GILTI TAX AND AMERICAN BUSINESSES ABROAD

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

September 2021

"The complexity of GILTI is overwhelming. Having your own business is hard enough. What the U.S. piles on us is unfair. I cannot understand what I did to deserve this. If the U.S. doesn't want Americans abroad to own businesses they should pass a law forbidding it."
Texas voter living and operating a small business in Switzerland

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INTRODUCTION

Congress is developing proposals for the 2021 Budget Reconciliation Bill to reform the international taxation provisions in the 2017 Tax Cuts and Jobs Act (TCJA) blamed for a nearly 40% decrease in corporate tax revenue and an increase in corporate investment abroad. The Global Intangible Low Tax Income (GILTI) Tax, implemented as part of the TCJA, was meant to dissuade offshoring of jobs and capture tax revenue from the profits of foreign subsidiaries of gigantic U.S. multinational corporations held offshore. Unfortunately GILTI Tax has also been assessed on the undeclared profits of small to medium size businesses supporting the families and futures of U.S. citizens living abroad. Whether this was a deliberate policy decision, an oversight in consideration or an accident of drafting does not change the fact that the impact on American small to medium size businesses abroad has been devastating. Research outlined herein demonstrates that point.

Americans abroad 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 needs to be included in the 2021 Budget Reconciliation Bill. This reform is essential for rescuing many thousands of businesses abroad on the brink of collapse and preserving the pledge to protect Americans abroad with income under $400,000 from tax increases.

BACKGROUND

Enacting the 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. It enables U.S. multinationals to repatriate the profits net of 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 recognized the impact the new tax system would have on the foreign companies of U.S. citizens living abroad. These 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, but this remains an open question.

2018 research by Democrats Abroad found that Americans abroad with small to medium size businesses registered in the countries where they live were completely blind-sided by the two new TCJA taxes.[1] They were also greatly confused, as the Trump tax bill was widely promoted as providing Americans across the board with tax cuts. The confusion became consternation and then fear when they began to investigate the new taxes.

> *"The complexity of GILTI is overwhelming. Having your own business is hard enough. What the U.S. piles on us is unfair. I cannot understand what I did to deserve this."*
>
> Texas voter living in Switzerland

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

TAX CUTS AND JOBS ACT REPATRIATION TAX AND GILTI TAX

The design of these new taxes was utterly bewildering.[2]

Repatriation Tax - a 15.5% tax imposed on foreign corporations' undistributed business profits from 1986 through 2017. Undeclared profits going back 30 years were to be brought on to the personal tax filing of the business owner and 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 business records are only required to be retained 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 the business from now and forever more.
- It is assessed on business profits even if they stay in the business as earnings retained for reinvestment rather than distributed as dividends.
- There are no GILTI Tax offsets, discounts or deductions available to Individuals like those 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.

U.S. citizens abroad using small to medium size businesses to raise families and save for the future wondered how this could be fair. They asked themselves - and Congress - how their businesses would survive.[3] **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 for them by the 2017 TCJA?**

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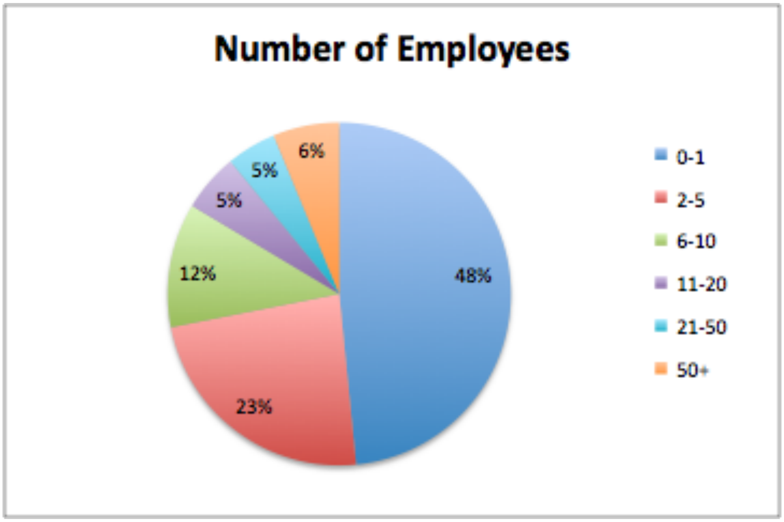
[2] A contradictory tax policy outcome exists here. While the GILTI Tax on profits plus its companion piece, the retroactive Repatriation Tax on past profits, were promulgated to migrate U.S. companies to a Territorial based system of taxation, they have had the exact opposite effect for U.S. individuals living and owning companies abroad. Their residency and their companies' registrations are offshore, yet these taxes pull non-U.S. company profits into the U.S. tax system rather than leave them in the territory where the company is registered and the shareholder resides.

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

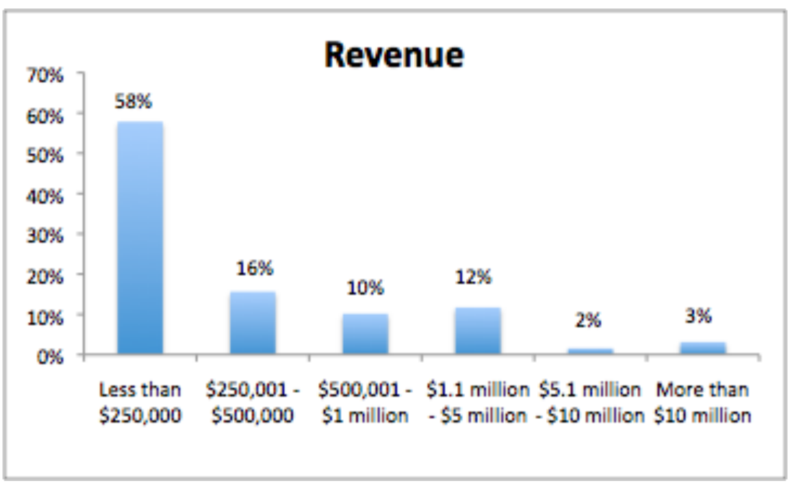
2021 GILTI TAX RESEARCH FINDINGS

In August 2021 Democrats Abroad published a survey for American owners of small to medium size businesses registered in countries other than the U.S. to assess the impact of GILTI Tax.[4] The survey received 147 submissions from research participants living in 30 countries. (See Appendix I.)

As measured by number of employees and annual business turnover, the businesses owned by Americans abroad are predominantly small businesses.

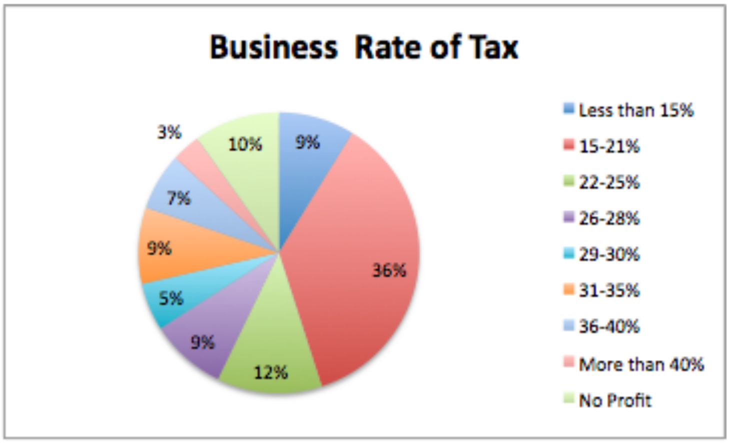


Forty-eight percent of respondents report their business has one employee; 71% have no more than five. Thirty-seven percent of respondents report their business have annual revenue of less than $100,000 (for more see Appendix II), 58% have annual revenue of less than $250,000 and 72% have annual revenue of less than $500,000.



