **U.S. shareholder's pro-rata share of tested loss**

Section 250 Deduction and Foreign Tax Credits

The OBBB reduced the amount of the Section 250 deduction allowed by domestic corporations against NCTI as compared to the Section 250 deduction that was allowed to offset GILTI. The Section 250 deduction was reduced from a 50% deduction to a 40% deduction for tax years beginning after December 31, 2025.[42]

Additionally, the OBBB increased, for domestic corporations, the amount of foreign taxes allowed as a foreign tax credit against NCTI. Section 960(d) used to require a 20% haircut against the initial GILTI eligible foreign taxes in order to compute the final GILTI eligible foreign taxes. For

[41] H.R.1 - 119th Congress (2025-2026): One Big Beautiful Bill Act, § 70323.

[42] H.R.1 - 119th Congress (2025-2026): One Big Beautiful Bill Act, § 70321.

domestic corporations, the haircut has been reduced to 10% for tax years beginning after December 31, 2025.[43]

The impact of both changes is that generally NCTI subject to a combined foreign tax rate of 14% or higher should not be subject to any additional U.S. federal income tax as the foreign tax credit should completely offset the U.S. federal income tax on the NCTI. This is subject to the impact of expense allocation and apportionment as discussed above, but in that regard the OBBB also made changes.

The OBBB changed the expenses required to be allocated and apportioned to income in the GILTI FTC basket. Specifically, for purposes of determining income in the GILTI FTC basket, only the Section 250 deduction and deductions directly allocable to NCTI are required to be allocated and apportioned to such income.[44]

Final Thoughts on NCTI Post-OBBB

The OBBB eliminated the deduction for the deemed tangible income return, which has the impact of subjecting even more of a controlled foreign corporation's income to U.S. federal income tax. Thus, the OBBB has moved the U.S. even further away from a territorial tax system, and more to a tax system of immediately taxing the income of a controlled foreign corporation. Additionally, the reduction in Section 250 deduction has the impact of increasing the U.S. tax rate that applies to NCTI income from 10.5% to 12.6%.

However, the changes made to the foreign tax credit rules should allow a greater amount of foreign taxes to be eligible and taken as a foreign tax credit against NCTI. It moves the U.S. tax system closer to only applying a U.S. top up tax to non-U.S. earnings of a controlled foreign corporation if such earnings are subject to a rate of foreign tax less than 14%.[45]

Finally, the removal of the net deemed tangible income return should eliminate the incentive for U.S. shareholders to make tangible property investments outside of the U.S. as a way of reducing their GILTI inclusion. In that regard, the carrots and sticks referenced in the beginning of this article are moving more towards aligning on investment into the United States.

D. Dividends Paid by Non-U.S. Subsidiaries - Section 245A Dividend Received Deduction

It was noted above that earnings of non-U.S. subsidiaries owned by U.S. persons will generally be taxed under four methods, including taxation when recognized as dividend income by domestic corporations, but subject to a 100% dividend received deduction. The following section of the outline discusses what types of dividends are eligible for a 100% dividend received deduction.

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[43] H.R.1 - 119th Congress (2025-2026): One Big Beautiful Bill Act, § 70312.

[44] H.R.1 - 119th Congress (2025-2026): One Big Beautiful Bill Act, § 70311. Specifically, interest expense and R&E expenses should not be allocated or apportioned to NCTI.

[45] However, NCTI is still an annual inclusion, with no carryovers for excess losses or foreign taxes. For example, local country foreign income taxes may be reduced because of local country tax attributes (*e.g.*, net operating losses) causing NCTI for that year to be low-taxed and therefore giving rise to U.S. top up taxes even if the controlled foreign corporation operated in a high-tax foreign country.

