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A Practical Guide to Tax Credit Ordering and Usage Rules

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Understanding and applying the Internal Revenue Code[1] rules for ordering and usage of the many federal income tax credits has always been important but is now even more important because of recent changes to the Code made by the 2020 Coronavirus Aid, Relief, and Economic Security Act ("CARES Act").[2]

Measures included in the CARES Act provide that:

— A taxpayer with a net operating loss ("NOL") arising in a 2018, 2019, or 2020 tax year can carry that loss back to each of the five preceding years unless the taxpayer elects to waive or reduce the carryback.

— The modified credit rules for prior-year alternative minimum tax ("AMT") liability of corporations—including to accelerate the recovery of remaining minimum tax credits of a corporation for its 2019 tax year from its 2021 tax year—allow a corporation to elect, instead, to recover 100 percent of any of its remaining minimum tax credits in its 2018 tax year. Corporate

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[1] Unless otherwise indicated, section references are to the Internal Revenue Code of 1986, as amended (the "Code") or the applicable regulations promulgated pursuant to the Code (the "regulations").

[2] Pub. L. No. 116-136.

AMT was eliminated for tax years beginning after December 31, 2017. Prior to these changes, section 55 imposed an AMT on corporations and the AMT was the excess of the tentative minimum tax ("TMT") over the regular tax for the tax year.

The tax code includes a wide variety of income tax credits that can help reduce, or fully satisfy, the income tax obligations of taxpayers, as well as the payroll tax obligations of taxpayers, and, even simply result in a net payment from the government to the taxpayer. These credits have many rules regarding the timing of when, in what order, and how much of the credits can be used (or carried forward or backward). This article provides a practical guide on tax compliance when tax credits are in the mix. Although this article focuses on some forms applicable to corporations, e.g., Form 1120, *U.S. Corporation Income Tax Return*, many of the forms mentioned, e.g., Form, 3800, *General Business Credit*, are also applicable to partnerships, S corporations, and individuals.

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I. Purpose

This article focuses on three of the most commonly used tax credits by taxpayers that file Form 1120, *U.S. Corporation Income Tax Return.*[3] The credit categories discussed in this article are: (1) foreign tax credits ("FTCs"), (2) general business credits ("GBCs"), and (3) credits for prior year alternative minimum tax ("AMT Credits") (collectively the "Big 3").[4] Effective tax determination and planning for use of these credits has the potential to provide the following benefits to taxpayers:[5]

— Reduce the effective tax rate ("ETR")

— Improve earnings per share ("EPS")

— Reduce (for tax years before 2026) the combined regular income tax and BEAT liability

— Cash tax savings

Readers are encouraged to fill out the applicable forms to see how changes in one component of the overall tax liability and payment calculations may affect other portions of the calculations—often there are some eye-opening results. Recognizing the potential tax implications in advance is invaluable to tax professionals.

3 Note that the discussion also includes any relevant forms to the credit filings in addition to the Form 1120.

4 Note that the Code allows for additional credits not classified under the "Big 3," e.g., the Section 30D Qualified Electric Vehicle Credit (Form 8834) and the Section 54A credit to Holders of Tax Credit Bonds (Form 8912); *See also* Form 1120, Schedule J – Tax Computation and Payment, Part I – Tax Computation, lines 5b and 5e, respectively. Furthermore, there are non-refundable personal credits at sections 21 through 25D. Discussions of these additional credits are outside of the scope of this article.

5 This is not an all-inclusive list of potential benefits.

II. Tax Terminology and Taxonomy

A. Credits "Determined" vs. "Allowed"

Tax terminology is important when discussing the usage of tax credits. The credit "determined" is the total amount of credit calculated for a taxpayer under the Code for a particular tax year. The credit "allowed" is the total amount of credit that may be utilized under the Code by a taxpayer for a particular year. The amount of the credit "determined" for a tax year is often in excess of than the credit "allowed," generally providing taxpayers with the potential to carry excess credits back one year or forward to future years.

As described in further detail below, the FTCs, GBCs, and AMT Credits cannot be used to directly offset the section 55 minimum tax or the section 59A BEAT.

