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In this article, Zhang discusses why the new U.S. tax on global intangible low-taxed income could lead some foreign corporations to be better off earning subpart F income by generating passive income and transactions with related parties.

Introduction

After 1962, U.S. federal income tax was generally imposed under subpart F on the foreign income of a controlled foreign corporation from specific passive sources or with related parties. Before the Tax Cuts and Jobs Act (P.L. 115-97), each CFC had an incentive to ensure that its income was not subpart F income.

The TCJA enacted new section 951A to impose U.S. tax on a CFC's so-called global intangible low-taxed income, which generally covers a CFC's foreign income other than its subpart F income. Although Congress intended for GILTI to have a lower overall tax burden than subpart F income, in some situations a CFC might be better off with subpart F income instead of GILTI. CFCs that previously moved their income out of the frying pan of subpart F into the new fire of GILTI might seek to move the income back.

Subpart F income

Foreign income earned by a foreign corporation was generally not subject to U.S. tax until the income is distributed to domestic shareholders. The Revenue Act of 1962 enacted subpart F of the code to ensure that specific types of a CFC's income, known as subpart F income, were subject to current U.S. taxation even if the CFC did not distribute anything. The federal government was concerned:

> primarily with what had been referred to as 'tax haven' devices. To accomplish this result the House bill in general sought to end tax deferral for income derived by U.S. controlled foreign corporations from insurance abroad of U.S. risks; for certain foreign investment income of these corporations; for their income from foreign sales subsidiaries which are separately incorporated from their manufacturing operations.[1]

A CFC is generally any foreign corporation with more than 50 percent of its stock owned by "United States shareholders," which is defined in section 951(b) as U.S. persons who each own 10 percent or more of the foreign corporation's stock, directly or constructively, by vote or value (in 2018 and later). A U.S. shareholder is generally subject to U.S. tax on its pro rata share of each of its CFC's subpart F income.

Subpart F income consists of passive income and other income from transactions with related parties. Specifically, subpart F income is composed of:

1. section 954(c) foreign personal holding company income (FPHCI), which generally consists of dividends, interest, royalties, rents, annuities, and capital gains from investment assets;
2. section 954(d) foreign base company sales income, which generally arises

[1] S. Rep. 87-1881, at 79 (1962).

from purchases and sales of personal property with related persons;

3. section 954(e) foreign base company services income, which generally arises from service transactions with related persons;
4. section 953 insurance income; and
5. income from Iran, North Korea, Sudan, Syria, and other disfavored sources.

Given the more limited tax planning opportunities for the fifth category — and to stay in the good graces of the Office of Foreign Assets Control — subpart F income is considered for simplicity to encompass only the first four categories above.

Each category of subpart F income has exceptions. For example, rental income is not FPHCI under section 954(c)(2)(A) if it is derived from the active conduct of a trade or business and is received from an unrelated person.

Section 952(b)(4) provides a high-tax exception, in that subpart F income does not include any amount subject to an effective foreign tax rate of more than 90 percent of the section 11 maximum rate of U.S. corporate income tax. Because the section 11 maximum rate is 21 percent in 2018 and later, the high-tax exception applies when the effective foreign income tax rate is more than 18.9 percent. Reg. section 1.954-1(d)(1) provides that the high-tax exception is elective on a CFC-by-CFC basis.

Subpart F income is generally determined separately for each CFC and is limited to the CFC's current earnings and profits under section 952(c)(1). If subpart F income is limited to current E&P, the CFC has additional subpart F income in a later year with current E&P exceeding subpart F income under section 952(c)(2).

For a domestic C corporation that is a U.S. shareholder of a CFC, section 960(a) provides the shareholder with an indirect foreign tax credit equal to 100 percent of the CFC's foreign taxes paid regarding the subpart F income. The shareholder has a gross-up under section 78, treated as a dividend, equal to the indirect FTC. For example, a domestic C corporation owns 100 percent of a CFC, which has $100 of pretax FPHCI and pays $10 of foreign tax. The $90 of after-tax FPHCI is subpart F income for the shareholder. The shareholder has a $10 indirect FTC. The shareholder also has a $10 section 78 gross-up, which increases its total income to $100.