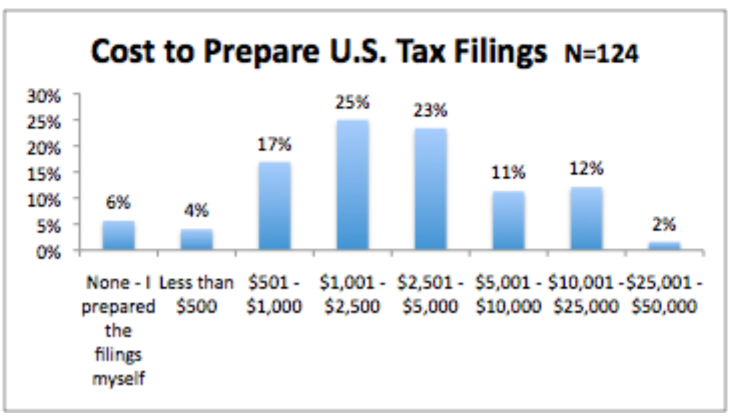
[4] The research also asked about Repatriation Tax. Twenty-five percent of respondents in business at 2017 report being impacted by Repatriation Tax. Nearly 60% of them had a Repatriation Tax liability. The average liability across this group was $163,211. Thirty-five percent paid the tax up front; 65% are paying it over 8 years, as allowed. https://bit.ly/GILTIDatapack

GILTI Tax and tax compliance is putting intolerable pressure on the businesses of these Americans abroad. Forty-five percent of respondents report that their businesses are paying tax at a rate of more than 21%. The average across the survey group was 21.3%, which compares to the average for U.S. small businesses of 19.8%.



Seven percent of respondents had closed their business because of GILTI Tax, but many sent comments that they feared reaching the point where they were forced to do the same.

Seventy-three percent of respondents report that they pay more than $1,000 for advisors to prepare their U.S. tax filings.



"Dealing with US taxes is by far the biggest headache and expense of conducting my business. With my personal and corporate tax my total tax rate this year may be as high as 45%."

Oregon voter living in Canada

"GILTI taxes non-taxable business dividends protected under EU Parent-Subsidiary directive, resulting in a very high tax burden and double taxation. There is no consideration to tax on business profits paid out as dividends. For me, with GILTI, the effective tax on dividends is 21% at the business level plus 56% at the individual level = 77%."

Maryland voter living in Sweden

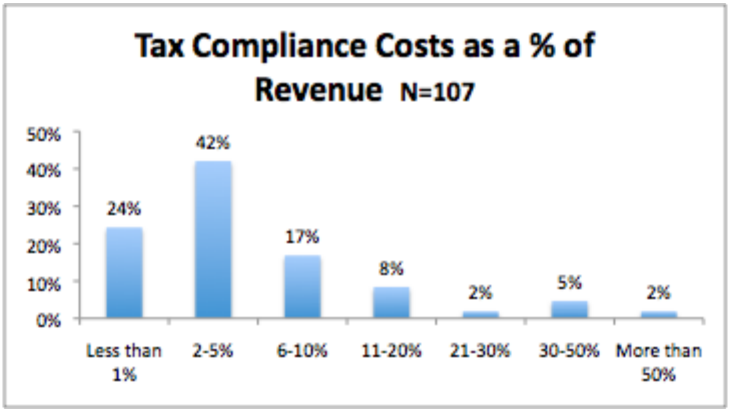
"Given that I pay tax on the profit of my business, plus other local taxes in France where my company is registered, I see no logical reason to pay a GILTI tax on top of that. What am I GUILTY of?"

Louisiana voter living in France

"I worked hard to build up my consulting business over the last 20 years. I cannot sustain the cost of tax prep due to complexities and punitive nature of the tax code so I will be forced to close my company shortly."

Ohio voter living in Canada

One in three respondents reports tax preparation costs comprise 5% or more of business revenue.



"We hire 2 different tax firms in order to file correctly. The average expat small business owner cannot do this. This is frustrating for those who try to follow the law no matter how convoluted it is."

Ohio voter living in Thailand

"The full impact of GILTI will be deferred due to COVID related losses. I have no tax liability but I have crushing return preparation and filing costs."

New Hampshire voter living in Czech Republic

"For my very small business I spend over 2% of my revenue to prepare my US taxes. That is 2 ½ times what I spend to file me CA taxes."

Pennsylvania voter living in Canada

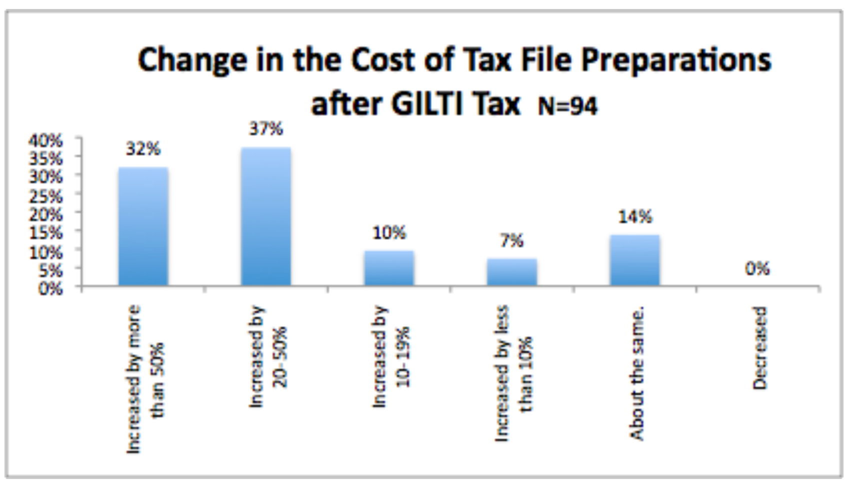
"We are a company that provides US accounting services, but the complexity of GILTI forced us to give out our personal return to a more specialized accounting firm, which costs us around $1,500 per year."