B. Internal Revenue Code Taxonomy

The wording of the Code is very precise and the taxonomy (or ordering/categorization of items) of the Code is also often not well understood. The taxonomy of the Code from highest level to lower levels is summarized as follows:

- United States Code
- Title 26 Internal Revenue Code
- Subtitles (e.g., subtitle A – Income Taxes)
- Chapters (e.g., chapter 1 – Normal Taxes and Surtaxes)
- Subchapters (e.g., subchapter A – Determination of Tax Liability)
- Parts (e.g., part I – Tax on Individuals)
- Subparts (e.g., subpart A – Nonrefundable Personal Credits)
- Individual Code sections

III. Restrictions on Ability to Use Credits from an Acquired Corporation

The Code has many provisions affecting the ability/timing of tax attributes in certain corporate acquisitions. These include section 381, *Carryovers in certain corporate acquisitions*; section 382, *Limitation on net operating loss carryforwards and certain built-in losses following ownership change*; and section 383, *Special limitations on certain excess credits, etc*. These rules are beyond the scope of this article, but they may come into play, especially section 383, when credits are related to an acquired corporation.

IV. Foreign Tax Credits ("FTC")

A. Overview of FTCs

Section 901(a) and (b) provide, in part:

> (a) ALLOWANCE OF CREDIT. — If the taxpayer chooses to have the benefits of this subpart, the tax imposed by this chapter[6] shall, subject to the limitation of Section 904, be credited with the amounts provided in the applicable paragraph of subsection (b) plus, in the case of a corporation, the taxes deemed to have been paid under Section 960. Such choice for any taxable year may be made or changed at any time before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by this chapter for such taxable year. The credit shall not be allowed against any tax treated as a tax not imposed by this chapter under Section 26(b).
>
> (b) AMOUNT ALLOWED. — Subject to the limitation of Section 904, the following amounts shall be allowed as the credit under subsection (a):
>
>> (1) CITIZENS AND DOMESTIC CORPORATIONS.— In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States;

Section 904(a) provides that the total amount of the credit taken under section 901(a) shall not exceed the same proportion of the tax against which the credit is taken which the taxpayer's taxable income from sources without the United States (but not in excess of the taxpayer's entire taxable income) bears to the taxpayer's entire taxable income for the same tax year.

Section 904(c) provides that:

> (c) CARRYBACK AND CARRYOVER OF EXCESS TAX PAID.— Any amount by which all taxes paid or accrued to foreign countries or possessions of the United States for any taxable year for which the taxpayer chooses to have the benefits of this subpart exceed the limitation under subsection (a) shall be deemed taxes paid or accrued to foreign countries or possessions of the United States in the first preceding taxable year, and in any of the first 10 succeeding taxable years, in that order and to the extent not deemed taxes paid or accrued in a prior taxable year, in the amount by which the limitation under subsection (a) for such preceding or succeeding taxable year exceeds the sum of the taxes paid or accrued to foreign countries or possessions of the United States for such preceding or succeeding taxable year and the amount of the taxes for any taxable year earlier than the current taxable year which shall be deemed to have been paid or accrued in such preceding or subsequent taxable year (whether or not the taxpayer chooses to have the benefits of this subpart with respect to such

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6 Section 901 is contained in subtitle A - Income Taxes, chapter 1 - Normal Taxes and Surtaxes.

> earlier taxable year). Such amount deemed paid or accrued in any year may be availed of only as a tax credit and not as a deduction and only if the taxpayer for such year chooses to have the benefits of this subpart as to taxes paid or accrued for that year to foreign countries or possessions of the United States. This subsection shall not apply to taxes paid or accrued with respect to amounts described in subsection (d)(1)(A).

Foreign tax credits are allowed under section 27, which provides:

> Taxes of foreign countries and possessions of the United States – The amount of taxes imposed by foreign countries and possessions of the United States shall be allowed as a credit against the tax imposed by this chapter[7] to the extent provided in section 901.

Therefore, when reading sections 904(c) and 27 together, FTCs may generally be carried back one year and carried forward for 10 years.[8]

FTCs are calculated and reported on Form 1118, *Foreign Tax Credit – Corporations*. The calculated total FTC flows from Form 1118, Part III – Summary of Separate Credits, line 6 –Total foreign tax credit; to Form 1120, Schedule J – Tax Computation and Payment, Part I – Tax Computation, line 5a - Foreign tax credit.

