BRIEFING NOTE

GILTI TAX AND AMERICAN BUSINESSES ABROAD

2021 RESEARCH AND RECOMMENDATIONS FOR PROVIDING GILTI TAX RELIEF TO AMERICANS ABROAD WITH SMALL TO MEDIUM SIZE BUSINESSES

The Repatriation Tax and the Global Intangible Low Tax Income (GILTI) Tax implemented in the Tax Cuts and Jobs Act (TCJA) was meant for the offshore subsidiaries of gigantic U.S. multinational corporations holding undeclared profits outside of the U.S. Unfortunately, it is also assessed on the profits of small to medium size businesses owned by and supporting the families and futures of U.S. citizens living abroad. Further, due to its design it disproportionately impacts these middle class American workers.

Americans abroad are closely following work by Congress on proposals for the 2021 Budget Reconciliation Bill to reform the international taxation provisions of the TCJA. These measures are blamed for a nearly 40% decrease in corporate tax revenue and the expansion of corporate investment abroad. Democrats Abroad and others are making the case to Congress that an exemption from GILTI Tax on the profits of small to medium size businesses owned by Americans abroad with income under $400,000 should be included in those international tax reforms.

The 2017 TCJA was the culmination of decades of work by U.S. multinationals to establish advantageous terms for taxing the profits of their foreign subsidiary companies. Per the TCJA, U.S. multinationals would recognize the profits after deductions for a 10% return on tangible assets, offsets for 80% of foreign taxes already paid and a 50% discount on the corporate tax rate. It was an enormous triumph for corporate America, celebrated by Wall Street and heralded as an innovation in corporate taxation that would lead to job creation and economic growth.

It is unclear whether Congress understood the impact the new tax system would have on the foreign companies of U.S. citizens living abroad. These companies were included in the new U.S. international taxation regime along-side the foreign subsidiaries of U.S. multinationals like Google, Starbucks and ExxonMobil. The inordinately complex formula for calculating GILTI tax makes it difficult to believe that the tax was intended for the profits of small businesses.

2018 research by Democrats Abroad[1] found that Americans abroad with small to medium size businesses registered in the countries where they live were completely blind-sided by the news that they'd be paying two brand new taxes. And greatly confused. The Trump tax bill was meant to provide Americans across the board with tax cuts; the inclusion of two NEW taxes made no sense. The confusion became consternation and then fear when they began to learn more about them.

TCJA REPATRIATION TAX AND GILTI TAX

An examination of the design of the two new taxes demonstrates how inappropriate – both impractical and unfair - they are for small to medium sized businesses of Americans abroad.

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[1] *"Another Accidental Tax Penalty for Americans Abroad: This Time Hitting Small to Medium-Sized Business Owners",* 2018, bit.ly/AnotherAccidentalTax.

Repatriation Tax - a 15.5% tax imposed on foreign corporations' undistributed business profits from 1986 through 2017. Undeclared profits going back 30 years to be brought on to the personal tax filing of the business owner, taxed at the shareholder's marginal tax rate.

- Repatriation Tax is a *retroactive* tax.
- The timing of the payment of the tax bears no relation to the realization of revenue that would be used to pay the tax.
- It taxes the profits of a foreign-registered business that may have no connection to the U.S. aside from the nationality of its shareholder(s).
- It is assessed on undeclared profits going back decades, although businesses are only required to retain records for 7 years.
- It forces the U.S. repatriation of company profits, although the company owner lives abroad and may have no plans to ever repatriate to the U.S.
- It taxes profits of a business, but at the shareholder's individual marginal tax rate.

GILTI Tax - starting in 2018, undistributed business profits of foreign companies must be declared on the personal tax filing of the U.S. citizen shareholder, taxed at the shareholder's marginal tax rate.

- GILTI Tax is a *second* U.S. tax on undeclared profits of a foreign-registered business that may have no connection to the U.S. aside from the nationality of its shareholder(s); an obligation imposed on your business from now and forever more.
- It is assessed on company profits even if they stay in the business as earnings retained for reinvestment in the operations.
- There are no GILTI Tax offsets, discounts or deductions available to individual shareholder like those that are available to U.S. corporations with foreign subsidiaries.
- And what happens when the profits are declared? Will tax on the dividends due to the country where the business is registered be offset by U.S. tax already paid?
- If not, then the profits will be double-taxed?

Democrats Abroad found U.S. small business owners abroad impacted by the taxes incredulous that these two taxes could have been constructed with features making them so inordinately challenging to comply with: very difficult to calculate; inequitable in their application; and punitive in their effect. They asked themselves - and Congress - how their businesses would survive under this new tax regime.

In August 2021 Democrats Abroad conducted research to answer this question: four years on, how have the small to medium size businesses of Americans abroad survived under the onerous new tax burdens created by the 2017 TCJA?

TCJA RESEARCH AND REFORM RECOMMENDATIONS

Over those four years, Americans abroad activists drew attention to the inequitable TCJA treatment of Americans abroad owners of small businesses abroad relative to U.S. corporate owners of offshore companies. In mid 2020 the U.S. Treasury issued new GILTI Tax guidance aimed at addressing the inequity, but since 2017 Congress has not acknowledged the inherent double taxation of profits or the serious and costly compliance challenges.