New York voter living in Israel

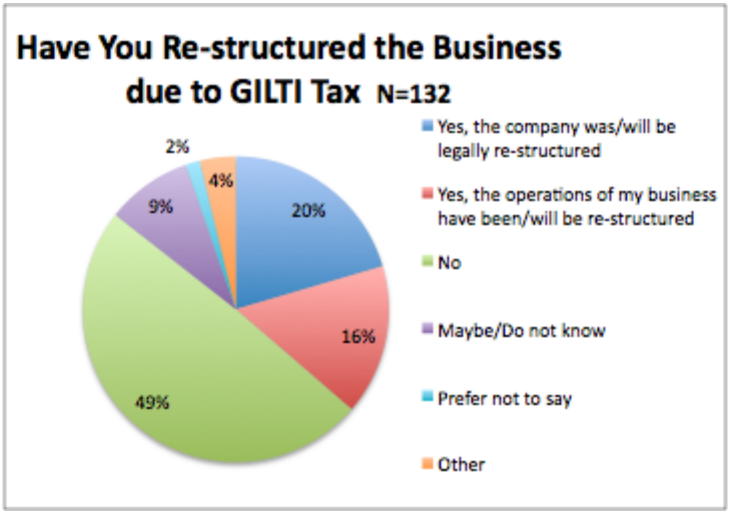
"There are no tax advisors in my country of residence who are familiar with GILTI. I had to hire an advisor in Florida. Even though I likely won't owe GILTI Tax, the cost of legal advice and preparation of tax filing has gone up substantially. And, unlike a tax, that cost to me is of no benefit to the US Treasury. For me and many SME's invested by US citizens living overseas, GILTI is simply a burden with no winners."

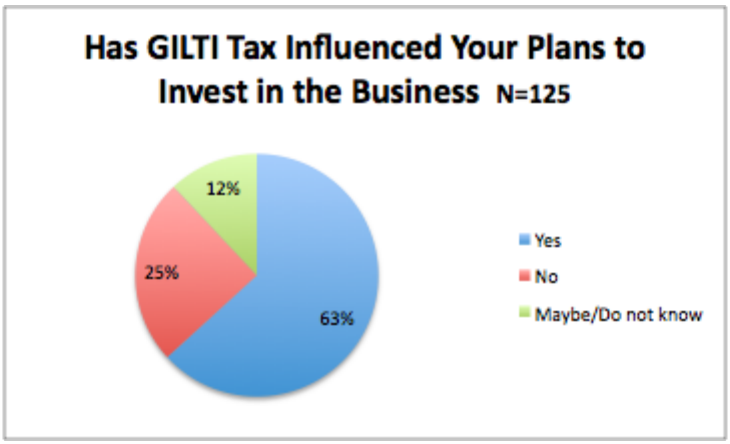
Pennsylvania voter living in an undisclosed country abroad

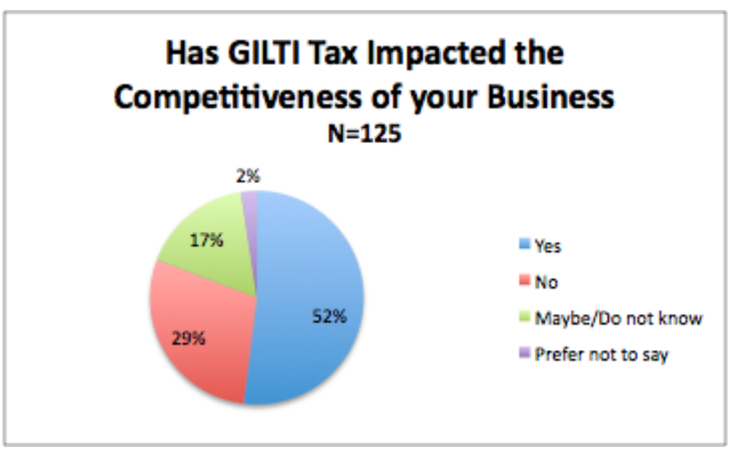
Sixty-nine percent are paying at least 20% more for tax return preparation than before TCJA and one in three are paying at least 50% more to have their U.S. tax returns filed.



The impact of GILTI Tax penetrates deeper into the businesses than the cashflow statement. Thirty-six percent of survey participants report they have had to restructure their business or operations, 63% have altered their plans to invest in the business and 52% say their business is less competitive.







"GILTI is killing the competitiveness of my company. Once again double/triple taxed. Even if there is no tax to pay for certain years, the accountant fees go up to fill out the forms properly."

California voter living in Japan

"Ironic that being a citizen of the most capitalistic country in the world means that one is at a competitive disadvantage with other businesses when operating outside of the U.S."

California voter living in Canada

"I feel like I'm being treated like a criminal by the US government for doing lawful business overseas. It's a big negative for US products and opportunities for Americans overseas and impairs US exports. Other countries support their citizens overseas. The US penalizes and emotionally persecutes Americans abroad."

Washington voter in Canada

"I will need to restructure or close the business. I cannot compete with the complexity of GILTI on my back."

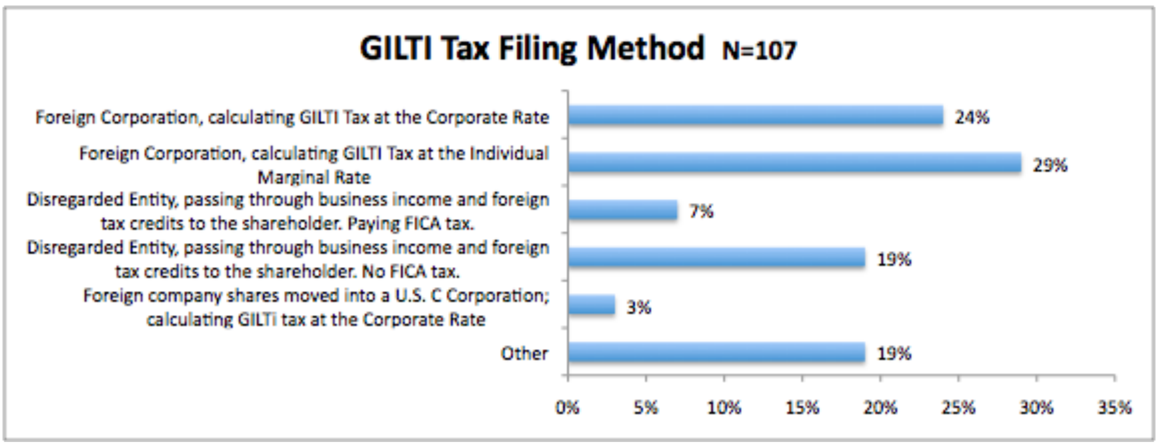
Wisconsin voter living in Taiwan

"I set up my business as a company in order to work as an IT contractor. GILTI tax both lowers my income and makes it harder for me to make a living."

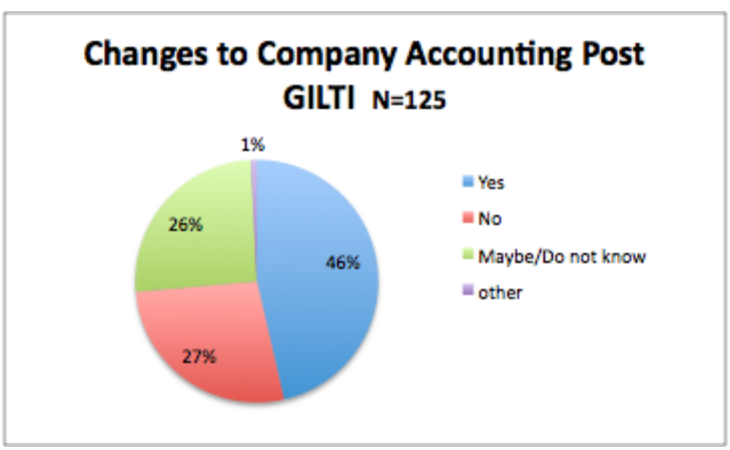
Wisconsin voter living in Canada

In July 2020 the U.S. Treasury published new guidance for shareholders in businesses registered abroad enabling them to elect to be treated, for the purposes of GILTI Tax, like corporations. It provided small business owners with the option of calculating GILTI Tax at the U.S. corporate tax rate of 21% (the Section 962 election) instead of the shareholder's marginal tax rate, and taking the 50% discount (the Section 250 deduction). Trade-offs for adopting this tax treatment included reporting business accounts on a U.S. calendar year basis and more, further increasing the accounting, tax preparation and other costs of GILTI Tax compliance. Importantly, when the Section 962 election is taken, a second tier of U.S. taxation applies when a dividend of those profits already taxed by GILTI is distributed to the owner.