GILTI

New section 951A provides that each U.S. shareholder of a CFC has gross income equal to the shareholder's GILTI in 2018 and later. A U.S. shareholder's GILTI is the aggregate "tested income" and "tested loss" from all the shareholder's CFCs, reduced by a "net deemed tangible income return" based on the depreciable assets of the CFCs.

For each CFC, its tested income or tested loss is the CFC's total income or loss, with exclusions for five types of income and their related deductions under section 951A(c)(2):

1. any U.S.-source income that is effectively connected with a U.S. trade or business and not subject to a treaty exemption or reduced U.S. tax rate, under section 952(b);
2. any subpart F income;
3. any income that is not subpart F income because of the section 954(b)(4) high-tax exception;
4. any dividend from a related person; and
5. any foreign oil and gas extraction income under section 907(c)(1).

All tested income and tested loss from CFCs are aggregated, so that a tested loss from one CFC may reduce the tested income from another CFC.

The CFCs' net deemed tangible income return under section 951A(b)(2) is equal to the excess of 10 percent of the shareholder's pro rata share of each CFC's qualified business asset investment (QBAI), which under section 951(d) is any CFC's adjusted tax basis in depreciable tangible assets used in a CFC's trade or business for the production of tested income, over any interest expense that was taken into account in tested income and tested loss.[2] QBAI might not include the depreciable tax basis of assets that give rise to tested losses.[3]

For example, a U.S. shareholder owns 100 percent of a CFC that earns only tested income. The CFC has $600 of depreciable tax basis in assets that earn $100 of income before interest expense, with $20 of interest expense. The tested income is the $80 of income after deducting interest expense. The net deemed tangible income return is the excess of $60 (10 percent of the $600 QBAI) over $20 of interest expense, or $40. The shareholder's GILTI is $40, equal to the CFC's $80 of tested income minus the $40 net deemed tangible income return. Since the $20 of interest expense reduces both tested income and net deemed tangible income return, GILTI is the same $40 if the CFC owns an unleveraged asset with $100 of income and $600 of depreciable tax basis.

GILTI is income to the U.S. shareholder. For a domestic C corporation that is a U.S. shareholder, section 960(d) provides the shareholder with an indirect FTC equal to 80 percent of the CFC's foreign income taxes paid on GILTI.[4] The shareholder also has a gross-up under section 78, treated as a dividend, equal to 100 percent (not 80 percent) of the CFC's foreign taxes paid on GILTI. For example, a domestic C corporation owns 100 percent of a CFC, which has $100 of pretax tested income and pays $10 of foreign income tax. The $90 of after-tax tested income is GILTI. The shareholder has an $8 indirect FTC and a $10 section 78 gross-up, which increases its total income to $100.

Also, section 250 provides a domestic C corporation with a 50 percent deduction in 2019 through 2025 for the shareholder's GILTI and section 78 gross-up. The section 250 deduction is reduced to 37.5 percent in 2026 and later. The 50 percent section 250 deduction reduces the 21 percent U.S. tax rate to effectively 10.5 percent, whereas the 37.5 percent section 250 deduction reduces the 21 percent tax rate to effectively 13.125 percent. The net result of the 80 percent indirect FTC and the section 250 deduction is that if the CFC is subject to a foreign tax rate of 13.125 percent, the allowed 10.5 percent (80 percent) of indirect FTCs may reduce the effective 10.5 percent U.S. tax rate to zero in 2018 through 2025. For 2026 and later, a foreign tax rate of 16.40625 percent would result in 13.125 percent (80 percent) of indirect FTCs that reduce the effective 13.125 percent U.S. tax rate to zero.

Once subpart F income or GILTI is included in the gross income of a U.S. shareholder, it is generally not subject to a second level of U.S. tax. Section 959 provides that the CFC's later distributions, to the extent of the subpart F income, are generally tax-free distributions of previously taxed income (PTI), and section 951A(f)(1) provides that GILTI is considered subpart F income under section 959.