B. Ordering and Utilization of FTCs

Of the Big 3 credits discussed in this article, FTCs are utilized first. FTCs are utilized before GBCs because section 38(c)(1) provides that:

> (c) Limitation based on amount of tax
>
> (1) In general. The credit allowed under subsection (a) for any taxable year shall not exceed the excess (if any) of the taxpayer's net income tax over the greater of—
>
> > (A) the tentative minimum tax for the taxable year, or
> >
> > (B) 25 percent of so much of the taxpayer's net regular tax liability as exceeds $25,000.
>
> For purposes of the preceding sentence, the term "net income tax" means the sum of the regular tax liability and the tax imposed by section 55, reduced by the credits allowable under subparts A and B of this part, and the term "net regular tax liability" means the regular tax liability reduced by the sum of the credits allowable under subparts A and B of this part.

Let's unpack section 38(c)(1).

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[7] Section 27 is contained in subtitle A - Income Taxes, chapter 1 - Normal Taxes and Surtaxes, subchapter A - Determination of Tax Liability, part IV - Credits Against Tax, subpart B – Other Credits.

[8] But see section 904(c) (last sentence) and section 904(d)(1)(A), which have the effect of not allowing FTCs to be carried back or forward for credits arising from payments of tax on section 951A GILTI.

For simplicity's sake, and since this article focuses on credits claimed by corporations, and since corporations are no longer subject to the AMT,[9] we can simplify section 38(c)(1) for corporations to:

> The GBC allowed for any taxable year shall not exceed the excess (if any) of the taxpayer's regular tax liability (less subpart A and subpart B credits) over 25 percent of so much of the taxpayer's regular tax liability (less subpart A and subpart B credits) as exceeds $25,000.

"Regular tax liability" is equal to the tax imposed by chapter 1 (i.e., sections 1 – 1400Z-2).[10] Importantly for our purposes, the section 27 foreign tax credit is a subpart B (of Part IV) credit.[11]

Thus, for a corporation that has the foreign tax credit, but no other subpart A or subpart B credits, section 38(c)(1) can be simplified further still:

> The GBC allowed for any taxable year shall not exceed the excess (if any) of the taxpayer's regular tax liability (less FTCs) over 25 percent of so much of the taxpayer's regular tax liability (less FTCs) as exceeds $25,000.

So understood, one sees that the GBC is only allowed after the available FTCs (i.e., after considering the FTC limitation rules under section 904) are claimed. The FTC has priority over the GBC. Furthermore:

- FTC is necessary to calculate the allowable GBC on Form 3800, *General Business Credit*, line 10a.[12] This reflects the section 38(c)(1) language discussed immediately above.

- When calculating the credit for prior year AMT Credit using Form 8827, *Credit for Prior Year Minimum Tax – Corporations*, the FTC (and allowable GBCs) are utilized on line 2, which states (in the instructions): "Enter the corporation's 2019 regular income tax liability, as defined in Section 26(b), minus any credits allowed under Chapter 1, Subchapter A, Part IV, subparts B, D, E and F of the Internal Revenue Code (for example, if filing Form 1120, subtract any credits on Schedule J, Part I, line 5a through 5c, from the amount on Schedule J, Part I, line 2)."[13]

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9 *See* section 55(a) ("In the case of a taxpayer *other than a corporation*, there is hereby imposed …") (emphasis added), as amended by the Tax Cuts and Jobs Act, Pub. L. No. 115-97 §12001(a).

10 *See* section 26(b)(1).

11 One might have thought that "regular tax liability" already included the credit for foreign taxes, since the Code sections most relevant to the foreign tax credit (i.e., section 27 and sections 901 – 909) are all contained within chapter 1. The JCT, however, has clarified that "regular tax liability" is a reference to a taxpayer's chapter 1 tax liability on a pre-credit basis (and, presumably, with the section 26(b)(2) exceptions for certain taxes). *See* Joint Comm. on Tax'n, Overview of the Base Erosion and Anti-Abuse Tax: Section 59A (Apr. 2019), BEAT Calculation Part 2 (this example refers to the section 59A(b)(1)(B) reference to "regular tax liability (as defined in section 26(b))" as a pre-credit calculation).

12 *See also* Internal Revenue Manual 21.7.4.4.8.1.2 (02-26-2018).

13 Strictly speaking, this Form 8827 language does not show that Foreign Tax Credits (which are a subpart B credit) are ahead of GBCs (subpart D credits), but it does at least suggest that FTCs (and GBCs) are of higher priority than the AMT Credit Carryforwards (subpart G credits).