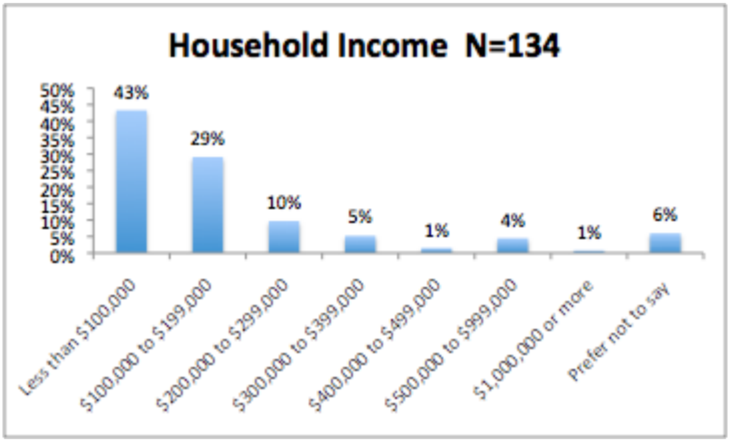
Fewer than one in four respondents indicate they are accessing the GILTI tax relief. Though the new regulations provided theoretical relief, the survey responses suggest genuine commercial relief remains out of the reach of many who need to access it.



Forty-six percent indicate that GILTI Tax compliance has forced them to change the accounting treatment of their business.



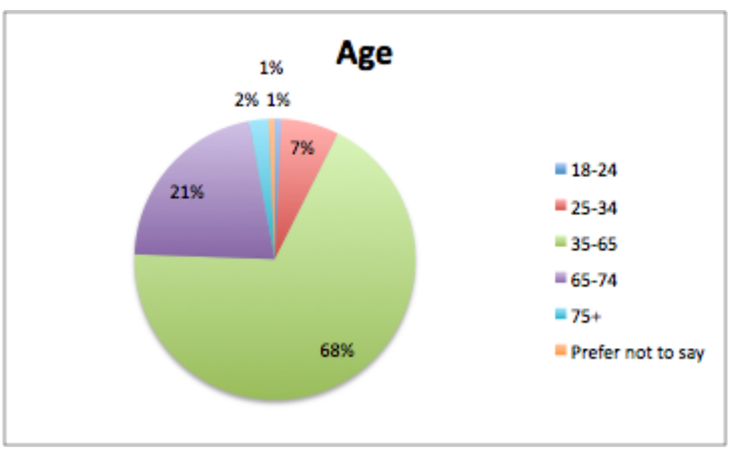
Americans abroad who own businesses are predominantly middle class. The charts that follow provide personal information about the survey respondents.



Forty-three percent of research participants have household income under $100,000. Eighty-seven percent have household income under $400,000. This is the cohort of Americans to be protected from tax increases coming this year.

Of the respondents to this research 54% owed tax to the U.S. in the last year that they filed. The average tax liability of those who owed was $12,900. The median was $7,500.

More than ⅔ are aged 35-65; these are the main wealth accumulation years of life.



"The US tax responsibilities (time and accounting fees) for myself as a US individual living abroad, as the owner of a small, incorporated Canadian business, and of our 2 children (dual citizens) seem extremely disproportionate to our incomes. We pay on average $C3000 a year to have our US taxes prepared."

New Jersey voter living in Canada

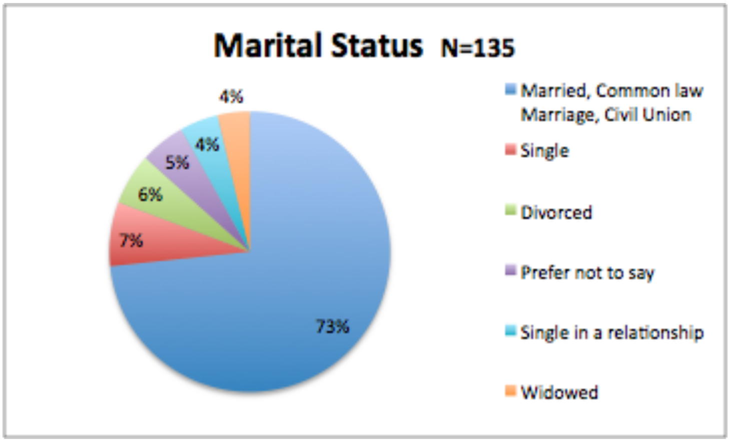
"We already pay Israeli taxes and have to pay $2500 from our own pocket to an American accountant to take care of GILTI and other US tax issues."

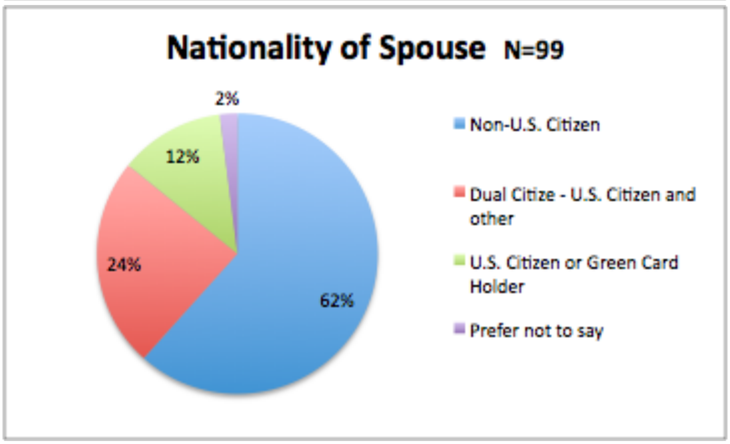
Kansas voter living in Israel

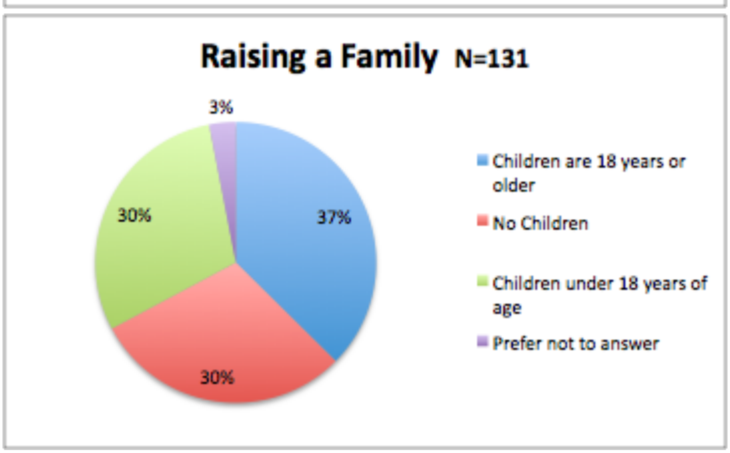
"I started my company in 1993 in a country that has been my home since then. I paid myself only what I needed to support my living including supporting a son as a single Dad, and I put the rest back into the business as it is my main asset and because the business needed growth capital, and bank loans were historically hard to access, given my status as a foreigner. I can't own property where I live so I don't own a house. Over 25 years, the accumulated profits are roughly 3.0 million. That is an average of roughly 125K/year. The shock and complexity of having to pay tax on that profit retroactively has had a devastating impact on personal liquidity and has created stress with other non-American shareholders who don't want to see cash taken out of the company to address 'my tax problems'."