1. TCJA

In addition to introducing the GILTI regime discussed above, the TCJA also introduced a 100% dividend received deduction for certain dividends received by domestic corporations from certain foreign corporations.[46] Specifically, a 100% dividend received deduction is available for the foreign portion of dividends received by domestic corporations for which the domestic corporation is a U.S. shareholder[47] of the foreign corporation paying the dividend.[48] However, dividends of certain types of foreign earnings are not allowed a dividend received deduction. For example, if a U.S. shareholder received a dividend from a controlled foreign corporation, and such dividend is a hybrid dividend, then a dividends received deduction is not allowed.[49]

Final Thoughts of the Section 245A Dividend Received Deduction

Post-TCJA, there are two main examples of foreign earnings for which domestic corporations receive a 100% dividend received deduction. Those examples are:

- Earnings of a controlled foreign corporation that were not included as GILTI because (i) they were offset by tested losses; (ii) they were offset by the deemed tangible income return or (iii) they were excluded from tested income because of the GILTI high-tax exception; and

- Earnings of a non-U.S. corporation which was owned 10% or greater by a domestic corporation, but was not considered to be a controlled foreign corporation (because more than 50% of its stock was not owned by U.S. shareholders).

Generally, in the case of U.S. multinationals, manufacturers and other industries that required high amounts of tangible assets had higher amounts of earnings from non-U.S. subsidiaries excluded from GILTI because of the deemed tangible income return. Those U.S. multinationals likely took greater advantage of the 100% dividend received deduction allowed under Section 245A as compared to U.S. multinationals in low tangible asset intensive industries (*e.g.,* U.S. multinationals in the technology or service sectors).

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[46] Similar to the Section 250 deduction, and the foreign tax credit allowed against U.S. federal income tax applied to GILTI, only domestic corporations are allowed a dividends received deduction.

[47] As defined under Section 951(b).

[48] Section 245A(a). The foreign portion of any dividend is an amount which bears the same ratio to such dividend as (i) the undistributed foreign earnings of the specified 10-percent owned foreign corporation paying the dividend, bears to, (ii) the total undistributed earnings of such foreign corporation. Section 245A(c)(1). Additionally, a dividends received deduction is not available if the dividend is paid by a foreign corporation that is a passive foreign investment company and not a controlled foreign corporation. Section 245A(b)(1).

[49] Section 245A(e)(1). A hybrid dividend is a dividend that would ordinarily be eligible for a 100% dividends received deduction under Section 245A, but also for which the controlled foreign corporation paying the dividend received a deduction (or other tax benefit) with respect to any income, war profits, or excess profits taxes imposed by any foreign country or possession of the United States. Section 245A(e)(4).

2. OBBB

The OBBB made no changes to Section 245A.

Final Thoughts of the Section 245A Dividend Received Deduction Post-OBBB

Post-OBBB, the deemed tangible income return is no longer available to reduce the amount of earnings of non-U.S. subsidiaries subject to GILTI (now NCTI). Thus, the amount of income eligible to be offset by a 100% dividend received deduction under Section 245A has been reduced to:

- Earnings of a controlled foreign corporation that were not included as NCTI because (i) they were offset by tested loss, or (ii) they were excluded from tested income because of the GILTI high-tax exception; and

- Earnings of a non-U.S. corporation which was owned 10% or greater by a domestic corporation, but was not considered to be a controlled foreign corporation (because more than 50% of its stock was not owned by U.S. shareholders).

There likely is no longer a significant difference between sectors with respect to the amount of earnings of non-U.S. subsidiaries subject to the 100% dividend received deduction (at least with respect to earnings earned after the effective date of OBBB).

One thing to note: In the case of earnings of a non-U.S. subsidiary that are subject to a low rate of tax, a U.S. shareholder may benefit by owning 50% or less of the stock of such non-U.S. subsidiary (assuming the non-U.S. subsidiary is not a controlled foreign corporation). This is because dividends from such non-U.S. subsidiary could be eligible for a 100% dividend received deduction, but NCTI inclusions required for U.S. shareholders of controlled foreign corporations might result in a U.S. top up tax. While this was also the case post-TCJA, the deemed tangible income return could offset part of a controlled foreign corporation's tested income, thereby reducing a U.S. shareholder's GILTI inclusion, and causing more of a controlled foreign corporation's earnings to be potentially eligible for a 100% dividend received deduction when paid as a dividend to a U.S. shareholder. Post-OBBB, the deemed tangible income return is no longer available to reduce net CFC tested income and thus more of a controlled foreign corporation's earnings could be subject to a U.S. top up tax under the NCTI regime, and less of the earnings could be eligible for a 100% dividend received deduction.