V. General Business Credits ("GBC")

A. Overview and GBC Credit Ordering Rules

Section 38(a) provides that there shall be allowed as a credit against the tax imposed by this chapter,[14] for the tax year, an amount equal to the sum of: (1) the business credit carryforwards carried to that tax year, (2) the amount of the current year business credit, and (3) the business credit carrybacks carried to that tax year. Section 38(b) provides a laundry list of GBCs and provide that the amount of the current year business credit is the sum of a number of credits determined for the tax year, including the research credit under section 41 (see the list below in the context of ordering of GBCs).

According to the Form 3800 instructions, GBCs are used on a first in first out ("FIFO") basis with the oldest GBCs being used first.[15] Then, within each tax year for which there are GBCs, there are ordering rules for which credits from that year get used first (see section 38(d)). The various GBCs are calculated on a variety of forms, e.g., the research tax credit is calculated using Form 6765, *Credit for Increasing Research Activities*. The individual GBCs then flow to Form 3800, *General Business Credit*. The GBCs allow for a current year flow from Form 3800, Part II - Allowable Credit, line 38; to Form 1120, Schedule J – Tax Computation and Payment, Part I - Tax Computation, line 5c.

Of the Big 3 Credits, GBCs come second in priority of usage; see section 53(c) discussed below. The secondary priority within the Big 3 given to GBCs is further supported by:

> When the credit for prior year AMT is calculated using Form 8827, *Credit for Prior Year Minimum Tax – Corporations*, the FTC (and allowable GBCs) are factored into line 5 which states, "[e]nter the corporation's 2017 regular income tax liability minus allowable tax credits (see instructions)." The instructions state, "[e]nter the corporation's 2017 regular income tax liability (as defined in section 26(b)) minus any credits allowed under Chapter 1, Subchapter A, Part IV, subparts B, D, E and F of the Internal Revenue Code (for example, if filing For 1120 subtract any credits on Schedule J, Part I, line 5a through 5c, from the amount on Schedule J, Part I, line 2)."

Section 39(a) has rules about carrybacks and carryforwards of GBCs, including:

> (1) 1- YEAR CARRYBACK AND 20-YEAR CARRYFORWARD. — If the sum of the business credit carryforwards to the taxable year plus the amount of the current year business credit for the taxable year exceeds the amount of the limitation imposed by subsection (c) of Section 38

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14 Section 38 is contained in subtitle A - Income Taxes, chapter 1 - Normal Taxes and Surtaxes, subchapter A - Determination of Tax Liability, part IV - Credits Against Tax, subpart D – Business Related Credits.

15 See also Conference Committee report on the Technical and Miscellaneous Revenue Act of 1988 (P.L. 100-647) which states "Finally, the conferees wish to clarify that the credit ordering rules included in the bill affect only the order in which credits arising in a single year are used. These rules do not affect the present-law rule that requires that credits arising in the earliest year be used first (the 'FIFO rule')." H.R. Conf. Rep. No. 100-1104, vol. 2, at 6-7 (Oct. 21, 1988).

for such taxable year (hereinafter in this Section referred to as the "unused credit year"), such excess (to the extent attributable to the amount of the current year business credit) shall be—

(A) a business credit carryback to the taxable year preceding the unused credit year, and

(B) a business credit carryforward to each of the 20 taxable years following the unused credit year,

and, subject to the limitations imposed by subsections (b) and (c), shall be taken into account under the provisions of Section 38(a) in the manner provided in Section 38(a).

(2) AMOUNT CARRIED TO EACH YEAR.—

(A) ENTIRE AMOUNT CARRIED TO FIRST YEAR.— The entire amount of the unused credit for an unused credit year shall be carried to the earliest of the 21 taxable years to which (by reason of paragraph (1)) such credit may be carried.

(B) AMOUNT CARRIED TO OTHER 20 YEARS.— The amount of the unused credit for the unused credit year shall be carried to each of the other 20 taxable years to the extent that such unused credit may not be taken into account under Section 38(a) for a prior taxable year because of the limitations of subsections (b) and (c).

The section 38 and 39 credit ordering rules are also summarized in the instructions to Form 3800 for 2019 which indicate that:

General Business Credits reported on Form 3800 are treated as utilized on a first-in, first-out ("FIFO") basis by offsetting tax liability with the earliest-earned credits first. Therefore, the order in which the credits are used in any tax year is:

- Carryforwards to that year, the earliest ones first;
- The general business credit earned in that year; and
- The carryback to that year.