There is generally no current U.S. taxation on a CFC's foreign income that is neither subpart F income nor GILTI, such as a CFC's subpart F income subject to the section 954(b)(4) high-tax exception, a CFC's net deemed tangible income return, and a CFC's tested income offset by another CFC's tested loss. A distribution by the CFC out of that income is a dividend. A corporate U.S. shareholder of the CFC may claim a 100 percent dividends received deduction under section 245A for the foreign-source portion of the dividend, if holding period and other requirements are met.

Foreign Tax Credits

Section 904(d)(1) divides foreign-source income and FTCs into four categories: general, passive, GILTI (new in 2018), and foreign branch (new in 2018). The U.S. tax on income in one category may be reduced only by FTCs in the same category. General, passive, and foreign branch category FTCs can be carried back one year and forward ten years under section 904(c), but GILTI category FTCs cannot be carried to any other year.

Subpart F income is either passive category or general category under section 904(d)(3), generally by looking through to the underlying

[2] The adjusted tax basis is determined under the section 168(g) alternative depreciation system, even though some foreign assets may use the section 168(c) general depreciation system under section 168(g)(4).

[3] *See* Martin A. Sullivan, "More GILTI Than You Thought," *Tax Notes*, Feb. 12, 2018, p. 845.

[4] The indirect FTC is reduced under section 960(d)(2) if the CFC's tested income is offset by a tested loss from another CFC, which can result in fewer available indirect FTCs than if the tested income and tested loss were earned by the same CFC.

income of the CFC. Section 904(d)(3)(G) provides the same look-through rule for the section 78 gross-up associated with subpart F income, by treating the section 78 gross-up as subpart F income for this purpose. Passive category income generally consists of FPHCI under section 904(d)(2)(B)(i). For example, if a CFC earns interest income that is FPHCI, the U.S. shareholder has subpart F income that is passive category income. In contrast, if a CFC has foreign base company sales income from sales to a related party, the subpart F income may be general category income.

Section 904(d)(1)(A) provides that any GILTI includable in gross income under section 951A (other than passive category income) is in a separate new GILTI category. GILTI is therefore either passive category or GILTI category, for which regulations could apply a look-through concept like that of subpart F income and CFC dividends under section 904(d)(3). There is no analogue to section 904(d)(3)(G) for GILTI's section 78 gross-up, which may end up as general category income, but Treasury has indicated that regulations will treat the gross-up as being in the same category as the GILTI.[5]

Because a CFC's FPHCI already gives rise to mostly subpart F income, the universe of passive category GILTI income tends to be limited to exclusions from subpart F income.

One possible source of passive category GILTI arises from section 952(c)(1), which generally limits a CFC's subpart F income to current E&P. If the CFC has FPHCI, and that income is not subpart F income because of the limitation to the CFC's current E&P, the FPHCI could give rise to passive category GILTI instead. It is not entirely clear whether the GILTI exclusion for gross amounts of subpart F income is determined before or after the current E&P limitation.

For example, a corporate U.S. shareholder owns 100 percent of a CFC that has no depreciable tax basis in assets. The CFC has $100 of passive foreign rental income. Its current E&P is zero because of $100 of business interest expense suspended under section 163(j). The $100 of passive foreign rental income is FPHCI under section 954(c)(1)(A), but the CFC's subpart F income is limited to its $0 current E&P by section 952(c)(1). The shareholder may have $100 of passive category GILTI because of the CFC's underlying $100 of FPHCI that is not subpart F income. Any foreign taxes paid by the CFC on the $100 of GILTI would give rise to 80 percent indirect passive category FTCs, which can be carried back one year and carried forward 10 years.

In year 2, the CFC has $0 of passive foreign rental income and $100 of current E&P. The U.S. shareholder does not have any GILTI in year 2. Because the $100 of current E&P is greater than the $0 of year 2 subpart F income, section 952(c)(2) could cause the U.S. shareholder to have $100 of subpart F income in year 2, which duplicates the $100 of GILTI in year 1.