Pennsylvania voter living in an undisclosed country abroad

Seventy-three percent are married, sixty-two percent to non-US citizens. Fifty-four percent are raising children under the age of 18.







"As a sole proprietor and sole breadwinner for my family, I have been afraid to incorporate my successful business in Canada because of concerns about how it would be treated by the IRS. As a result, I pay enormous taxes at personal tax rates rather than corporate tax rates, making it very difficult to save for retirement, pay off debt, and otherwise reap the rewards of my hard work."

Maine voter living in Canada

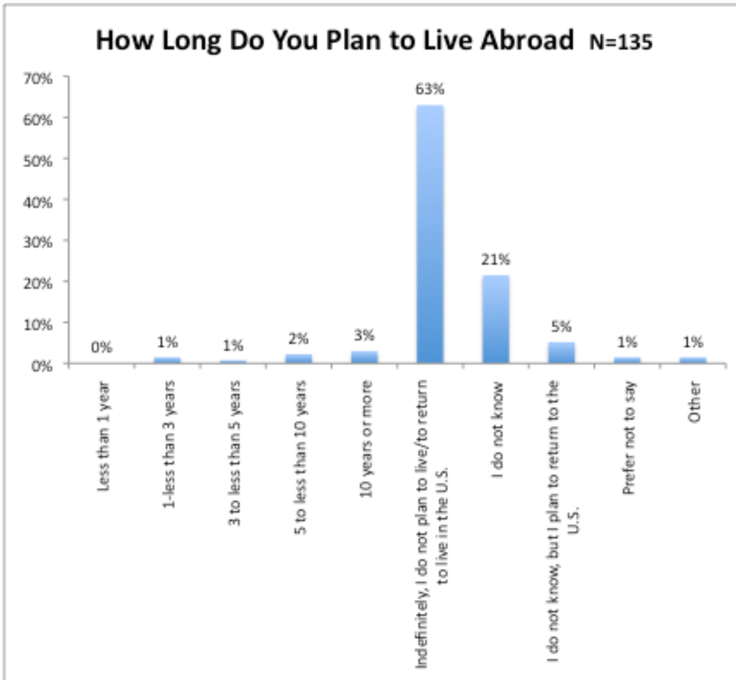
It has a stupid name. Honestly, if you'd called it the Patriotic Tax or the Home Aid Tax I'd have paid it willingly. Calling it "GILTI" just makes me ANGRY. I am NOT GUILTY of tax evasion, ever, and am proud to be an American living abroad. I feel like I am being PUNISHED for marrying a foreigner and keeping my American citizenship.

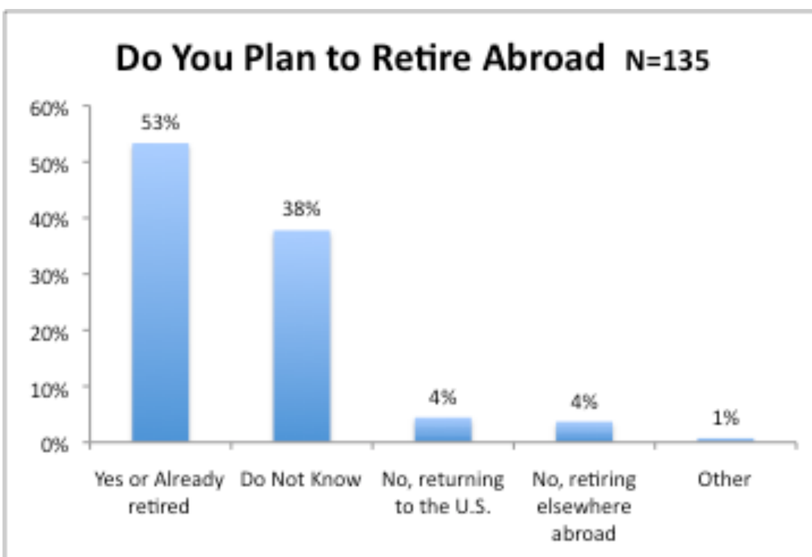
Pennsylvania voter living in the UK

I have a young daughter and family to support. The paperwork and accounting fees for IRS reporting are overwhelming. Please help us with relief from this onerous reporting. It is extremely negative for US citizens with small businesses to be subject to this. It also frustrates Americans overseas and makes it less likely that US products and US citizens will be promoted and encouraged overseas.

Washington voter living in Canada

At least 63% have made their life outside the U.S. and have no plans to return. Fifty-seven percent plan to retire outside the U.S. (some in the country they currently live in, some in other countries abroad) or already have.





GILTI TAX AND AMERICANS ABROAD

Over the four years since the law was enacted, Americans abroad activists have drawn attention to the inequitable TCJA treatment of Americans abroad who own small businesses abroad relative to U.S. corporate owners of offshore companies. Corporations pay GILTI Tax at an adjusted rate as low as 10.5%, whereas individuals pay GILTI tax at their individual marginal tax rate. In mid 2020, at last, Treasury issued new GILTI Tax guidance aimed at addressing the inequity. Taking advantage of the regulatory relief requires, amongst other things, adjustments to the way the business' accounts are prepared. This drives compliance costs even higher, placing the relief out of the reach of most small to medium size business owners.

To this point Congress has not, unfortunately, acknowledged the serious and costly compliance challenges nor the inherent double taxation of profits experienced by Americans abroad with small businesses caught by GILTI.

Congress is now at work on proposals for the 2021 Budget Reconciliation Bill to "overhaul" the international taxation provisions in the TCJA. With the support of the data provided herein, Americans abroad are making the case to Congress that, included in those reforms, should be **an exemption for Americans abroad with income under $400,000 from GILTI Tax on the profits of their small to medium size businesses**, on the basis that:

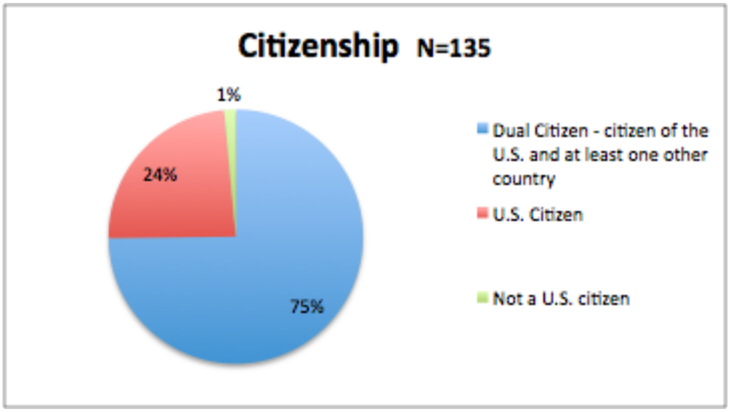
- Although GILTI Tax was designed as a tax on the profits of the overseas subsidiaries of large U.S. multinational corporations, it also, unfortunately, applies to the small to medium size businesses of ordinary Americans living, working, raising families and retiring abroad.
- GILTI has been implemented 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.
- 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.
- 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.