The instructions for Form 3800 further note that:

Order in which credits are used. When relevant, the components of the general business credit reported on Form 3800 arising in a single tax year are used in the following order:

- Investment credit (in the following order—rehabilitation credit, energy credit, qualifying advanced coal project credit, qualifying gasification project credit, and qualifying advanced energy project credit) (Form 3468)
- Qualifying therapeutic discovery project credit (carryforward only)
- Work opportunity credit (Form 5884)

- Biofuel producer credit (Form 6478)
- Credit for increasing research activities (Form 6765)
- Low-income housing credit (Form 8586)
- Enhanced oil recovery credit (Form 8830)(carryfoward only)
- Disabled access credit (Form 8826)
- Renewable electricity, refined coal, and Indian coal production credit (Form 8835)
- Empowerment zone employment credit (Form 8844)
- Renewal community employment credit (carryforward only)
- Indian employment credit (Form 8845)
- Employer social security and Medicare taxes paid on certain employee tips (Form 8846)
- Orphan drug credit (Form 8820)
- New markets credit (Form 8874)
- Credit for small employer pension plan startup costs (Form 8881)
- Credit for employer-provided childcare facilities and services (Form 8882)
- Qualified railroad track maintenance credit (Form 8900)
- Biodiesel and renewable diesel fuels credit (Form 8864)
- Low sulfur diesel fuel production credit (Form 8896)
- Credit for oil and gas production from marginal wells (Form 8904)(carryforward only)
- Distilled spirits credit (Form 8906)
- Nonconventional source fuel credit (carryforward only)
- Energy efficient home credit (Form 8908)
- Energy efficient appliance credit (carryforward only)
- Alternative motor vehicle credit (Form 8910)
- Alternative fuel vehicle refueling property credit (Form 8911)
- Mine rescue team training credit (Form 8923)
- Agricultural chemicals security credit (carryforward only)

— Credit for employer differential wage payments (Form 8932)

— Carbon dioxide sequestration credit (Form 8933)

— Qualified plug-in electric drive motor vehicle credit (Form 8936)

— Qualified plug-in electric vehicle credit (carryforward only)

— Credit for small employer health insurance premiums (Form 8941)

— Employee retention credit (Form 5884-A)

— Employer credit for paid family and medical leave (Form 8994)

— General credits from an electing large partnership (Schedule K-1 (Form 1065-B)) (carryforward only)

TIP: Although these credits are aggregated on Form 3800, it is important to keep a separate record of each credit, including whether the credit was an ESBC [Eligible Small Business Credit], for purposes of proper accounting.

B. Eligible Small Businesses Credits

Section 38(c)(5) defines an eligible small business as follows:

> 38(c)(5) RULES RELATED TO ELIGIBLE SMALL BUSINESSES.—
>
> (A) ELIGIBLE SMALL BUSINESS.— For purposes of this subsection, the term “eligible small business” means, with respect to any taxable year—
>
> (i) a corporation the stock of which is not publicly traded,
>
> (ii) a partnership, or
>
> (iii) a sole proprietorship,
>
> if the average annual gross receipts of such corporation, partnership, or sole proprietorship for the 3-taxable-year period preceding such taxable year does not exceed $50,000,000. For purposes of applying the test under the preceding sentence, rules similar to the rules of paragraphs (2) and (3) of section 448(c) shall apply.
>
> (B) TREATMENT OF PARTNERS AND S CORPORATION SHAREHOLDERS.— For purposes of paragraph (4)(B)(ii), any credit determined under section 41 with respect to a partnership or S corporation shall not be treated as a specified credit by any partner or shareholder unless such partner or shareholder meets the gross receipts test under subparagraph (A) for the taxable year in which such credit is treated as a current year business credit.

These ESBC provisions have relevance insofar as (1) ESBCs determined in tax years beginning in 2010 (which have been carried forward or were carried, and (2)) the research credit determined under section 41 for the tax year with respect to an eligible small business (as defined in paragraph (5)(A) after application of the rules of paragraph (5)(B)) (which makes the research credit for an eligible small business a specified credit).

C. Credits from Passive Activities

Section 469, *Passive activity losses and credits limited*, affects whether a loss or credit from a passive activity will be allowed to a taxpayer. The details of these rules are beyond the scope of this memo, but the non-passive or passive nature of the activity giving rise to a GBC comes in to play when completing Form 3800.