Another possible source of passive category GILTI may arise from a subpart F de minimis rule in section 954(b)(3)(A), which treats a CFC as having no subpart F income if its gross subpart F income is less than $1 million and less than 5 percent of total gross income. Section 904(d)(3)(E) has a corresponding de minimis provision for FTC category purposes, in that such CFC's dividends are not subject to a look-through rule and do not end up being up to 5 percent passive category dividends. The provision was enacted so that the CFC's shareholders "may avoid the recordkeeping burden of applying the look-through rules to limited amounts" of CFC passive category income.[6] Section 904(d)(3)(E) does not explicitly apply to GILTI, so that a CFC with de minimis amounts of FPHCI may give rise to up to 5 percent passive category GILTI with its associated recordkeeping burdens.

Individual U.S. Shareholders

An individual U.S. shareholder of a CFC is subject to U.S. tax on subpart F income and GILTI, without any indirect FTCs to offset the U.S. tax. The individual cannot claim the section 250 deduction for GILTI, which is allowed only for C corporations. The individual therefore pays the

[5] *See* Alison Bennett, "Good News Likely on Foreign Tax Credit, 'GILTI,'" *DTR*, May 14, 2018.

[6] H. Conf. Rep. 99-841 Part 2, at II-575.

full U.S. individual income tax rate, up to 37 percent, on both subpart F income and GILTI.

Subpart F income can be more favorable than GILTI if the individual has FTCs from other sources. Since subpart F income is either general category or passive category, the shareholder's other FTCs from those categories may reduce the U.S. tax on subpart F income. The shareholder may have excess non-GILTI category FTCs from other activities, such as a carryover of general category FTCs from foreign branch activities in 2017 and earlier, which cannot reduce the U.S. tax on foreign branch category income in 2018 and later. In contrast, GILTI is generally GILTI category, and the individual is less likely to have matching FTCs given the unavailability of (GILTI category) indirect FTCs.

An individual U.S. shareholder may make a section 962(b) election, which has three effects specified in section 962 for the individual's subpart F income. Section 962(a)(1) provides that the U.S. income tax imposed on amounts included in the individual's gross income under section 951(a) (that is, subpart F income) shall be the tax that would be imposed under section 11 if those amounts were received by a domestic corporation. Section 962(a)(2) allows the individual shareholder to claim indirect FTCs under section 960 against the deemed corporate tax. Section 962(d) provides that the CFC's distributions cease to be all tax-free PTI distributions.

GILTI is treated under section 951A(f)(1) as subpart F income for purposes of section 962. As a result, an electing individual U.S. shareholder has U.S. income tax imposed under section 962(a)(1) on GILTI equal to the tax that would be imposed under section 11 if GILTI were received by a domestic corporation. The individual shareholder may claim indirect FTCs to reduce the deemed corporate tax, which is the 80 percent of indirect FTCs allowed under section 960(d) for GILTI.

Section 962 was not amended by the TCJA to add a section 250 deduction as a fourth effect of a section 962(d) election. The text of section 962(a)(1), that the deemed corporate tax is the amount that would be imposed under section 11 if GILTI were received by a domestic corporation, may implicitly take into account any deductions available to the hypothetical domestic corporation. However, section 962(a)(1) refers to the "gross amount" of the subpart F income or GILTI, not a net amount after any deduction, and reg. section 1.962-1(b)(1)(i) provides that the "taxable income" subject to the deemed corporate tax "shall not be reduced by any deduction of the United States shareholder."

An unfavorable precedent may be the TCJA's new section 965, which generally taxes a U.S. shareholder's share of post-1986 deferred foreign income of its CFCs and some other foreign corporations. Section 965(c) generally provides a deduction against the repatriation income to result in a lower effective tax rate, equal to 8 percent or 15.5 percent for a corporate shareholder. In Notice 2018-26, 2018-16 IRB 480, Treasury stated that the section 965(c) deduction should be taken into account in determining an individual's section 962 corporate tax. The notice stated that reg. section 1.962-1(b)(1)(i) will be amended to "provide that 'taxable income' as used in section 11 shall be reduced by the section 965(c) deduction. These regulations will not apply to any other deductions, and therefore existing section 1.962-1(b)(1)(i) will continue to provide that 'taxable income' as used in section 11 shall not be reduced by any other deductions." The category of "any other deductions" could include the section 250 deduction.