Congress is now developing proposals for the 2021 Budget Reconciliation Bill to reform the TCJA international taxation provisions blamed for a nearly 40% decrease in corporate tax revenue. Americans abroad are making the case to Congress that those reforms should include an exemption from GILTI Tax on the profits of small to medium size businesses owned by Americans abroad with income under $400,000, on the basis that:

- The GILTI Tax itself and the compliance burdens it creates are putting existential operating and financial pressure on the small to medium size businesses of Americans abroad;
- By its very nature and in view of the method of calculation, it appears that the GILTI Tax was not meant for the profits of small to medium size businesses;
- The GILTI Tax relief put in place by the U.S. Treasury last year involves even greater complexity and cost, and is therefore not accessible to those it was meant for;
- Most of the businesses impacted by GILTI Tax exist to support ordinary, middle class Americans who are living, working, raising families and retiring abroad; and
- The GILTI Tax their businesses will face under the proposals for the 2021 Budget Reconciliation Bill will go up, which contravenes ambitions to protect those with income under $400,000 from tax increases.

Our research[2] shows the following[3]:

The businesses of Americans abroad are predominantly small to medium size businesses:

- 48% have only 1 employee
- 71% have no more than 5 employees
- 37% have revenue of less than $100,000
- 74% have revenue of less than $500,000

GILTI Tax and tax compliance is putting intolerable pressure on the businesses of these Americans abroad:

- 45% have a business tax rate of greater than 21%
- 63% have altered their plans to invest in the business
- 52% say their business is less competitive
- 30% have had to restructure their business or operations
- Fewer than one in four are accessing the Treasury GILTI relief (Sec 962 Election to be taxed at the corporate rather than individual rate and Sec 250 Deduction applying the 50% discount)
- 46% have had to change their business accounting treatment
- 73% pay more than $1,000 for tax return preparation
- 34% report that tax preparation costs comprise more than 5% of revenue
- 69% are paying at least 20% more for tax return preparation than before TCJA
- 32% are paying at least 50% more for tax return preparation than before TCJA

Americans abroad who own businesses are predominantly middle class:

- 43% have household income under $100,000
- 87% have household income under $400,000 (the cohort of Americans meant to be protected from tax increases this year)
- 73% are married, 62% to non-U.S. citizens
- 24% are raising children under the age of 18
- 68% are aged 35-65 (the wealth accumulation years)

2 *"GILTI Tax and American Businesses Abroad",* September 2021, bit.ly/GILTITaxAndAmericansAbroad

3 The research also asked respondents about experience with the TCJA Repatriation Tax. Twenty-five percent of respondents who were in business at 2017 report being impacted by Repatriation Tax. Nearly 60% of them had a Repatriation Tax liability. The average liability across this group was $163,211. Thirty-five percent paid the tax up front; 65% are paying it over 8 years, as allowed.

Democrats Abroad proposes an exemption from the GILTI tax for American business owners abroad with income under $400,000.

In summary:

- Although GILTI tax was designed as a tax on the profits of the overseas subsidiaries of large U.S. multinational corporations, it also, unfortunately, applies to the small to medium size businesses of ordinary Americans living, working, raising families and retiring abroad.
- GILTI has been implemented inequitably from the start, with corporations entitled to offsets, deductions and discounts inaccessible to individual small business owners.
- The complex formula to calculate GILTI tax suggests that it was never intended for the profits of small businesses. Most report a tax rate greater than 21%.
- Due to GILTI Tax, U.S. tax compliance costs increased by more than 20% for most of the small to medium size business owners in the study.
- The U.S. Treasury's retroactive regulatory relief is very expensive to access and so has provided support to very few of those for whom it was intended. These survey responses suggest fewer than one in four are taking the Sec. 962 election.
- Most Americans abroad with small businesses hit by GILTI Tax are ordinary working class people raising families and saving for the future.
- GILTI Tax and tax compliance is putting pressure on the small businesses of Americans abroad that does not exist for the businesses they compete with. 7% of responses were from Americans abroad who closed or sold their business because of GILTI Tax.
- An exemption from GILTI tax for American business owners abroad with income under $400,000 will protect them from the GILTI tax increases expected to be included in the 2021 Budget Reconciliation Bill.
- This is in line with the government's ambition to create tax policy that ensures large corporations and the wealthy pay their fair share and protects Americans with income under $400,000 from tax increases.

Democrats Abroad has published the findings referenced herein in a report entitled "GILTI Tax and American Businesses Abroad" which also includes dozens of comments from U.S. citizens abroad that own small to medium size businesses put at risk because of GILTI Tax. We have also published a datapack of the research survey submissions. These documents can be downloaded from taxation page the Democrats Abroad website[4].

Please send questions to taxationtf@democratsabroad.org.

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democratsabroad.org/taxation

[4]https://www.democratsabroad.org/carmelan/democrats_abroad_publishes_new_data_on_the_experience_of_americans_abroad_and_the_gilti_tax