GILTI Tax on USVI Subsidiaries of US Companies: Examples for EDC Companies

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The USVI Tax System

- The US Virgin Islands (USVI) has a mirror tax code, which means that essentially it is a duplicate (a mirror) of the US income tax system, including the US corporate income tax system.

- Consequently, the corporate income tax rate in the USVI is the same as the rate for the US, currently 21%.

- For income tax purposes, the USVI is not generally considered part of the US and the income tax revenue collected under the USVI tax system accrues to the USVI government, not to the US Treasury. This is provided for in sections 934 and 937 of the I.R.C.

- However, companies that qualify for the tax incentives offered by the USVI Economic Development Commission (EDC) are awarded tax incentives that reduce their effective tax rate to 10% of the US rate, or 2.1% under current law (as allowed under I.R.C. section 934(b)).

GILTI Tax – Current Law

- GILTI is an acronym that stands for Global Intangible Low Taxed Income. The tax is a US tax, not a USVI tax.

- The GILTI tax is a minimum tax, currently at roughly a 10.5% rate, on GILTI earned by certain corporate subsidiaries of US headquartered corporations, including subsidiaries operating in the US Virgin Islands.

- Under the GILTI regime, the US federal government taxes intangible income earned in foreign locations at a rate sufficient to bring the total tax rate on that income up to a minimum of approximately 10.5% (ambiguity arises in part because of the limitation on the foreign tax credit, as noted on slide 4). Because the USVI is treated as a foreign country for purposes of the GILTI regime, the US federal government taxes intangible income earned in the USVI at a rate sufficient to bring the total tax rate on that income – the sum of the tax paid to the UVSI and the tax paid to the US federal government – up to a minimum of approximately 10.5%.

- The GILTI tax regime applies to USVI corporations owned by US residents and so does not apply to all businesses operated in the USVI.

GILTI Tax – Current Law (continued)

- For purposes of understanding these examples, the important features of the GILTI tax system are:

  - the 10.5% rate is calculated by allowing business to deduct one half of GILTI from the US taxable income subject to the 21% US corporate rate (10.5% is one half of 21%);

  - GILTI tax is assessed after an exemption from US taxable income of a 10% rate of return on tangible assets used to produce income in the foreign location (it is this exemption that makes the tax approximate to one on intangible income);

  - the net US tax is after a credit for taxes paid to the USVI (to prevent double taxation of the income), but the credit is reduced (haircut) by 20%.

GILTI Tax – Biden Administration Proposal

- The Biden Administration proposes major tax changes that could dramatically raise the tax burden on USVI companies which participate in the EDC program.

- The changes relevant for these examples are:

  - raise the US corporate income tax rate from 21% to 28% (relevant in part because the USVI has a mirror tax code);

  - reduce the GILTI deduction from 50% to 25%;

  - eliminate the exemption of the 10% return on tangible assets (so that the tax would be imposed an all foreign source income, not on an approximation of the excess return or the return on intangible assets).

- Under the Biden Administration proposal, the GILTI tax rate would be (approximately) 21% (= 75% of the 28% US corporate tax rate).

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Examples

- The examples that follow walk through the GILTI calculation in detail and compute the tax imposed by the current version of GILTI, the GILTI tax proposed by the Biden Administration, and a proposal to exempt USVI subsidiaries of US companies via a 100% deduction of GILTI income from US taxable income.

- Examples are included for a financial services business, a manufacturing business and a hotel, all of which are corporations subject to GILTI. The businesses differ largely in the extent to which they have tangible assets that qualify for the current deduction of a 10% return. All business qualify for EDC incentives and so have a USVI effective tax rate that is 10% of the US rate.

- The examples are hypothetical, but constructed based on conversations with the USVI government and on information from publicly available US tax data.

- The examples are not intended to be complete simulations of tax payments due for any actual companies. They do not include all the details relevant for a tax calculation for an actual company. They assume that the USVI subsidiary is the only foreign subsidiary of the US parent. Effects may be different for subsidiaries owned by US parents with multiple subsidiaries including those located in multiple jurisdictions.

Results: GILTI - Current Law

- GILTI can substantially increase the total tax rate on corporate income earned by USVI subsidiaries of US companies that qualify for EDC tax incentives, effectively negating the value of those congressionally authorized incentives.
- The tax increasing effect of GILTI is attenuated to the extent that the business has substantial tangible capital and so can benefit from the current exemption from US tax of a 10% return on that capital.
  - This is illustrated by comparing the hotel example (high tangible assets, lower GILTI so lower US and total tax rates) with the examples for the other businesses (lower tangible assets, higher GILTI so higher US and total tax rates).