If the individual who makes a section 962(b) election cannot benefit from a section 250 deduction, the individual is better off with subpart F income instead of GILTI. Subpart F income is allowed 100 percent of indirect FTCs, compared with 80 percent of indirect FTCs allowed for GILTI, in addition to the FTC category advantages for subpart F income.

Corporations and Section 250 Deduction

A corporate U.S. shareholder's section 250 deduction generally outweighs its 20 percent reduction in indirect FTCs for GILTI. However, section 172(d)(9) provides that the section 250 deduction is not taken into account in computing a taxpayer's net operating loss deduction and its NOL carryovers and carrybacks. The net effect is that a corporate taxpayer with NOL carryovers and other current year losses greater than 50 percent (or 62.5 percent in 2026 or later) of its

GILTI would not benefit from the full section 250 deduction.

For example, a domestic C corporation has $100 of GILTI in 2018 and a $60 NOL carryover to 2018. The 50 percent section 250 deduction is a $50 deduction that eliminates any positive taxable income. The corporation's NOL deduction is the excess of its deductions over gross income, but not including the GILTI deduction. Since the excess of its $60 tax loss over $100 of GILTI is not positive, the corporation has no NOL deduction and therefore no NOL carryover to a later year. The corporate taxpayer effectively used its entire $60 NOL carryover and benefited from only a $40 or 40 percent section 250 deduction.

The break-even point, between a U.S. shareholder's U.S. tax on subpart F income and the U.S. tax on GILTI, occurs when the effective foreign tax rate (*R*) is more than five times the U.S. tax rate (*T*) multiplied by the section 250 deduction (*D*):

$$R > 5TD.$$

If the section 250 deduction (*D*) is allowed at the full 50 percent, and the statutory U.S. tax rate is 21 percent, the foreign tax rate must exceed 52.5 percent for subpart F income to be better than GILTI based on allowed indirect FTCs. The section 250 deduction reduces the U.S. tax rate effectively by 10.5 percent, which is less than disallowed indirect FTC of more than 10.5 percent (that is, 20 percent of more than 52.5 percent).

If the section 250 deduction is less than 18 percent, the foreign tax rate can be less than 18.9 percent for subpart F income to be better than GILTI.

Even when a substantial section 250 deduction is allowed, a corporate U.S. shareholder may be better off with subpart F income instead of GILTI because of the ability to use and carry over non-GILTI category FTCs.

High-Tax Exception

GILTI tested income excludes subpart F income, as well as income that would have been subpart F income except for the section 954(b)(4) high-tax exception. There is no exclusion for other income subject to high foreign taxes. Because GILTI is applied on an aggregate basis, high-taxed GILTI may be beneficial in offsetting U.S. tax on low-taxed GILTI.

For example, a corporate U.S. shareholder owns 100 percent of two CFCs that have no depreciable tax basis in assets. The first CFC has $100 of income and pays no foreign taxes. The second CFC has $100 of pretax income, on which it pays $20 of foreign taxes.

If both CFCs earn only GILTI tested income, the shareholder has a total $200 of GILTI and section 78 gross-up, with $16 (80 percent) of indirect FTC. The shareholder has $100 of taxable income after the 50 percent section 250 deduction, which results in $21 of U.S tax. The U.S. tax is reduced to $5 after the indirect FTC.

In contrast, if the first CFC earns only GILTI tested income while the second CFC earns only subpart F income, subject to the section 954(b)(4) high-tax exception, the shareholder has only $100 of GILTI. The shareholder has $50 of taxable income after the 50 percent section 250 deduction, which results in $10.50 of U.S. tax.