E. Other Dividends Paid by Non-U.S. Subsidiaries

As discussed at the beginning of Section II of this outline, earnings of non-U.S. subsidiaries owned by U.S. persons will generally be taxed under the following four methods:

- Immediate taxation of Subpart F income earned by controlled foreign corporations;

- Immediate taxation of GILTI / NCTI earned by controlled foreign corporations;

- Taxation when recognized as dividend income by domestic corporations, but subject to a 100% dividend received deduction; and

- Taxation when recognized by U.S. persons, but without a 100% dividend received deduction.

The prior sections covered the first three methods of taxing earnings of non-U.S. subsidiaries. This section will cover the fourth. Dividends paid by non-U.S. subsidiaries to U.S. persons that are generally included as taxable income without a 100% dividend received deduction include:

- Dividends paid by a non-U.S. subsidiary to a domestic corporation which is a U.S. shareholder in such foreign corporation, but which do not qualify for the 100% dividend received deduction (as discussed above);

- Dividends paid by a non-U.S. subsidiary to a domestic corporation which is not a U.S. shareholder in such foreign corporation; and

- Dividends paid by a non-U.S. subsidiary to any U.S. person that is not a domestic corporation.

In these fact patterns, the U.S. recipient of the dividend should include the dividend in taxable income and subject it to tax.

There is one other type of dividend received from non-U.S. subsidiaries. In the case of U.S. shareholders of controlled foreign corporations, such controlled foreign corporations may make a dividend of previously taxed earnings and profits. These are earnings that have been subject to tax under the Subpart F, GILTI/NCTI, or other regime, and for which should not be taxed again when paid as a dividend to the U.S. shareholder that had the income inclusion in the first place. In that case, the dividend is not considered to be income to the U.S. shareholder recipient.[50]

III. Foreign Income Earned By U.S. Companies (Not Including Foreign Dividends and Foreign Branches)

Section II of the outline discussed how earnings of non-U.S. subsidiaries are taxed. Section III focuses on the "carrot" of the TCJA and will discuss the taxation of foreign income earned by domestic companies.[51]

A. TCJA

The TCJA introduce a new deduction to offset 37.5% of a domestic corporation's foreign derived intangible income ("FDII").[52]

[50] Section 959(a).

[51] Staff of the Joint Comm. on Tax'n, *General Explanation of Public Law 115-97*, JCS-1-18, at 371 (Comm. Print 2018). ("FDII is designed to 'encourage U.S. companies to own valuable intangible assets and earn intangible income in the United States, rather than in low- or zero-tax jurisdictions.")

[52] Section 250(a)(1)(A).

Calculation of FDII

A domestic's corporation's FDII is the amount which bears the same ratio to the "deemed intangible income" of such corporation as:

i. The "foreign-derived deduction eligible income" of such corporation, bears to

ii. The "deduction eligible income" of such corporation.

The deemed intangible income of a domestic corporation is the excess (if any) of:

i. The deduction eligible income ("DEI") of the domestic corporation, over

ii. The "deemed tangible income return" of the domestic corporation. The deemed tangible income return of a domestic corporation is an amount equal to 10% of the domestic corporation's QBAI.[53]

Deduction eligible income with respect to a domestic corporation is the excess, if any, of the gross income of such domestic corporation determined without regard to:

- Subpart F income inclusions;
- GILTI / NCTI income inclusions;
- Financial service income (determined under Section 904(d)(2)(D));
- Dividends received from a controlled foreign corporation of such domestic corporation;
- Domestic oil and gas extraction income of such domestic corporation;
- Foreign branch income; over
- The deductions (including taxes) properly allocable to such gross income.[54]

The term "foreign-derived deduction eligible income" ("FDDEI") means, with respect to a domestic corporation for any taxable year, any deduction eligible income of such taxpayer which is derived in connection with:

- Property which is sold by the taxpayer to any person who is not a United States person, and which is for a foreign use, and

[53] Section 250(a)(2)(A). QBAI has the same definition as was used for determining a controlled foreign corporation's net deemed tangible income return, but in the case of determining the deemed tangible income of a domestic corporation, QBAI should be determined with regard to tangible assets that generate deduction eligible income rather than tested income.