D. Completing Form 3800

Care should be taken with respect to a number of areas of Form 3800. The various GBCs are reported each year on Form 3800 and Part III, General Business Credits or Eligible Small Business Credits, of Form 3800 must be completed first, i.e., complete Part III before completing parts I and II. Part III has a number of boxes that can be checked including:

A. General Business Credit from a Non-Passive Activity

B. General Business Credit from a Passive Activity

C. General Business Credit Carryforwards

D. General Business Credit Carrybacks

E. Reserved

F. Reserved

G. Eligible Small Business Credit Carryforwards

H. Reserved

I. If you are filing more than one Part III with box A or B checked, complete and attach first an additional Part III combining amounts from all Parts III with box A or B checked. Check here if this is the consolidated Part III

The Instructions for Form 3800 further state:

> Complete a separate Part III for each box checked. In addition, for each box A or B checked, if you have a credit from more than one source and one of the sources is a pass-through entity, including a cooperative (see *Column (b)*, later), a separate Part III is needed for each pass-through entity for which you received the same credit. As a result, one checkbox could have multiple Parts III if you receive a single credit from multiple pass-through entities.

Caution: *After you have completed all necessary Parts III, complete Part I, if necessary, then Part II.*

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Assembling Form 3800. To ensure Form 3800 is correctly processed, assemble Form 3800 in the following order.

1. Page 1.
2. Page 2.
3. Part III with box I checked.
4. All Parts III with box A checked.
5. All Parts III with box B checked.
6. Part III with box C checked.
7. Part III with box D checked.
8. Part III with box G checked.

Thus, it is very important to identify the correct box and create a separate Part II for each box checked – the boxes and other aspects of Form 3800 effectuates the application of the various credit ordering and usage rules (including (1) rules for allowance of passive activity related credits; (2) how empowerment zone and renewal community employment credit can offset up to 25 percent of AMT; and, (3) specified credits may be used to offset AMT). Further, after the appropriate box has been checked, additional care should be taken with regard to which line of Part III a credit gets reported on. For example, an R&D credit from Form 6765 can be reported on line 1c or line 4i depending upon whether the R&D credit is from an eligible small business, in which case it gets reported on line 4i, or if it is not from an eligible small business it gets reported on line 1c.

E. GBCs and the Tax Liability Limitation Rules

GBCs that are determined are generally allowed only to reduce the actual tax liability of a taxpayer to a limited extent. In addition to the limitations based upon amount of tax in section 26(a) discussed above, section 38(c)(1) provides that the credit allowed under subsection (a) for any tax year shall not exceed the excess (if any) of the taxpayer’s net income tax over the greater of: (A) the tentative minimum tax for the tax year, or (B) 25 percent of so much of the taxpayer’s net regular tax liability as exceeds $25,000. For purposes of the preceding sentence, the term “net income tax” means the sum of the regular tax liability and the tax imposed by section 55,[16] reduced by the credits allowable under

[16] Section 55 is the AMT.

subparts A and B of this part,[17] and the term “net regular tax liability” means the regular tax liability reduced by the sum of the credits allowable under subparts A and B of this part.

Accordingly:

- GBCs generally cannot reduce regular tax liability to less than the taxpayer’s TMT. Because AMT is the taxpayer’s TMT in excess of regular tax, a taxpayer that is actually in an AMT position for a particular tax year cannot use GBCs for that tax year unless the GBCs are empowerment zone employment credits (Form 8844), which can offset up to 25 percent of TMT or specified credits, which are allowed against up to 100 percent of TMT, and these rules are discussed later in this article. Note that the Tax Cuts and Jobs Act (“TCJA”)[18] repealed the corporate AMT effective for tax years beginning after December 31, 2017,[19] therefore the TMT reference no longer applies to corporations for tax years beginning after December 31, 2017.[20]

- GBCs generally cannot reduce regular tax liability (regular tax minus FTC and certain other non-GBCs credits, plus AMT—see sections 55(c) and 38(c)(1)) to an amount less than 25 percent of the regular tax liability (minus FTC and certain other non-GBCs credits) after the first $25,000 of tax.

Thus, the tax liability limitation is determined separately for the general business credit attributable to:

- Empowerment zone and renewal community employment credit (Form 8844);
- Eligible small business[21] credit that was allowed in a tax year that began in 2010; and
- “Specified Tax Credits.”[22]

Empowerment Zone and Renewal Community Employment Zone Credits Can Generally Offset up to 25 Percent of AMT

For purposes of the empowerment zone and renewal community employment credit, the allowable credit may not exceed “net income tax” minus the greater of (a) 75 percent of the tentative minimum tax

[17] Section 38 is contained in subtitle A - Income Taxes, chapter 1 - Normal Taxes and Surtaxes, subchapter A - Determination of Tax Liability, part IV - Credits Against Tax, subpart D – Business Related Credits. Thus, the reference to subparts A and B of this part refer to subpart A – Nonrefundable Personal Credits (these are contained in Code section 21 through 26) and subpart B – Other Credits (which are contained in Code sections 27 through 30D).