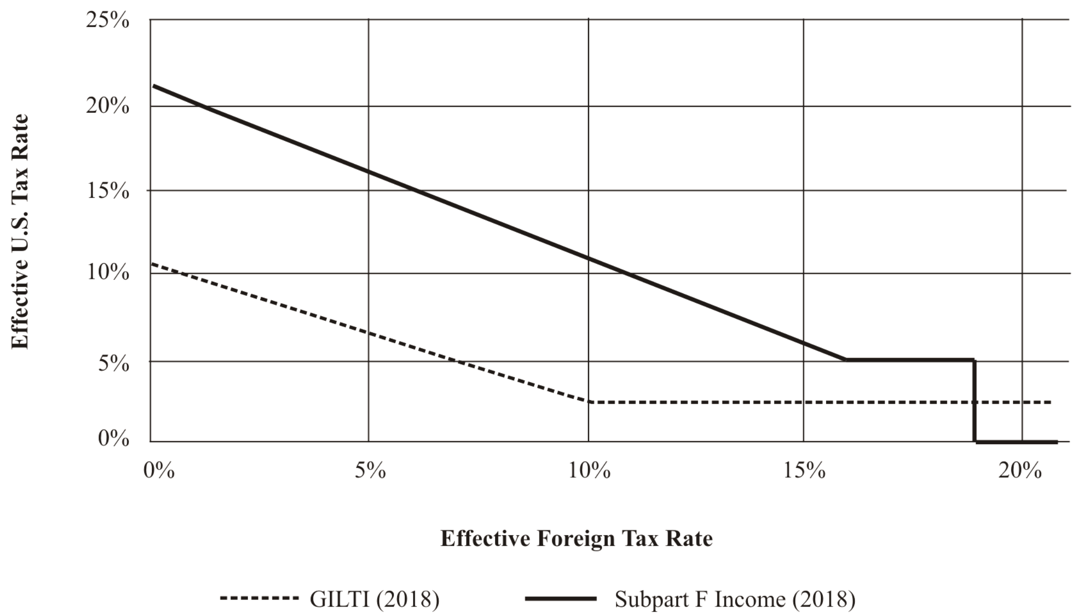
However, FTCs can be limited or disallowed. An individual U.S. shareholder may prefer no current taxable income, which would occur if the CFC's income subject to high foreign taxes is subpart F income, instead of GILTI with an unusable indirect FTC. A REIT also generally cannot use FTCs, nor can the REIT pass through the FTCs to the REIT's shareholders in a manner similar to RICs under section 853.

For C corporations that are not REITs nor RICs, the section 59A base erosion and antiabuse tax generally imposes a minimum tax on modified taxable income, if the minimum tax is more than the corporation's regular income tax. The section 59A minimum tax rate is 5 percent in 2018, 10 percent in 2019 through 2025, and 12.5 percent in 2026 and later. The minimum tax does not allow FTCs.[7]

Modified taxable income is generally taxable income with the addback of some deductions and payments to related parties (base erosion tax benefits). The section 59A minimum tax applies if the taxpayer generally has more than $500 million of average annual gross receipts over a three-year

[7] The only tax credits allowed to reduce the minimum tax, and only from 2018 through 2025, are the section 41(a) research credit, 80 percent of the section 42(a) low-income housing tax credit, 80 percent of the section 45(a) renewable electricity production credit, and 80 percent of the section 48 energy credit.

Figure 1



period and its base erosion tax benefits generally exceed 3 percent of the taxpayer's total deductions.[8]

For example, a domestic C corporation, which is subject to the section 59A minimum tax because of some payments to related parties, owns 100 percent of a CFC that has no depreciable tax basis in assets. The CFC has $100 of pretax non-subpart-F income in 2018, against which the CFC paid $20 (20 percent) of foreign tax.

The shareholder's total GILTI and section 78 gross-up is $100. The section 250 deduction is $50, which reduces taxable income to $50. The corporate shareholder's 21 percent U.S. regular income tax on the $50 of taxable income is $10.50, which is entirely offset by the $16 (80 percent) of allowed indirect FTC. However, the section 59A minimum tax on the $50 of modified taxable income is $2.50 in 2018.[9]

In contrast, if the CFC instead has only $100 of subpart F income, on which it pays $20 (20 percent) of foreign tax, the income is excluded from subpart F income and from GILTI by the section 954(b)(4) high-tax exception. The shareholder has no taxable income and no modified taxable income, so that the regular income tax and the minimum tax are both zero.

The section 59A minimum tax can apply to GILTI that is subject to foreign tax rates lower than 18.9 percent, but the crossover point, where subpart F income is better than GILTI, occurs at an effective foreign income tax rate of 18.9 percent. The effective U.S. tax rate in 2018, when the section 59A minimum tax rate is 5 percent, is shown in Figure 1.

