JCT Counsel Hammer Nails Down Thinking on GILTI

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By Andrew Velarde

Viva Hammer, legislation counsel for the U.S. Joint Committee on Taxation, offered insights into the rationale behind the residual method used in the Tax Cuts and Jobs Act's global intangible low-taxed income (GILTI) provision.

“You could ask why this method isolates related-party [intangible property]," Hammer said April 13 at an event sponsored by the American Bar Association Section of Taxation in Washington. "Doesn’t related-party [intangible property] also have value? Isn’t it also capital? But this is the issue: Markets for related-party comparables are so thin that we don’t know what the value is,” she said. Hammer contrasted valuing a building with ascertaining the value of patent rights transferred during the early testing stage, when there may be no transfers between unrelated parties of a similar kind of right.

Hammer cautioned that her remarks should not be construed to represent the position of any member of the JCT or Congress.

Enacted partially to combat companies’ proclivity to base erode though intangibles transfers, GILTI, which is taxed at 10.5 percent, is calculated on supernormal returns on foreign profits attributable to intangibles. Because it is a residual concept, taxpayers without intangibles can still be subject to GILTI liability.

GILTI is defined as the excess of a U.S. shareholder’s net controlled foreign corporation tested income over their net deemed tangible income return. The latter is 10 percent of the aggregate of the shareholder’s pro rata share of each CFC’s qualified business asset investment less some interest expense.

The 10 percent is intended to represent a normal return on a “homogeneous plain investment” on tangible property, Hammer said.

“For example, what kind of return do you have on making disposable cups? There’s not a lot of difference between disposable cups, not a lot of brand value,” Hammer said before dismissing arguments that the rate should be pegged at the safe rate of return on a Treasury bond. That argument would ignore the risk behind investing in businesses, for which investors should be compensated, she said. Normal rate of return is better framed as enterprise risk, while separating extranormal returns from intangible property or monopoly elements in a brand name or proprietary technology, she added.

Hammer was also dismissive of arguments that would have applied to the calculation a markup for workforce in place, calling it the “epitome of intangible capital,” with companies using management skill to obtain value out of workers beyond their market value.

“Some argue you should get credit for labor in the calculation. But that implies that labor is capital, which is antithetical to the 13th Amendment,” Hammer said. “Labor is only capital when it is unpaid and people can be traded, and we’ve already fought one war over that.”

Hammer acknowledged there is a markup for labor in transfer pricing cases, but said that is a misunderstanding of what is being measured, which is a return on tangible assets.

“A person can never be an asset, and the management skills that make the person valuable is exactly what intellectual property is about,” Hammer said.