How the US are stopping large corporates avoid tax

Wednesday 30 December, 2020

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Global Intangible Low Tax Income or GILTI for short, is a relatively new Tax Law in the US, it has only been in effect a short while, beginning after the 31st December 2017. It was a countermeasure to businesses that continuously have enormous turnover whilst operating in the US, but through loopholes and the shifting of profit into low or even zero tax jurisdictions, they pay little to no tax at all.

WHAT IS GILTI?

When GILTI was first introduced in 2017, it was a new concept added to the Tax Code which changed the way foreign income was reported by corporations and thus changed the way foreign income was taxed. The aim for the introduction of GILTI was to rid of the incentives of holding their Intellectual Property in countries with significantly lower tax costs than the US.

Any C Corporation, S Corporation, Partnership or Individual can be subject to GILTI. It is worked out by taking the Gross Income, Income then subject to different tax regulations, foreign oil and gas extraction income, for example, is then removed. You then remove expenses from the remaining figure, to give you what is called the '**Tested Income**'.

Then taking the Tested Income and deducting the **Shareholders Net Tangible Return,** leaves you with GILTI. This figure is then taxed at 21%, however, if the corporation does not engage in US trade or business, this can be halved. GILTI is then taxed at the halved rate of 10.5%.

WHAT IS THE NEED FOR GILTI?

Have you ever wondered how a company like Amazon can have a profit of more than $11 Billion in 2018, yet pay $0 tax? Yes, $0 in 2018. Well, the main reason for this is, Amazon offers pretty much every employee stock-based pay or stock-based incentives, which can then be offset against the federal income tax. No foul play or anything illegal is being done, it is purely using the system to your advantage. The more successful your business becomes if you use this type of method, the less tax you pay!

So, the US decided they must come up with a way to counteract the fact that large corporations can easily move assets or use certain loopholes in order to avoid the majority, if not all tax - Introducing GILTI (pronounced Guilty!) The tax method that the US hoped would answer the problem.

The US hoped this would have corporations second-guessing whether they would need to keep their intellectual property overseas because the incentive would then be cancelled out by the new need to report GILTI.

HAS IT WORKED?

While it seems a good idea in theory, in practice there have been some drawbacks and unintended consequences of implementing GILTI. For one, the Tax Law has come under fire for focusing solely on large scale corporations and neglecting to think about smaller international traders that are trading abroad for legitimate business purposes rather than to reduce their tax bill. Because of this, they are now facing higher charges, of which some they cannot afford because the bigger corporations have been taking advantage of the system already in place. They are therefore losing out and struggling as a result of the implementation of GILTI.

Another drawback of GILTI is companies that operate in high tax jurisdictions already. Now initially this may come as a surprising drawback, as GILTI is only supposed to come into effect with companies that have an effective tax rate of 13.125%. However, when delving deeper into some of the tax laws at work, you can see why they can cause some issues. For example, Foreign tax credits are limited in the US depending on which proportion of your income derives from the US and which proportion is international, so a company who earns 60% of their income internationally will therefore only be able to claim Foreign tax credits in the US against the 60% of their total income. But then when taking into account some expenses allocation rules, companies are required to allocate some expenses against foreign income rather than US income. This in turn lowers the Foreign profit and thus Foreign tax credits can only be used on a reduced amount of total income. For example, if your 60% of profit becomes 30% due to additional expenses being allocated, your foreign tax credits have then also been restricted further. Not only this, but if these expenses then reduce your effective tax rate below the threshold, you could be in a high tax jurisdiction, whilst also being charged additional tax for GILTI.

SUMMARY

GILTI has been implemented to try and address a problem that has been occurring for many years, it is a step in the right direction, but more refinements and adjustments need to be discussed and perfected before it can achieve the goal that it was set out for.

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