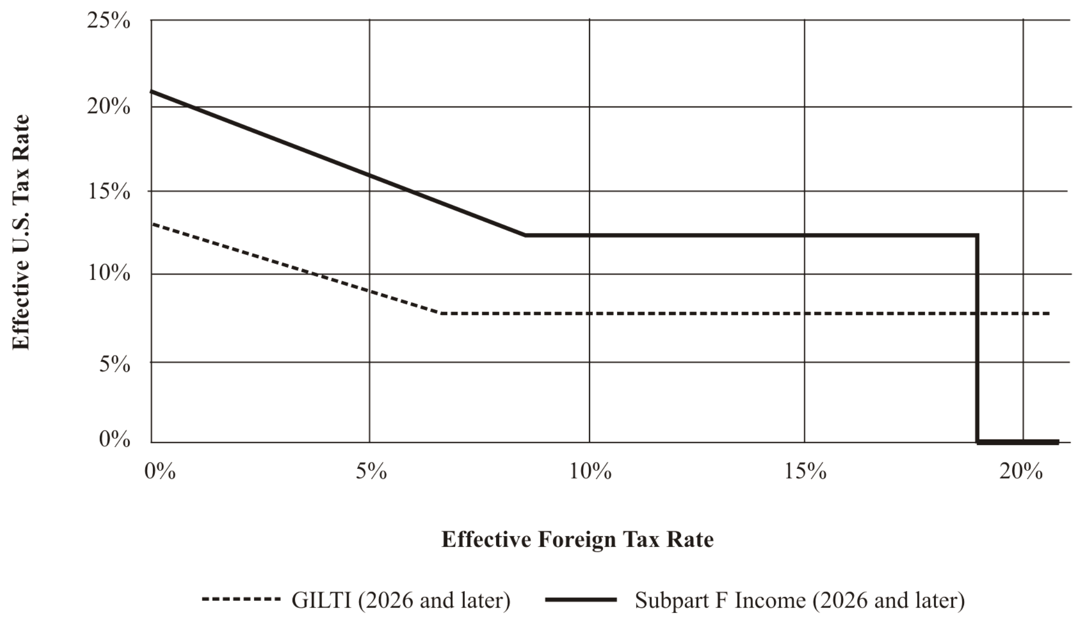
The minimum tax has a greater impact in later years. When the minimum tax rate is 12.5 percent and the section 250 deduction is 37.5 percent in 2026 and later, the effective U.S. tax rate is shown in Figure 2.

One legislative approach to achieve parity is to create an elective GILTI high-tax exception for non-subpart-F income, like the elective section 954(b)(4) high-tax exception for subpart F income. The GILTI high-tax exception may follow the same policy principles and treat GILTI as highly taxed if the residual U.S. regular income tax rate, after allowed indirect FTCs, is less than 2.1 percent (that is, 10 percent of the 21 percent corporate tax rate). From 2018 through 2025,

[8]The 3 percent is reduced to 2 percent for a taxpayer in an affiliated group with a bank or registered securities dealer.

[9]Although FTCs cannot reduce the section 59A minimum tax, the section 78 gross-up that corresponds to the FTCs is still part of modified taxable income.

Figure 2



when the section 250 deduction is 50 percent, a foreign income tax rate higher than 10.5 percent would be sufficient. In 2026 and later, when the section 250 deduction is 37.5 percent, a foreign income tax rate higher than 13.78125 percent would be sufficient.

For example, a corporate U.S. shareholder owns 100 percent of a CFC, which has $100 of pretax tested income in 2026 subject to $13.79 of foreign income tax. The shareholder has $100 of GILTI and section 78 gross-up, which results in $62.50 of taxable income after the section 250 deduction. The 21 percent U.S. tax on $62.50 of taxable income is $13.125, which is reduced by $11.032 (80 percent) of FTCs to arrive at $2.093 of net U.S. tax liability. The CFC's income could be considered high-taxed GILTI.

