

February 11, 2019

## Advisory Notice – Global Low Intangible Low-Taxed Income (“GILTI”) and Foreign-Derived Intangible Income Deduction (“FDII”) Tax Policy Update

**How does the City of Philadelphia treat the GILTI and FDII provisions for the Business Income and Receipts Tax (BIRT)?**

**GILTI – Answer:**

- For BIRT purposes, GILTI income is treated as dividend income and will be included in the BIRT Income Tax base of Method II taxpayers.
- For BIRT Method II taxpayers, Philadelphia does not conform to the federal GILTI deduction under new IRC Section 250, which is considered a special deduction.
- For most BIRT Method II taxpayers, GILTI income will be eligible for<sup>1</sup>:
  - A deduction for dividends received from another corporation of the same affiliated group or from a corporation of which the receiving corporation or partnership owns at least 20% of the voting power of all classes of stock and at least 20% of each class of nonvoting stock.
- In calculating the BIRT Gross Receipts Tax, GILTI income is excluded from taxable receipts as dividends received from another corporation of the same affiliated group or from a corporation of which the receiving corporation or partnership owns at least 20% of the voting power of all classes of stock and at least 20% of each class of nonvoting stock.
- Only dividends received from < 20% owned subsidiaries would be included in the BIRT gross receipts and net income tax bases and in the sales factor for apportionment of taxable income.
- Because the includable income and deductions under GILTI are not reflected on a taxpayer’s books and records, these federal tax adjustments would not be applicable to BIRT Method I taxpayers.

**Federal Changes:**

- Under new Section 951A of the federal Tax Cuts and Jobs Act, signed into law on December 22, 2017, a U.S. shareholder who owns 10% of a controlled foreign corporation (CFC) is subject to tax on certain income of the CFC (GILTI income). The U.S.

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<sup>1</sup> BIRT Regulations – Section 404(B) 5(a)(.1) and 5(a)(.2)

shareholder must include the GILTI income in its current income. GILTI income is included in federal taxable income, Federal 1120, Line 28.<sup>2</sup>

- GILTI provisions are effective for tax years beginning after December 31, 2017 and apply to corporate and non-corporate U.S. shareholders.
- U.S. C corporation shareholders are allowed a federal deduction under new IRC Section 250 of up to 50% of GILTI income, reducing the federal effective tax rate to 10.5% on the GILTI inclusion. The GILTI deduction is reported as a special deduction on Federal 1120, Line 29b.

#### **FDII – Answer:**

- For BIRT Method II taxpayers, foreign-derived intangible income is included in the BIRT Income Tax base. When applicable, in addition to dividends, interest, royalties, and distributive share of partnership income, a corporation may deduct all other receipts received from another corporation which is a member of the same affiliated group.<sup>3</sup> An affiliated group includes both domestic and foreign corporations.
- For BIRT Method II taxpayers, Philadelphia does not conform to the FDII deduction under new IRC Section 250, which is considered a special deduction for federal income tax purposes.
- Because the deduction under FDII is not reflected in a taxpayer's books and records, this federal adjustment would not be applicable to BIRT Method I taxpayers.

#### **Federal Changes:**

- Foreign-derived intangible income is certain income earned in the U.S. related to foreign sales and services. Effective for tax years beginning after December 31, 2017, new IRC Section 250 of the federal Tax Cuts and Jobs Act allows a deduction of 37.5% of the foreign-derived intangible income of a domestic corporation. The deduction results in a reduced federal effective tax rate of 13.125%, subject to a taxable income limitation on the amount of the deduction allowed.
- The FDII deduction is reported as a special deduction on Federal 1120, Line 29b.

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<sup>2</sup> GILTI is a new category of income that is treated similarly to Subpart F income in that it is deemed repatriated in the year earned (i.e. treated as a deemed dividend).

<sup>3</sup> BIRT Regulations – Section 404(B), 5(b)