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**NOTICE: INCOME TAX GUIDANCE
ON GLOBAL INTANGIBLE LOW-TAXED INCOME (GILTI)
FOR CORPORATIONS, INDIVIDUALS, TRUSTS and ESTATES**

Issued: January 28, 2020

Generally, for tax years beginning after December 31, 2017, the federal Tax Cuts and Jobs Act¹ created a new category of foreign-sourced deemed income—global intangible low-taxed income (“GILTI”). GILTI is included in gross income² and, therefore, impacts the determination of federal taxable income (“FTI”) for corporations and adjusted gross income (“AGI”) for individuals, trusts and estates. This notice provides guidance on how GILTI and related provisions of the Tax Cuts and Jobs Act impact Michigan income tax reporting.

Federal Treatment of GILTI

Federal calculation of GILTI for U.S. Shareholders: IRC 951A provides:

Each person who is a United States shareholder of any controlled foreign corporation for any taxable year of such United States shareholder shall include in gross income such shareholder’s *global intangible low-taxed income* for such taxable year.³

The federal determination of U.S. shareholder⁴ or controlled foreign corporation⁵ (“foreign corporation”) status and the complexities of calculating GILTI are beyond the scope of this notice. However, in very general terms, GILTI is a U.S. shareholder’s pro-rata share of:

| | | |
|--|-------------|---|
| Foreign corporations’ net income not subject to U.S. tax | <i>less</i> | Each foreign corporation’s presumed 10% return on its tangible business assets, with adjustments |
|--|-------------|---|

¹ Public Law 115-97, enacted December 22, 2017.

² IRC 951A. The GILTI provisions are effective for foreign corporations in months beginning after December 31, 2017, and to tax years of U.S. shareholders in which or with which such foreign corporations’ tax years end.

³ IRC 951A(a). Emphasis added.

⁴ IRC 951A(e)(2).

⁵ IRC 951A(e)(3).

Federal GILTI adjustments for corporations: In addition to determining the amount of GILTI in gross income, a corporate taxpayer may make two adjustments. First, for some taxpayers, IRC 78 “grosses up” income by treating as a dividend certain foreign taxes deemed paid, including taxes attributable to GILTI.⁶ Second, IRC 250(a)(1)(B) allows a 50% deduction of GILTI and the IRC 78 gross-up attributable to GILTI.⁷

Example 1: Assume a corporation is subject to IRC 78 gross-up and is deemed to have paid foreign tax of \$10 on \$90 of GILTI included in gross income.

| GILTI for Corporations | |
|--|----------------|
| GILTI under IRC 951A | \$90.00 |
| Plus: IRC 78 gross-up attributable to GILTI | 10.00 |
| <u>Less: IRC 250(a)(1)(B) deduction of 50%</u> | <u>(50.00)</u> |
| GILTI included in FTI | \$50.00 |

Foreign-derived intangible income (FDII). IRC 250 also establishes a new category of a U.S. corporation’s income, Foreign Derived Intangible Income (“FDII”), and provides a deduction separate from the GILTI and gross-up deduction discussed above. Generally, FDII is an estimate of a U.S. corporation’s direct income from sales of goods and services to foreign markets that exceeds a presumed return on its tangible assets.⁸ If a U.S. corporation has FDII, 37.5% of that amount for a taxable year can be deducted.⁹

Federal GILTI adjustments for electing individuals, trusts and estates. Generally, individuals, trusts and estates include GILTI in gross income without adjustments under IRC 78 and IRC 250. However, an individual, trust or estate may elect to pay a tax equal to a U.S. corporation’s on GILTI under IRC 962(a)(1) and 951A(f).¹⁰ If the federal election is made, these taxpayers also apply the corporate adjustments for IRC 78¹¹ and IRC 250(a)(1)(B).¹²

Federal treatment of an actual distribution of earnings and profits for electing individuals, trusts and estates. An individual, trust or estate that made an IRC 962(a)(1) election to pay a tax equal to a corporate tax on GILTI may receive an actual distribution (as opposed to GILTI, which is deemed income) from the foreign corporation in the future. If an actual dividend is paid, IRC 962(d) requires the taxpayer to include in gross income the actual dividend less any federal tax paid on specific income, which includes GILTI.

⁶ IRC 78, IRC 960.

⁷ The 50% deduction is reduced to 37.5% for taxable years beginning after 2025. IRC 250(a)(3)(B).