APPENDIX I - Research Participants

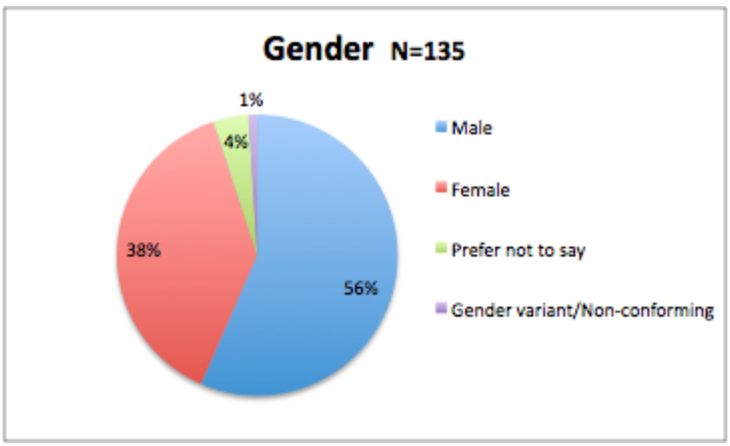
APPENDIX II - Businesses Abroad of the Research Participants

APPENDIX I - Research Participants

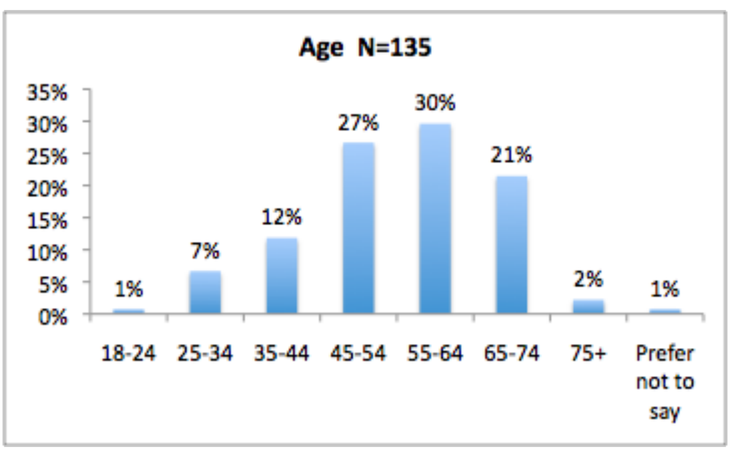
I.1 Citizenship



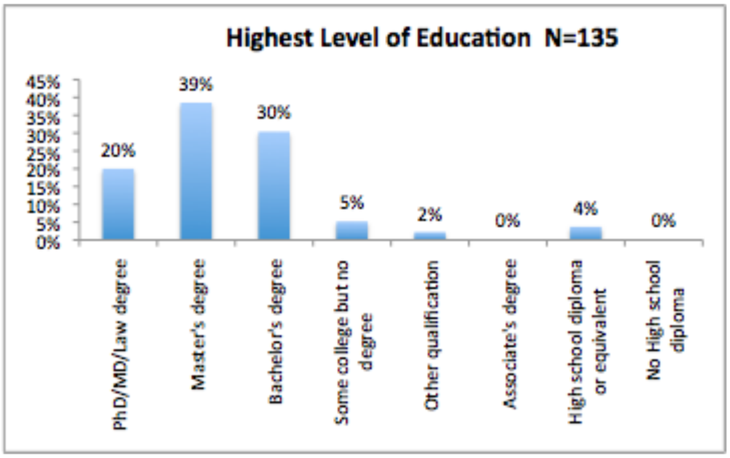
I.2 Gender



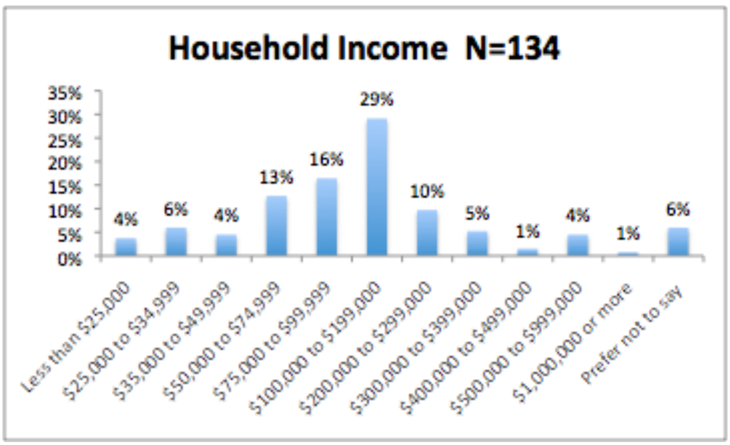
I.3 Age



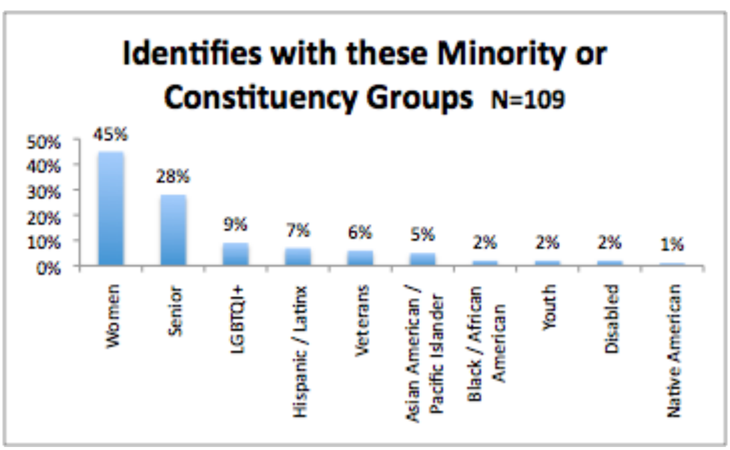
I.4 Education



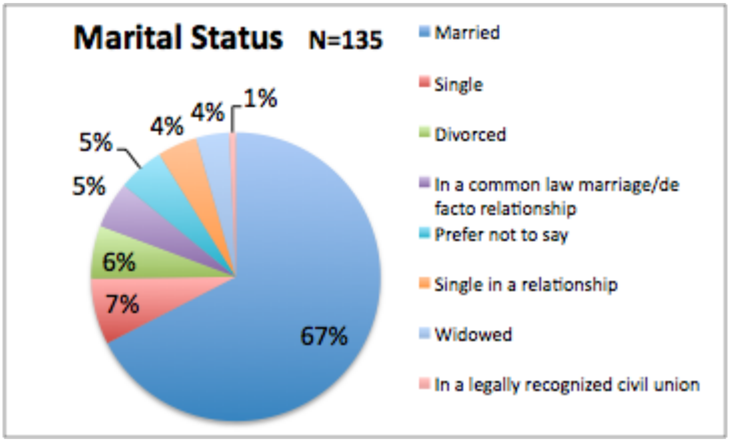
I.5 Household Income



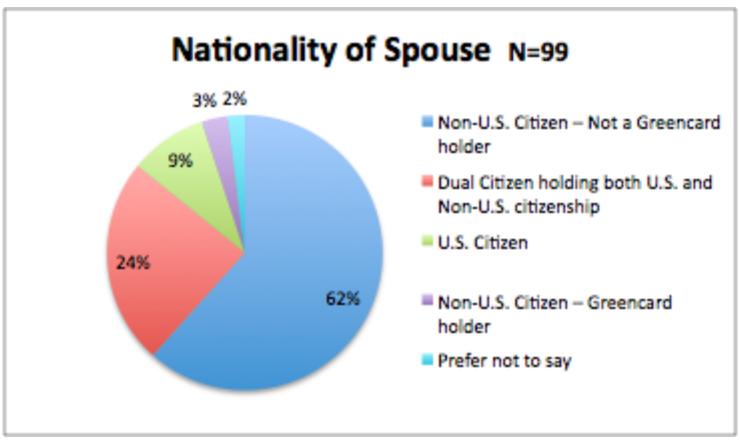
I.6 Minority and Constituency Group Affiliations



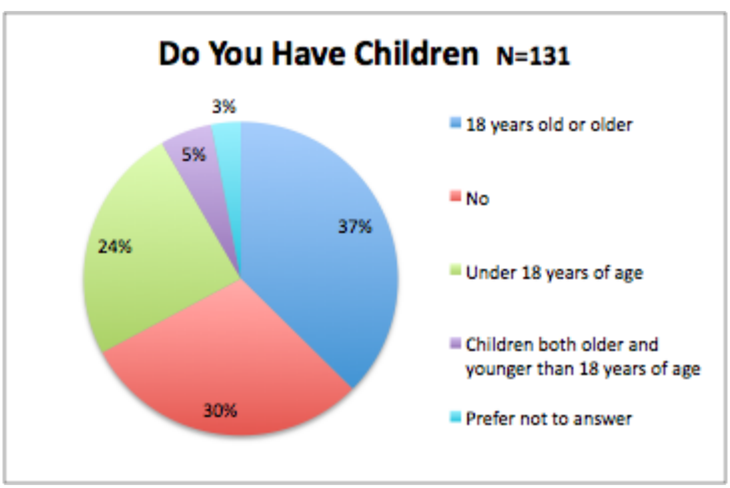
I.7 Marital Status



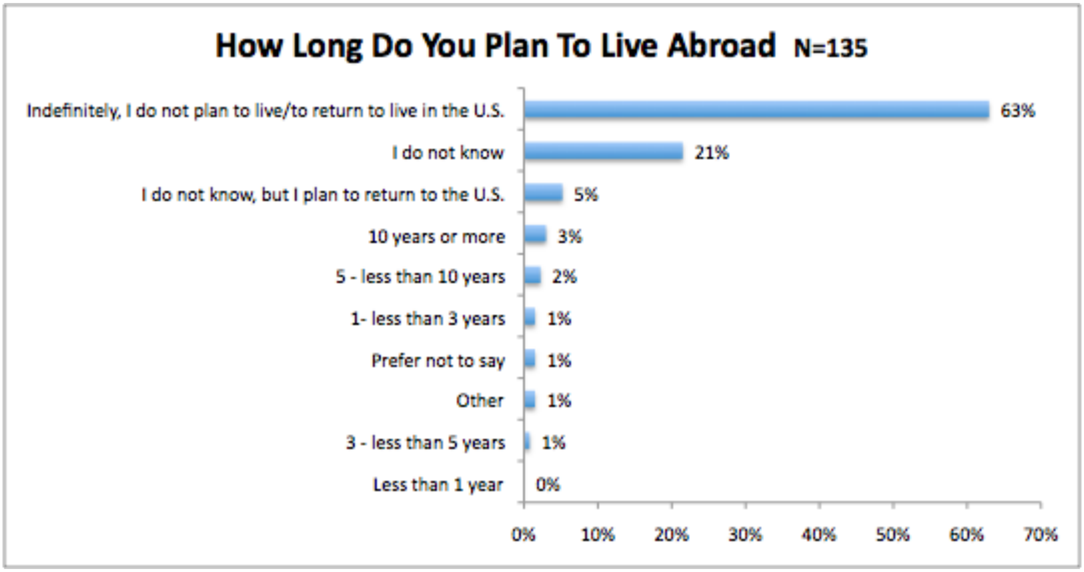
I.8 Nationality of Spouse



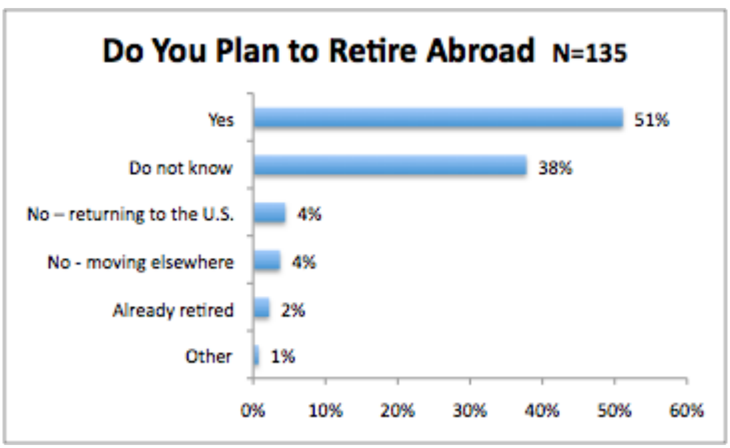