[54] Section 250(b)(3).

- Services provided by the taxpayer that are provided to any person, or with respect to property, not located within the United States.[55]

The equation for computing a domestic corporation's FDII can be illustrated as follows:

The equation for computing a domestic corporation's deemed intangible income can be illustrated as follows:

Section 250 Deduction

A domestic corporation is allowed a deduction under Section 250 equal to 37.5% of its FDII.[56] Similar to GILTI, such deduction is limited to taxable income (see Section II.B for the discussion of the taxable income limitation).

The impact of the deduction allowed under Section 250 was to cause FDII to be taxed at an effective tax rate of approximately 13.125%. This rate was intended to be similar to the foreign effective tax rate that had to apply to GILTI in order for a domestic corporation to not be taxed on its GILTI inclusion (*i.e.*, 13.125% after taking into consideration both the 50% deduction allowed under Section 250 and the foreign tax credit haircut of 20%). It was Congress's intention that the incentive of the deduction was great enough to cause U.S. multinationals retain income derived from foreign sources within the U.S. rather than moving such income outside of the United States.[57]

Final Thoughts on FDII

While intending to use the deduction allowed under Section 250 as the carrot to incentivize domestic companies to retain assets and activities that generate foreign income, two interesting policy decisions were made.

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[55] Section 250(b)(4). Detailed rules and substantiation requirements are provided in Section 250 and the associated regulations on how to determine if income from a property sale or income from a service qualifies as foreign derived deduction eligible income.

[56] Section 250(a)(1)(A). Prior to the enactment of the OBBB, the deduction allowed under Section 250 was set to be reduced to 21.875% for tax years beginning after December 31, 2025.

[57] See https://bipartisanpolicy.org/explainer/the-2025-tax-debate-gilti-fdii-and-beat-under-the-tax-cuts-and-jobs-act. ("It may be useful to think of FDII as the carrot to GILTI's stick. GILTI is, in theory, a disincentive for domestic companies to keep valuable assets abroad, by levying a minimum tax on the profits those assets produce. FDII is, in theory, an incentive for domestic companies to bring assets back to the U.S. (or keep them here) by reducing the tax rate charged on a portion of the profits generated by those assets.")

First, tangible asset investment in the U.S. reduced the amount of income eligible for the deduction. This is because only the "deemed intangible income" was eligible to be considered FDII, and deemed intangible income is income of a domestic corporation reduced by 10% of such domestic corporation's QBAI. Thus, if QBAI goes up because a domestic corporation makes an investment in a U.S. manufacturing site, the amount of income potentially eligible for a deduction under Section 250 goes down. This could lead a domestic corporation to decide to invest in manufacturing outside of the United States, which also had the effect of reducing a domestic corporation's GILTI inclusion.

Second, one of the income streams of a domestic corporation that is potentially eligible for a deduction under Section 250 is gain recognized from the sale of intangible property to a person outside of the U.S. (including deemed royalties recognized by a domestic company from transferring its intangible property outside the United States as required under Section 367(d)). Thus, a domestic corporation could transfer domestic owned intangible property to a related non-U.S. subsidiary, as part of a non-U.S. subsidiary starting a manufacturing facility outside of the United States, and the result could be a reduction of such domestic company's taxable income as compared to keeping the intangible property in the U.S. and charging the related non-U.S. subsidiary a royalty. A perverse result indeed.

Again, there were a number of areas that Congress could focus on for improvement in the Big Beautiful Bill.

B. OBBB

Three main changes were made to FDII in the OBBB:

- Deduction eligible income no longer includes gains from sale of intangible property (including deemed royalties under Section 367(d));
- The deduction allowed under Section 250 was reduced from 37.5% of FDII to 33.34% of FDDEI.
- FDII is no longer what the deduction is applied against, instead it is applied against FDDEI, thereby removing any reduction for QBAI.

Additionally, under the TCJA, certain of a domestic corporation's expenses must be allocated and apportioned to FDDEI. The expenses required to be allocated and apportioned to FDDEI have been reduced, thus generally increasing the amount of FDDEI, but this change will not be discussed further in this outline.