⁸ Internal Revenue Service, *Notice of proposed rulemaking, Deduction for Foreign-Derived Intangible Income and Global Intangible Low-Taxed Income*, 84 FR 8188 (March 6, 2019).

⁹ IRC 250(a)(1)(A). The 37.5% deduction is reduced to 21.875% for taxable years beginning after 2025. IRC 250(a)(3)(A).

¹⁰ Trusts and estates may make an IRC 962(a)(1) election under Treas. Reg. 1.962-2(a).

¹¹ Treas. Reg. 1.962-1(b)(1)(i)(B)(3).

¹² 84 FR 8200 (March 6, 2019).

Example 2: An individual makes the election under IRC 962(a)(1). Assume for purposes of IRC 78 that the individual is deemed to have paid foreign tax of \$10 on \$90 of GILTI included in gross income. The individual paid no other tax on income to which the election under IRC 962(a)(1) applies.

| Year 1: Deemed income (GILTI) | | Year 2: Actual income | |
|--|----------------|--|---------------|
| GILTI in gross income | \$90.00 | | |
| Plus: IRC 78 foreign tax gross-up | 10.00 | | |
| <u>Less: IRC 250(a)(1)(B) deduction, 50%</u> | <u>(50.00)</u> | Foreign dividend | \$90.00 |
| GILTI included in AGI | \$50.00 | <u>Less: Tax paid in Year 1 on GILTI</u> | <u>(2.50)</u> |
| | | Net foreign dividend in gross income | \$87.50 |
| U.S. tax @ 21% corporate rate | \$10.50 | | |
| <u>Less: 80% foreign tax credit</u> | <u>(8.00)</u> | | |
| Net U.S. tax | \$2.50 | | |

Michigan Income Tax Treatment of GILTI

C corporations

Tax base. The starting point of Michigan CIT is “business income,”¹³ which is “federal taxable income.”¹⁴ Therefore, GILTI, IRC 78 gross-up, and the IRC 250 deductions for GILTI and FDII are included in the starting point of the CIT return (Form 4891, line 12 or Form 4897, line 21 for unitary business group members) to the extent they are included in (or deducted from) FTI. Business income is then adjusted to reach the corporate income tax base before allocation or apportionment.¹⁵ One adjustment provides:

*To the extent included in federal taxable income, deduct dividends and royalties received from persons other than United States persons and foreign operating entities, including, but not limited to, amounts determined under section 78 of the internal revenue code or sections 951 to 964 of the internal revenue code.*¹⁶

The extent to which GILTI and IRC 78 gross-up are included in FTI are their *net* amounts after their IRC 250(a)(1)(B) deduction. Therefore, business income is adjusted on Form 4891, line 28 (Form 4897, line 33 for unitary business group members) to remove—to the extent included in or deducted from FTI—GILTI, IRC 78 gross-up, and the IRC 250(a)(1)(B) deduction.

¹³ MCL 206.603(3).

¹⁴ MCL 206.607(1), subject to adjustments for IRC 168(k) and 199.

¹⁵ MCL 206.23(2).

¹⁶ MCL 206.623(2)(d). Emphasis added.

Example 3: Assume the facts given in the “Federal Taxable Income” column.

| Federal Taxable Income | | Corporate Income Tax Base | |
|---|--------------|---|-------------|
| Ordinary Income ¹⁷ | \$100 | FTI | \$120 |
| Plus: IRC 951A GILTI inclusion | 90 | | |
| Plus: IRC 78 gross-up attributable to GILTI | 10 | MCL 206.623(2)(d) subtraction: | |
| Less: IRC 250 deduction: | | IRC 951A (GILTI) | 90 |
| (a)(1)(A): 37.5% FDII | (30) | IRC 78 gross-up of GILTI | 10 |
| (a)(1)(B): 50% GILTI + IRC 78 | (50) | Less: IRC 250(a)(1)(B) | (50) |
| Total IRC 250 deduction | (80) | Net GILTI Subtraction | (50) |
| FTI | \$120 | Corporate Income Tax Base¹⁸ | \$70 |

Note: There is no adjustment in the CIT for the IRC 250(a)(1)(A) FDII deduction; therefore, the CIT tax base reflects the taxpayer’s \$30 FDII deduction.

