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

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For tax years beginning after December 31, 2017, the federal Tax Cuts and Jobs Act[1] created a new category of foreign-sourced deemed income, global intangible low-taxed income ("GILTI"). GILTI is included in gross income[2] 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. shareholder[4] or controlled foreign corporation[5] ("foreign corporation") status and the complexities of calculating GILTI are beyond the scope of this notice. However, in general terms, GILTI is a U.S. shareholder's pro-rata share of:

Foreign corporations' net income not subject to U.S. tax	*less*	Each foreign corporation's presumed 10% return on its tangible business assets, with adjustments

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"

[1] Public Law 115-97, enacted December 22, 2017.
[2] IRC 951A. The GILTI provisions are effective of 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).
[4] IRC 951A(e)(2).
[5] IRC 951A(e)(3).

income by adding foreign taxes deemed paid. Second, IRC 250 allows a 50% deduction of GILTI and the IRC 78 gross-up attributable to GILTI.[6]

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 foreign tax gross-up	10.00
Less: IRC 250 deduction of 50%	(50.00)
GILTI included in FTI	$50.00

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, individuals, trusts, and estates may elect to be taxed as domestic corporations on GILTI under IRC 962(a)(1)[7]. If the federal election is made, these taxpayers may claim both corporate adjustments.

Federal treatment of an actual distribution of earnings and profits for electing individuals, trusts, and estates. An individual, trust, or estate that elected under IRC 962(a)(1) to be taxed as a corporation on GILTI may receive from a foreign corporation an actual distribution (as opposed to GILTI, which is deemed income) 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.

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	Foreign dividend	$90.00
Plus: IRC 78 foreign tax gross-up	10.00	*Less*: Tax paid in Year 1 on GILTI	(2.50)
Less: IRC 250 deduction of 50%	(50.00)	Net foreign dividend in gross income	$87.50
GILTI included in AGI	$50.00		
U.S. tax @ 21% corporate rate	$10.50		
Less: 80% foreign tax credit	(8.00)		
Net U.S. tax	$2.50		

[6] IRC 250. The 50% deduction is reduced for tax years after 2025. IRC 250 also includes a deduction for Foreign Derived Intangible Income (FDII), which may be computed separately from the GILTI and gross-up deduction.
[7] Trusts and estates may make an IRC 962(a)(1) election under Treas. Reg. 1.962-2(a).

Michigan Income Tax Treatment of GILTI

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Gross Receipts Threshold. A Michigan CIT return is not required if a corporation's allocated or apportioned gross receipts are less than $350,000.[8] "Gross receipts" are defined in MCL 206.607(4) to mean, "the entire amount received by the taxpayer from any activity whether in intrastate, interstate, or foreign commerce carried on for direct or indirect gain, benefit, or advantage to the taxpayer or to others." Several exceptions are listed in the statute[9]. GILTI is received by the taxpayer—and thus is included in gross receipts.

Tax base. The starting point of Michigan CIT is "business income,"[10] which is "federal taxable income."[11] 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.[12] 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.[13]

The extent to which GILTI and IRC 78 gross-up are included in FTI are their *net* amounts after their IRC 250 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 portion of the IRC 250 deduction attributable to those amounts.

Example 3:

Federal Taxable Income		Corporate Income Tax Base	
Ordinary income	$100	FTI	$120
Plus: GILTI in gross income	90	MCL 206.623(2)(d) adjustment	
Plus: IRC 78 gross-up	10	IRC 951A (GILTI) = $90	
Less: IRC 250 deduction		IRC 78 gross-up = 10	
50% GILTI + IRC 78 = $50		*Less*: IRC 250 deduction	
37.5% FDII = 30	(80)	attributable to IRC 951A & 78 = (50)	(50)
FTI	**$120**	**Corporate Income Tax Base[14]**	**$70**

[8] MCL 206.685.
[9] MCL 206.607(4)(a)-(p).
[10] MCL 206.603(3).
[11] MCL 206.607(1), subject to adjustments for IRC 168(k) and 199.
[12] MCL 206.23(2).
[13] MCL 206.623(2)(d). Emphasis added.
[14] Subject to allocation or apportionment and adjustment for business loss, if available. MCL 206.623(2).

Allocation and Apportionment. The corporate income tax base is subject to allocation or apportionment based on a sales factor.[15] "Sales" are generally limited to amounts received by the taxpayer as consideration.[16] However, one type of sales is carved out from those characteristics:

> 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.[17]

Most corporations have business activities beyond those described in subdivision 609(4)(e) and 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 may be income from an investment activity—i.e., an investment in a foreign corporation—and may be included in the sales factor. If included in sales, grossed up GILTI is considered other income from investment assets and is sourced to where the benefit is received 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 attributable to this state under MCL 206.110. The character of GILTI is not affected by electing to be taxed as a domestic corporation.

Tax base and the IRC 962(d) recapture. If an individual, trust, or estate elects federally to be taxed on GILTI as a domestic corporation 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.[18] 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

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[15] MCL 206.661.
[16] MCL 206.609(4).
[17] MCL 206.609(4)(e).
[18] MCL 206.30(1).

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, which is not subject to apportionment.

The apportionment formula uses a single sales factor.[19] "Sales" for purposes of apportionment are defined as "all gross receipts of the taxpayer."[20] 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.[21] Therefore, GILTI is included in the sales factor numerator if the commercial domicile of the entity is located in Michigan.[22]

[19] MCL 206.121.
[20] MCL 206.20(1).
[21] MCL 206.6(1).
[22] MCL 206.123(a).