Calculation of FDDEI

As mentioned above, FDII is no longer required to be determined for tax years of domestic corporations beginning after December 31, 2025. However, for tax years beginning prior to January 1, 2026, the definition of DEI was modified to exclude gains from sale of intangible property (including deemed royalties under Section 367(d)).[58]

[58] This modification to Section 250(b)(3) was made retroactive to any sales or other dispositions that occurred after June 16, 2025. H.R.1 - 119th Congress (2025-2026): One Big Beautiful Bill Act, § 70322.

For tax years of domestic corporations beginning after December 31, 2025, only FDDEI must be determined.

Section 250 Deduction

The deduction allowed to domestic corporations under Section 250 was reduced from 37.5% of its FDII to 33.34% of its FDDEI.[59] The taxable income limitation continues to apply.

The impact of the change to the deduction allowed under Section 250 was to cause foreign derived income of a domestic corporation to be taxed at an effective tax rate of approximately 14%.

Final Thoughts on FDII (now FDDEI) Post-OBBB

As discussed above, the original deduction allowed under Section 250 applied to gains from the sale of intangible property from a domestic corporation to a foreign person (including a related foreign person), and the benefit of the original deduction was reduced as a domestic corporation made investments in tangible assets located in the United States. The changes made under the OBBB eliminate both of these perverse incentives by eliminating any benefit for income or gains recognized from the transfer of intangible property to foreign persons and by eliminating the deduction against deduction eligible income for 10% of a domestic corporation's QBAI. These changes should be viewed positively by U.S. multinationals and should allow FDDEI to be a bigger carrot to reward U.S. multinationals for retaining assets and activities that generate foreign income in the United States.

IV. OECD's Base Erosion and Profits Splitting (BEPS) Project Pillar 2 Update

In addition to the changes under the OBBB discussed above, there has been some discussion about changes to the Organisation for Economic Co-operation and Development's ("OECD") Base Erosion and Profit Shifting ("BEPS") project as it relates to U.S. multinationals.

As a reminder, the OECD started its BEPS project in 2013 to combat tax avoidance by multinational enterprises. The key output from the initial BEPS project was 15-point action plan that was intended to be used by OECD members to draft laws to tackle tax avoidance by multinational enterprises, focusing on hybrid mismatches, profit shifting, transfer pricing abuse, and lack of transparency.[60] One of those action plans, Action Plan 1 - Addressing the Tax Challenges of the Digital Economy, as a next steps agreed to continue work following the completion of the other follow-up work on the BEPS project.[61] The goal was to issue a report reflecting the outcome of the continued work in relation to the digital economy by 2020.

This is where the current OECD BEPS project picked up, and in its July 1, 2021 statement, the OECD and G20 formally agreed to a two-pillar solution to tackle tax challenges arising from the

[59] H.R.1 - 119th Congress (2025-2026): One Big Beautiful Bill Act, § 70321.

[60] OECD (2016), *BEPS Project Explanatory Statement: 2015 Final Reports*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/9789264263437-en.

[61] OECD (2015), *Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/9789264241046-en.

digitalization of the economy.[62] For purposes of this outline, only the second pillar will be discussed ("Pillar 2"), which is commonly referred to as the global minimum tax.

A. Structure of the Global Minimum Tax Rules

Pillar 2 is intended to be two interlocking rules, the income inclusion rule ("IIR") and the undertaxed profits rule ("UTPR") that work in tandem to ensure that all income earned globally is assessed at a minimum tax rate of 15%.[63] The OECD first released the Pillar 2 model rules in December 2021,[64] and since then has released commentary and guidance providing details on how the IIR and UTPR should be implemented. In addition, it was acknowledged that countries may also implement their own minimum tax rules applicable to income earned within their respective countries, and if qualified (*i.e.*, qualified domestic minimum top up tax or QDMTT), such tax would also interlock with the IIR and UTPR.

Generally, the Pillar 2 rules work as follows:

- Countries can first choose to apply their own QDMTT to income earned within their country. If a QDMTT is applied, then an IIR and UTPR should not be applied to such income.