I.9 Do You Have Children



I.10 How Long Do You Plan To Remain Living Abroad



I.11 Do You Plan To Retire Abroad



I.12 Country of Residence

Country			Country	
Canada	39%		United Arab Emirates	2%
France	11%		United States of America*	2%
United Kingdom	8%		Brazil	1%
Netherlands	5%		Cameroon	1%
Italy	3%		China	1%
Singapore	2%		Czech Republic	1%
Sweden	3%		Denmark	1%
Switzerland	3%		Guatemala	1%
Australia	2%		India	1%
Germany	2%		Ireland	1%
Japan	2%		Latvia	1%
Belgium	2%		Mexico	1%
Israel	2%		New Zealand	1%
Portugal	2%		Romania	1%
Thailand	2%		Taiwan	1%
				N=132

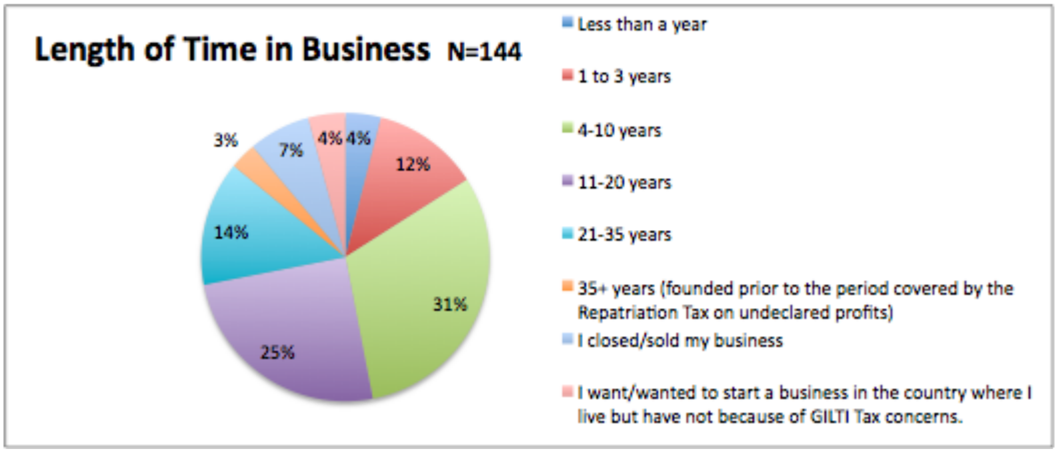
* Participants noting that COVID has forced them to relocate temporarily back in the U.S.