Net Deemed Tangible Income Return

A CFC may have assets with zero or low depreciable tax basis and high leverage, in which case a lower tax could result from the assets generating subpart F income instead.

For example, a corporate U.S. shareholder owns 100 percent of a CFC that has two assets. Asset A has depreciable tax basis of $100, value of $1,000, and debt of $600. Asset A earns $10 of tested income, after deducting $30 of interest expense. Asset B has depreciable tax basis of $200, value of $400, and no debt. Asset B earns $20 of tested income.

The CFC's total tested income is $30. Its QBAI is $300. The net deemed tangible income return is $30 (10 percent of QBAI) less the $30 interest expense, or $0. The shareholder's GILTI is the $30 tested income less $0 net deemed tangible income return, or $30. The shareholder has $15 of taxable income after a 50 percent section 250 deduction.

Alternatively, the CFC puts Asset A to use so that it generates the net $10 of income as $10 of subpart F income. GILTI thus applies only to Asset B. The CFC's tested income is $20. Its QBAI is $200, as only Asset B is used in the production of tested income. Net deemed tangible income return is $20 (10 percent of QBAI) less the $0 interest expense, or $20. GILTI is the $20 tested income less $20 net deemed tangible income return, or $0. The shareholder's only taxable income is $10 of subpart F income from the CFC's Asset A.

Asset A provides a negative contribution to the shareholder's net deemed tangible income return that outweighs the benefit of the section 250 deduction regarding Asset A's income. The relative effects of each can be generalized:

Let T be the CFC's tested income before interest expense, I be the CFC's interest expense allocable to the tested income, and $QBAI$ be the taxpayer's qualified business asset investment. GILTI is:

$$T - I - (0.1QBAI - I).$$

The shareholder is better off with subpart F income instead of GILTI when the section 250 deduction (D) on GILTI is less than the contribution to net deemed tangible income return:

$$D[T - I - (0.1QBAI - I)] < - (0.1QBAI - I).$$

The formula can be rearranged into an inequality with T on one side:

$$T < \frac{1}{D} I - \frac{1 - D}{D} 0.1QBAI.$$

When the section 250 deduction (D) is allowed at 50 percent, the formula simplifies to:

$$T < 2I - 0.1QBAI.$$

In the above example for Asset A, its pre-interest income T is \$40, its interest I is \$30, and its 10 percent of $QBAI$ is \$10. The above inequality is true, as \$40 < \$60 - \$10, confirming that the taxpayer is better off with Asset A generating subpart F income.

When the asset's QBAI is minimal, such as for land or an intangible, it is better for the asset to generate subpart F income when its pre-interest income is less than twice its interest expense (or less than 2-2/3 of the interest expense in 2026 or later).

When Asset A is sold, the CFC may prefer that Asset A is not subject to subpart F in the year of sale, so that the \$900 of gain is GILTI with a \$450 section 250 deduction instead of \$900 of subpart F income. Lookback rules exist in other situations for gain recognized after a change in use of an asset, such as reg. section 1.469-2(f)(5) in the section 469 passive activity loss context, but not for GILTI.

Conclusion

For individuals who might not benefit from GILTI's section 250 deduction, GILTI is structurally worse than subpart F income in almost all cases.

A REIT cannot claim the section 250 deduction nor use any FTCs for its GILTI from foreign taxable REIT subsidiaries. Both GILTI and subpart F income are not explicitly qualifying income for purposes of the REIT gross income tests in section 856(c)(2) and (c)(3). If the GILTI is subject to more than 18.9 percent foreign tax, the REIT would be better off converting the GILTI to subpart F income in order to exclude the income with the high-tax exception. Foreign rental income may be converted to subpart F income by moving all the active rental business employees to an affiliated entity.

The result varies for other corporations depending on the specific facts, such as its NOL deductions compared with the section 250 deduction and the applicability of the section 59A minimum tax.

Statutory changes might mitigate some subpart F advantages, such as greater carryover of GILTI category FTCs, a GILTI high-tax exception, and allowing FTCs for the minimum tax. Otherwise, as the section 250 deduction is reduced and the minimum tax increases over time, more taxpayers could find themselves better off with previously disfavored passive income and transactions with related parties. ■