- The top parent entity that is incorporated in a country that has enacted Pillar 2 rules can then apply an IIR to all income earned by its subsidiaries globally (if the country of the subsidiary has not already applied a QDMTT to such income), and assess and collect a minimum tax on such income.

- All entities incorporated within countries that have enacted Pillar 2 rules can then apply a UTPR and assess and collect a minimum tax on any other entity for which a QDMTT or IIR has not been applied. Such tax is allocated across all members that assess a UTPR to limit the same income from being taxed more than once under the Pillar 2 rules.

The IIR was generally effective for the 2024 tax year, and the UTPR was generally effective for the 2025 tax year in the countries where Pillar 2 laws were enacted.

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[62] OECD/G20 Inclusive Framework on BEPS, *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (July 1, 2021), https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2021.pdf.

[63] The Pillar 2 rules are only intended to apply to multinational organization with global revenues that exceed Euro 750 million.

[64] OECD (2021), *Tax Challenges Arising from Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/782bac33-en.

B. Landscape Until January 2025

Although many countries enacted Pillar 2 laws, the United States has not and appears unlikely to enact rules compliant with Pillar 2.[65]

In November 2021, the United States House of Representatives passed the Build Back Better Act,[66] which would have converted the GILTI system to compute the GILTI top up tax on a country-by-country basis, more closely mimicking the Pillar 2 IIR. However, the bill never passed the U.S. Senate, and thus did not become law.

The OECD has published safe-harbors that have generally limited UTPR from applying to U.S. multinationals,[67] however those safe-harbors will expire at the end of 2025. Additionally, the OECD published guidance on how to push down U.S. income taxes that applied to GILTI in order to reduce Pillar 2 top up tax, but such guidance only applies through the 2026 tax year for most U.S. multinationals.

Without changes to the global minimum tax rules, it is anticipated that the rules would begin to significantly impact U.S. multinationals, potentially resulting in double taxation once the safe-harbors no longer apply.

C. Post January 2025

In January 2025, President Donald Trump issued a memorandum declaring that:

- The Secretary of the Treasury and the Permanent Representative of the United States to the OECD shall notify the OECD that any commitments made by the prior administration on behalf of the United States with respect to the Global Tax Deal have no force or effect within the United States absent an act by the Congress adopting the relevant provisions of the Global Tax Deal; and

- The Secretary of the Treasury in consultation with the United States Trade Representative shall investigate whether any foreign countries are not in compliance with any tax treaty with the United States or have any tax rules in place, or are likely to put tax rules in place, that are extraterritorial or disproportionately affect American companies, and develop and present to the President, through the Assistant to the President for Economic Policy, a list of options for protective measures or other actions that the United States should adopt or take in response to such non-compliance or tax rules.

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[65] A non-exclusive list of countries that have adopted Pillar 2 laws as of July 2024 can be found here: https://www.ey.com/content/dam/ey-unified-site/ey-com/ja-jp/insights/tax/documents/beps-2-0-pillar-two-developments-tracker.pdf.

[66] H.R. 5376, 117th Cong., Nov. 2021.

[67] *See* UTPR Safe Harbor. OECD (2023), Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two), July 2023, OECD/G20 Inclusive Framework on BEPS, OECD, Paris, www.oecd.org/tax/beps/administrative-guidance-global-anti-base-erosionrules-pillar-two-july-2023.pdf.

In the original draft of the OBBB, both the House and Senate version of the bill included a provision that would enact increased income tax and withholding tax rates on U.S. income recognized by countries that applied Pillar 2 rules to U.S. entities (overriding existing income tax treaties that may have existed). In June 2025, the G7 issued the following statement related to the U.S. and Pillar 2:

> "Following discussions on this issue [*Pillar 2's applicability to U.S. companies*] – which were informed by analysis of the respective minimum tax regimes, including consideration of recently proposed changes to the U.S. international tax system based on the Senate amendment of H.R. 1 (introduced June 16, 2025), the *One Big Beautiful Bill Act* (OBBBA), the removal of section 899 in the Senate version of the OBBBA, and consideration of the success of Qualified Domestic Minimum Top-up Tax (QDMTT) implementation and its impact – there is a shared understanding that a side-by-side system could preserve important gains made by jurisdictions in the Inclusive Framework in tackling base erosion and profit shifting and provide greater stability and certainty in the international tax system moving forward.
>
> This understanding, which builds on our continued commitment to collaborate jointly through the Inclusive Framework to address the potential risks of base erosion and profit shifting, is based on the following accepted principles:
>
> - A side-by-side system would fully exclude U.S. parented groups from the UTPR and the IIR in respect of both their domestic and foreign profits.
>
> - A side-by-side system would include a commitment to ensure any substantial risks that may be identified with respect to the level playing field, or risks of base erosion and profit shifting, are addressed to preserve the common policy objectives of the side-by-side system.
>
> - Work to deliver a side-by-side system would be undertaken alongside material simplifications being delivered to the overall Pillar 2 administration and compliance framework.
>
> - Work to deliver a side-by-side system would be undertaken alongside considering changes to the Pillar 2 treatment of substance-based non-refundable tax credits that would ensure greater alignment with the treatment of refundable tax credits."

Statements both before and after the G7 statement have further expanded on the implementation of a side-by-side system including:

- April 2025, it was reported that "The EU Council's Polish presidency reportedly has proposed three options to assuage U.S. concerns about the OECD's pillar 2 minimum tax rules." The three options being proposed included:
  - "… to revisit the GLOBE rules on the treatment of tax credits…",
  - "to limit the application of the UTPR — for example, by amending the pillar 2 EU directive to extend the transitional safe harbor or by removing the UTPR mechanism entirely…", and

- "to consider the U.S. global intangible low-taxed income regime equivalent to the IIR..." [68]

- June 2025, the OECD Secretary-General issued a statement that included,

  "I warmly welcome today's breakthrough statement by the G7, setting out a proposed way forward for the operation of global minimum tax arrangements.

  The introduction of global minimum taxes in the U.S. and through the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting represents a vital reform in international tax systems. This initiative is crucial for enhancing fairness and effectiveness in our increasingly digital and global economy.

  The G7 statement on a side-by-side arrangement offers the opportunity to fulfill the original aim of establishing multilaterally agreed limitations on corporate tax competition and also safeguards the tax bases of governments. Moreover, any agreement along those lines would provide businesses worldwide with the certainty and stability they need in international tax frameworks.

  I welcome the engagement now with the broader OECD Inclusive Framework regarding the proposed side-by-side arrangement."[69]

- July 2025, it was reported that the German Chancellor Friedrich Merz has called for the suspension of the European Union's rollout of the global corporate minimum tax, arguing the plan is no longer viable without U.S. participation.[70]

- July 2025, it was reported by Bloomberg Tax that the OECD is exploring a range of options—including new safe harbors and additional guidance—to ensure that a "side-by-side" system takes effect before U.S. multinationals are subjected to global minimum levies in other countries as early as next year. [71]

As you can see from the statements above, the G7 statement has thrown a wrench into the implementation of the global minimum tax, and it is unclear how and whether countries will modify their Pillar 2 laws before the end of the year to exclude U.S. multinationals from the Pillar 2 rules.

[68] 2025 TNTI 80-4, *EU Presidency Lays Out Options to Address U.S. Pillar 2 Concerns.*

[69] *See* Statement by the OECD Secretary-General on G7 Progress on International Tax Co-operation, 28 June 2025.

[70] *See* https://www.yahoo.com/news/merz-calls-eu-suspend-global-153235660.html.

[71] Bloomberg Law News 2025-07-22, OECD Resolving Concerns Over G7 Minimum Tax Pact, Official Says.

V. Closing

The OBBB has moved the existing U.S. international tax system on to a more permanent footing by enacting Section 250 deduction rates that do not expire or change without a future change in law, by made other aspects of the U.S. international tax system permanent, and by more aligning the carrots and sticks to investments in the United States.

At the same time, the system of global minimum tax and its impact on U.S. multinationals continues to be in flux.

All that is certain is that the state of international tax globally will continue to remain an area of change, which makes this international tax practitioner excited to see what comes next.