Allocation and Apportionment. The corporate income tax base is subject to allocation or apportionment based on a sales factor.¹⁹ “Sales” are generally limited to amounts received by the taxpayer as consideration.²⁰ However, certain sales are carved out from those criteria. Section 609(4)(e) states:

For taxpayers not engaged in any other business activities, sales include, interest, dividends, and other income from investment assets and activities and from trading assets and activities.²¹

Most taxpayers have business activities beyond those described in section 609(4)(e) and, thus, will not include GILTI or IRC 78 gross-up in their sales factor. However, for a taxpayer with no other activity, GILTI and IRC 78 gross-up attributable to GILTI are income from an investment activity—i.e., an investment in a foreign corporation—and are consequently included in the sales factor. For a unitary business group, each member’s respective business activity should be considered to determine if the income from investment activity is included in sales.

If GILTI and IRC 78 gross-up are included in sales, those sales are sourced under MCL 206.665(10)(b).

Individuals, trusts and estates

Tax base. If a Michigan individual, trust or estate has GILTI from direct ownership of a foreign corporation, to the extent it is included in adjusted gross income, that GILTI is intangible nonbusiness income

¹⁷ Assume this taxpayer’s activity and assets produce FDII in the amount of \$80, which is a component of the \$100 of ordinary income.

¹⁸ Subject to allocation or apportionment and adjustment for business loss, if available. MCL 206.623(2).

¹⁹ MCL 206.661.

²⁰ MCL 206.609(4).

²¹ MCL 206.609(4)(e).

attributable to this state under MCL 206.110. If GILTI flows through to a resident or nonresident from a flow-through entity, the income is business income and is subject to allocation or apportionment under Chapter 3 of the Michigan Income Tax Act.²² The character of GILTI is not affected by making an election under IRC 962.

Tax base and the IRC 962(d) recapture. If an individual, trust or estate elects federally to be taxed on GILTI under IRC 962(a)(1), the taxpayer will recognize GILTI adjusted for IRC 78 gross-up and IRC 250 deduction in AGI in that year as deemed income. In a later year, the foreign corporation may issue a cash dividend that includes an amount equal to a portion of GILTI included in a prior year's AGI.

In Example 2, above, the electing taxpayer recognized GILTI of \$90.00 and, after adjustments, included net GILTI of \$50 in AGI. In year two, the foreign corporation issued the electing taxpayer a cash dividend of \$90.00. After deducting the federal tax paid on GILTI, the taxpayer included \$87.50 in AGI for year two. The taxpayer recognized \$ 50.00 of income from the same earnings and profits in AGI in both year one and year two.

Part 1 of the Michigan Income Tax Act begins with federal AGI and reaches taxable income through statutory adjustments.²³ Part 1 of the Act has no statutory adjustment to reduce income that is included in more than one year of federal AGI.

Allocation and apportionment. If GILTI flows through to the owner of a domestic flow-through entity, the income is business income and is subject to allocation or apportionment under Chapter 3 of the Michigan Income Tax Act. As noted above, if GILTI is received directly from a foreign corporation by the individual, estate or trust, it is nonbusiness income allocable to the individual's state of residence and not subject to apportionment.

The apportionment formula uses a single sales factor.²⁴ "Sales" for purposes of apportionment are defined as "all gross receipts of the taxpayer."²⁵ GILTI is a gross receipt that must be included in the denominator of the sales factor.

For an IRC 962(a)(1) electing taxpayer, the denominator includes GILTI plus the IRC 78 foreign tax gross up. It does not include the IRC 250 deduction. If the electing taxpayer recognizes an actual dividend in income in a future year, the amount of dividend that is included in the sales factor is the amount recognized in income (the dividend after the adjustment for federal taxes paid in the prior year.)

For intangible income, including GILTI, received through a flow-through entity, the income-producing activity is attributable to the state where the flow-through entity is directed or managed. The state where an entity is directed or managed is its commercial domicile.²⁶ Therefore, GILTI is included in the sales factor numerator if the commercial domicile of the entity is located in Michigan.²⁷ The business activity is that of the flow-through entity, not the business activity of the foreign corporation.

²² Chapter 3: Allocation of Taxable Income to Michigan or Other States. MCL 206.110 *et seq.*

²³ MCL 206.30(1).

²⁴ MCL 206.121.

²⁵ MCL 206.20(1).

²⁶ MCL 206.6(1).

²⁷ MCL 206.123(a).