[18] The Tax Cuts and Jobs Act was signed into law on December 22, 2017, as an act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018, Public Law 115-97, 131 Stat. 2054 (2017).

[19] *See* modifications to section 55(a).

[20] *See* section 53(d)(2).

[21] An “Eligible Small Business” includes a corporation whose stock is not publicly traded, a partnership, or sole proprietorship whose average annual gross receipts for the 3-tax-year period preceding the tax year of the credit cannot exceed $50 million. This is discussed in greater detail below in the article.

[22] See section 38(c)(2), as amended by the Creating Small Business Jobs Act of 2010, Pub. L. No. 111-240.

or (b) 25 percent of "net regular tax liability" above $25,000. This result is reduced by the general business credit allowed for the tax year that is attributable to the components other than (1) the empowerment zone and renewal community employment credit, (3) the eligible small business credits determined for the first tax year of an eligible small business beginning in 2010, (4) the "specified credits" to arrive at the limitation on the general business credit attributable to the empowerment zone employment credit.[23]

Specified Credits Can Offset up to 100 Percent of AMT

Specified tax credits are limited by the taxpayer's net income tax minus the greater of (a) the tentative minimum tax, assumed to be zero, or (b) 25 percent of the taxpayer's regular income tax in excess of $25,000, reduced by any other business credits allowed for the tax year (other than the specified credits).

The **"Specified Tax Credits"** are found under section 38(c)(4)(B) and include the following:

- Alcohol fuels credit (Form 6478);
- Research credit with respect to an eligible small business (Form 6765);
- Low-income housing credit (Form 8586, Part II);
- Renewable electricity, refined coal, and Indian coal production (Form 8835);
- Employer social security and medicare taxes paid on certain employee tips (Form 8846);
- Railroad track maintenance credit (Form 8900);
- Small employer health insurance credit (Form 8941);
- Investment credit (Form 3468, Part III) (attach Form 3468);
- The work opportunity credit (Form 5884); and
- The paid family and medical leave credit (Form 8994).

As stated in Form 3800 Instructions, if a taxpayer's general business credits exceed its tax liability limit, the credits are utilized in the following order and based on the order show under the order in which general business credits are used as provided above:

[See table on page 16]

[23] See section 38(c)(2), as amended by the Creating Small Business Jobs Act of 2010, Pub. L. No. 111-240.

Instructions to Form 3800 Text	Comments
Credits reported on line 2 of all Parts III with boxes A, B, C, and D checked	Line 2 of Part III totals GBCs from lines 1a through 1zz of Part III and includes most GBCs except for (1) empowerment zone employment credit (Form 8844) that gets reported on Part III Line 3 and (2) specified credits that get report on Part III lines 4a through z. The only Part III box that is not included here that is not “Reserved” is box G, eligible small business carryforwards
Credits reported on Part II, line 25	Line 25 adds (1) lines 22, which combines the amounts from Part III line 3 empowerment zone and renewal community employment credit (Form 8844) of all Parts III with box A, C, or D checked and (2) line 24 which is the applicable passive activity (so with box B checked) credit amount for the empowerment zone and renewal community employment credit allowed from Form 8582-CR or Form 8810. The passive activity credit amount allowed on Part II, line 24, only applies to the empowerment zone and renewal community employment credit reported on Part III, line 3, plus any prior year unallowed passive activity empowerment zone and renewal community employment credit.
Non-ESBC (eligible small business credits) reported on line 5 of all Parts III with boxes A, B, C, and D checked	Line 5 combines the specified credits that get report on Part III lines 4a through z; the only Part III box that is not included here that is not “Reserved” is box G, Eligible small business carryforwards
ESBC credits reported on line 6 of all Parts III with box G checked	Part III box G is eligible small business carryforwards