	USVI Effective Tax Rate	US Tax Rate (GILTI)	Total Tax Rate
Financial Services	2.1%	8.7%	10.8%
Manufacturing	2.1%	7.7%	9.8%
Hotel	2.1%	0.8%	2.9%

Results: GILTI - Biden Administration Proposal

- This proposal would substantially increase the total tax rate on corporate income earned by USVI subsidiaries of US companies that qualify for EDC incentives.
- Each business in these examples sees its total tax rate rise to approximately the 21% GILTI tax rate (slightly higher because of the 20% reduction in the foreign tax credit).
- The increase above the current law total tax rate is especially significant for the hotel, which is adversely affected by the Biden Administration proposal's repeal of the exemption from US tax of a 10% return on tangible assets (the hotel's total tax rate goes from 2.9% to 21.6%).

	USVI Effective Tax Rate	US Tax Rate (GILTI)	Total Tax Rate
Financial Services	2.8%	18.8%	21.6%
Manufacturing	2.8%	18.8%	21.6%
Hotel	2.8%	18.8%	21.6%

Results: Exclusion from GILTI

- Exclusion from GILTI, or another mitigating policy such as a tax credit against GILTI liability, would reduce the effective tax rate on corporate income earned by USVI subsidiaries of US companies to the rate imposed by USVI law, e.g., 2.8% under the Biden proposal to raise the US corporate rate to 28%.
- With an exclusion, tax credit, or other mitigating policy in place, the effective tax rate would be approximately the effective rate obtained under the US tax rules prior to GILTI, whether or not additional changes to GILTI proposed by the Biden Administration are enacted. (GILTI was created by the TCJA. Under pre-TCJA law, US tax on USVI income would be due only when dividends are repatriated to the US parent and so could be postponed indefinitely, leaving only the USVI tax as a current obligation.)

Financial Services Business

	Current GILTI	Biden Proposed GILTI with Higher US Corporate Tax Rate	Biden Proposed Higher US Corporate Tax Rate, Exempt from GILTI
Pre- tax income in USVI	**$10,000,000**	**$10,000,000**	**$10,000,000**
USVI effective tax rate (90% reduction from statutory rate)	2.10%	2.80%	2.80%
Foreign taxes	($210,000)	($280,000)	($280,000)
After-foreign tax income	$9,790,000	$9,720,000	$9,720,000
Net tested income	**$9,790,000**	**$9,720,000**	**$9,720,000**
Tangible assets	$1,000,000	$1,000,000	$1,000,000
Normal rate of return	10.00%	0.00%	0.00%
Normal return on foreign assets, deductible in US	($100,000)	$0	$0
GILTI (net tested income - deduction of normal return)	**$9,690,000**	**$9,720,000**	**$9,720,000**
Inclusion percentage (GILTI/tested income, adjusts for the deduction of the normal return)	99.00%	100.00%	100.00%
Tested foreign income tax	$210,000	$280,000	$280,000
Foreign tax gross-up (foreign taxes * inclusion percentage)	$207,855	$280,000	$280,000
GILTI inclusion in taxable income	**$9,897,855**	**$10,000,000**	**$10,000,000**
GILTI deduction percentage	50.00%	25.00%	100.00%
Deduction for GILTI	($4,948,927)	($2,500,000)	($10,000,000)
Net GILTI inclusion in US taxable income = GILTI income - deduction	**$4,948,927**	**$7,500,000**	**$0**
US Tax rate	21.00%	28.00%	28.00%
U.S. Tax on GILTI income, before credit	**$1,039,275**	**$2,100,000**	**$0**
Deemed paid foreign taxes (20% reduction from tested foreign tax gross-up)	$166,284	$224,000	$224,000
Allowable foreign tax credit (FTC= min (US tax, deemed paid foreign taxes))	$166,284	$224,000	$0
Residual U.S. tax = US tax - allowable FTC	**$872,991**	**$1,876,000**	**$0**
Total tax (US and USVI combined)	**$1,082,991**	**$2,156,000**	**$280,000**
Total tax rate (total tax/(pre-tax income))	**10.80%**	**21.60%**	**2.80%**