I.13 Voting State

New York	16%		New Mexico	2%
California	15%		North Carolina	2%
Pennsylvania	9%		Ohio	2%
Florida	9%		Oklahoma	2%
Massachusetts	7%		Oregon	2%
Illinois	5%		Vermont	2%
Washington	5%		Alaska	1%
Texas	4%		Kansas	1%
Colorado	3%		Louisiana	1%
Wisconsin	3%		Maine	1%
Arizona	2%		Michigan	1%
Connecticut	2%		Nevada	1%
Indiana	2%		South Carolina	1%
Maryland	2%		Virginia	1%
New Hampshire	2%		Wyoming	1%
New Jersey	2%			N=129

APPENDIX II - Businesses Abroad of the Research Participants

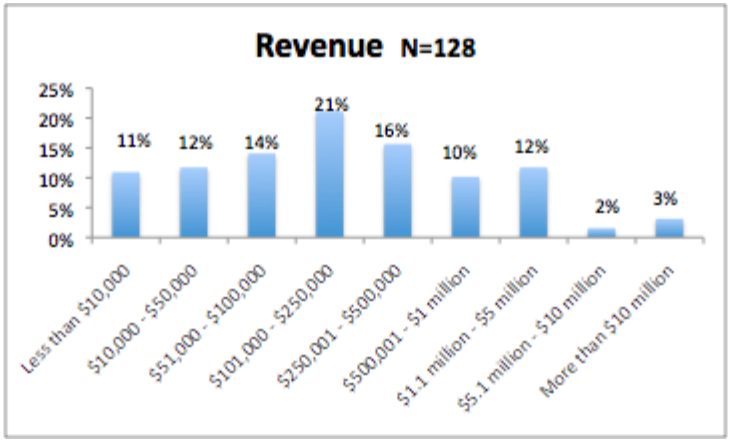
II.1 Length of Time the Company Has Been in Business



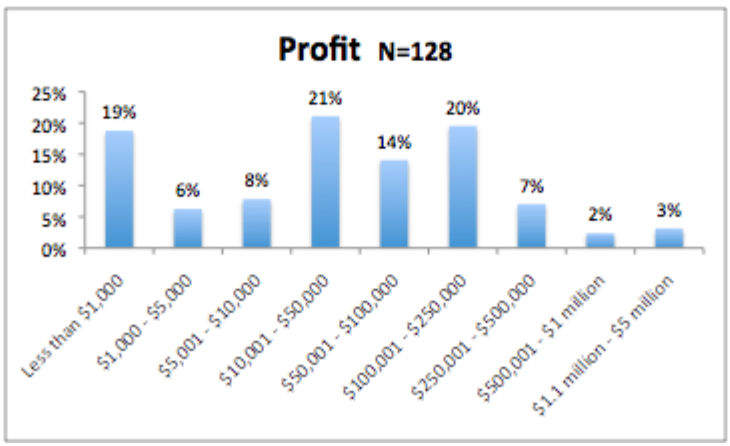
II.2 Industry

Consulting & Strategy	17%
IT and Comm Technology	14%
Healthcare & Medical	7%
Advertising, Media, Marketing & Communications	7%
Hospitality & Tourism	6%
Accounting, Banking & Finance	5%
Education & Training	6%
Culture, Arts & Entertainment	6%
Manufacturing, Transport, Logistics, Trades & Services	5%
Engineering, Design & Architecture	6%
Retail & Consumer Products	4%
Legal, Insurance and Superannuation	3%
Science & Technology	2%
Real Estate and Property	2%
Administration, Office Support, Human Resources & Recruitment	2%
Farming, Animals & Conservation	2%
Fitness, Sport & Recreation	1%
Other	5%
	N=121

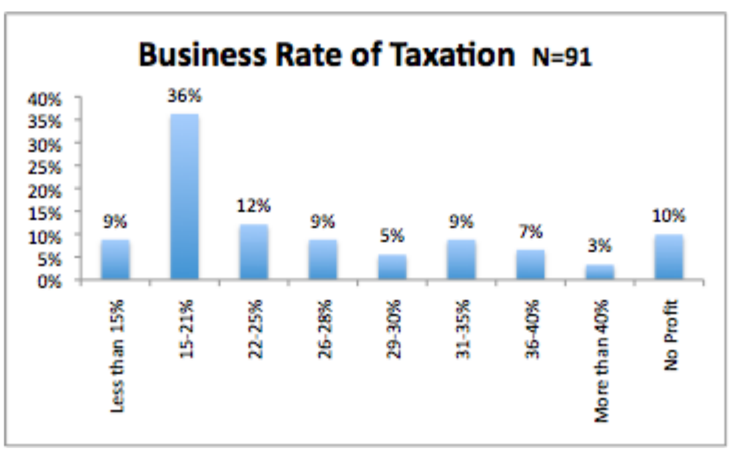
II.3 Annual Revenue



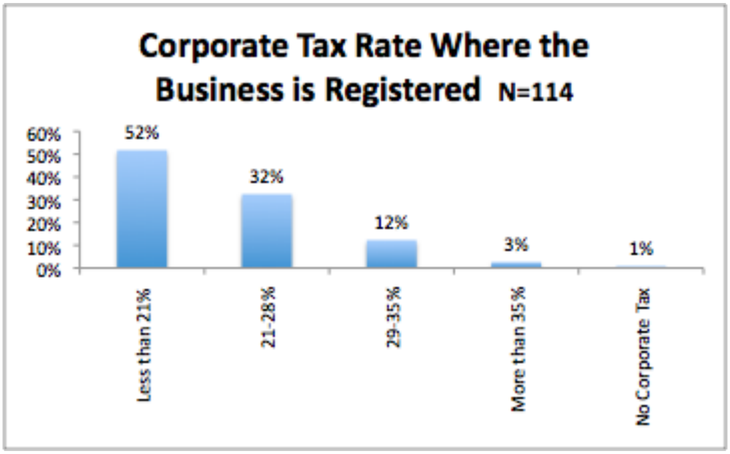
II.4 Profit



II.5 Business's Rate of Taxation



II.6 Corporate Tax Rate of Country Where the Business is Registered



DEMOCRATS ABROAD