Manufacturing Business

	Current GILTI	Biden Proposed GILTI with Higher US Corporate Tax Rate	Biden Proposed Higher US Corporate Tax Rate, Exempt from GILTI
Pre- tax income in USVI	**$2,600,000**	**$2,600,000**	**$2,600,000**
USVI effective tax rate (90% reduction from statutory rate)	2.10%	2.80%	2.80%
Foreign taxes	($54,600)	($72,800)	($72,800)
After-foreign tax income	$2,545,400	$2,527,200	$2,527,200
Net tested income	**$2,545,400**	**$2,527,200**	**$2,527,200**
Tangible assets	$3,120,000	$3,120,000	$3,120,000
Normal rate of return	10.00%	0.00%	0.00%
Normal return on foreign assets, deductible in US	($312,000)	$0	$0
GILTI (net tested income - deduction of normal return)	**$2,233,400**	**$2,527,200**	**$2,527,200**
Inclusion percentage (GILTI/tested income, adjusts for the deduction of the normal return)	87.70%	100.00%	100.00%
Tested foreign income tax	$54,600	$72,800	$72,800
Foreign tax gross-up (foreign taxes * inclusion percentage)	$47,907	$72,800	$72,800
GILTI inclusion in taxable income	**$2,281,307**	**$2,600,000**	**$2,600,000**
GILTI deduction percentage	50.00%	25.00%	100.00%
Deduction for GILTI	($1,140,654)	($650,000)	($2,600,000)
Net GILTI inclusion in US taxable income = GILTI income - deduction	**$1,140,654**	**$1,950,000**	**$0**
US Tax rate	21.00%	28.00%	28.00%
U.S. Tax on GILTI income, before credit	**$239,537**	**$546,000**	**$0**
Deemed paid foreign taxes (20% reduction from tested foreign tax gross-up)	$38,326	$58,240	$58,240
Allowable foreign tax credit (FTC= min (US tax, deemed paid foreign taxes))	$38,326	$58,240	$0
Residual U.S. tax = US tax - allowable FTC	**$201,211**	**$487,760**	**$0**
Total tax (US and USVI combined)	**$255,811**	**$560,560**	**$72,800**
Total tax rate (total tax/(pre-tax income))	**9.80%**	**21.60%**	**2.80%**

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Hotel

	Current GILTI	Biden Proposed GILTI with Higher US Corporate Tax Rate	Biden Proposed Higher US Corporate Tax Rate, Exempt from GILTI
Pre- tax income in USVI	**$9,000,000**	**$9,000,000**	**$9,000,000**
USVI effective tax rate (90% reduction from statutory rate)	2.10%	2.80%	2.80%
Foreign taxes	($189,000)	($252,000)	($252,000)
After-foreign tax income	$8,811,000	$8,748,000	$8,748,000
Net tested income	**$8,811,000**	**$8,748,000**	**$8,748,000**
Tangible assets	$80,000,000	$80,000,000	$80,000,000
Normal rate of return	10.00%	0.00%	0.00%
Normal return on foreign assets, deductible in US	($8,000,000)	$0	$0
GILTI (net tested income - deduction of normal return)	**$811,000**	**$8,748,000**	**$8,748,000**
Inclusion percentage (GILTI/tested income, adjusts for the deduction of the normal return)	9.20%	100.00%	100.00%
Tested foreign income tax	$189,000	$252,000	$252,000
Foreign tax gross-up (foreign taxes * inclusion percentage)	$17,396	$252,000	$252,000
GILTI inclusion in taxable income	**$828,396**	**$9,000,000**	**$9,000,000**
GILTI deduction percentage	50.00%	25.00%	100.00%
Deduction for GILTI	($414,198)	($2,250,000)	($9,000,000)
Net GILTI inclusion in US taxable income = GILTI income - deduction	**$414,198**	**$6,750,000**	**$0**
US Tax rate	21.00%	28.00%	28.00%
U.S. Tax on GILTI income, before credit	**$86,982**	**$1,890,000**	**$0**
Deemed paid foreign taxes paid (20% reduction from tested foreign tax gross-up)	$13,917	$201,600	$201,600
Allowable foreign tax credit (FTC= min (US tax, deemed paid foreign taxes))	$13,917	$201,600	$0
Residual U.S. tax = US tax - allowable FTC	**$73,065**	**$1,688,400**	**$0**
Total tax (US and USVI combined)	**$262,065**	**$1,940,400**	**$252,000**
Total tax rate (total tax/(pre-tax income))	**2.90%**	**21.60%**	**2.80%**

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