The above ordering such that Part III box G eligible small business credits are used last appears to be based upon prior provisions in sections 38. The Small Business Jobs Act of 2010 (P.L. 111-240) made various changes to sections 38 and 39 related to eligible small business credits determined in tax years beginning in 2010. Relevant sections of the Small Business Jobs Act of 2010 included section 2013, General Business Credits of Eligible Small Businesses in 2010 Not Subject to Alternative Minimum Tax, which made changes to section 38, including changes that resulted in section 38(c)(5)(A)(i) to provide that:

> 38(c)(5) SPECIAL RULES FOR ELIGIBLE SMALL BUSINESS CREDITS IN 2010.—
>
> (A) IN GENERAL.— In the case of eligible small business credits determined in taxable years beginning in 2010—
>
> > (i) **this section and section 39 shall be applied separately with respect to such credits**, and [emphasis added]

(ii) in applying paragraph (1) to such credits—

(I) the tentative minimum tax shall be treated as being zero, and

(II) the limitation under paragraph (1) (as modified by subclause (I)) shall be reduced by the credit allowed under subsection (a) for the taxable year (other than the eligible small business credits).

Old section 38(c)(5)(A)(i), was stricken by Division U, Tax Technical Corrections, of the Consolidated Appropriations Act, 2018 (P.L. 115-141), Title IV— Clerical Corrections and Deadwood. Section 401, (b) General Deadwood-related Provisions.— (5)(A).

Parts I and II of Form 3800 pull the various GBCs from Part III, taking into account the lines that they are reported on and the Part Iii boxes that are checked, to apply the credit ordering and limitation rules. Part I of Form 3800 calculates the current year credit for credits not allowed against tentative minimum tax. Part II of Form 3800 calculates the overall allowable GBC for the current year on line 38, and this amount goes from Part II line 38 to Form 1120, Schedule J, Part I, Line 5c.

As a result of the tax credit usage and ordering rules, (1) the GBCs included in on Form 3800 Line 2 are entered on Part I and are not allowed against tentative minimum tax while (2) the total of (A) non-passive empowerment zone employment credits (Form 8844) from Part III line 3 and (B) passive empowerment zone employment credits (Form 8844) from Part III line 3 to the extent allowed, can offset up to 25 percent of tentative minimum tax, and (3) specified credits from Line 5 are entered into Part II which are allowed against up to 100 percent of tentative minimum tax.

From a practical standpoint, the form pulls the three categories of credits separately then combines and compares the various credits from Lines 2 (which totals lines 1a through 1zz), 3, 5 (which totals lines 4a through 4z) and 6 of Part III on Lines 17, 28, and 30 to compute the overall GBC limitation.

<u>Example: General Business Credit Example</u>

A taxpayer has $225,000 of regular tax liability for the current tax year. The taxpayer has zero foreign tax credits and zero credits for prior year AMT credits, for the current tax year. The taxpayer has zero GBCs carried forward into the current tax year and a section 45C orphan drug credit determined for the current tax year of $300,000. None of the $300,000 of current tax year orphan drug credit can be used in the prior tax year, so none can be carried back to that year. The taxpayer is allowed to use GBCs to offset the first $25,000 of the current year regular tax liability of $225,000 plus 75 percent of the remaining $200,000 of tax liability, for a total of $175,000 ($25,000 plus $150,000). The remaining $50,000 current year of tax liability cannot be offset by GBCs and the remaining $125,000 of orphan drug credit ($300,000 determined less $175,000 allowed) can be carried forward in to the next tax year.

A formal illustration of this example is below:

Item	Amount	Formula Legend	Formula Notes
Total Regular Tax Liability	$225,000	A	Not applicable
Current credit year orphan drug tax credit determined	$300,000	B	Not applicable
First $25,000 of regular tax	$25,000	C	= MIN of B or $25,000
Amount of Tax Liability in Excess of first $25,000	$200,000	D	= MAX of (B – C) or $200,000
75% of excess of total tax over $25,000	$150,000	E	= D x 75%
Total GBCs allowed	$175,000	F	= C + E
Remaining tax liability that orphan drug GBCs cannot be used to pay	$50,000	G	= A – F
GBCs not allowed to be used this year and may be carried back one year and if not used then carried forward to next 20 years	$125,000	H	= B - F

V. Credit for Prior Year AMT

A. Overview and Utilization of Prior Year AMT Credit

Section 53(a) provides that a credit shall be allowed against the tax imposed by this chapter[24] for an amount equal to the "minimum tax credit" for the tax year. Section 53(b) defines the "minimum tax credit" as the excess (if any) of: (1) the adjusted net minimum tax imposed for all prior tax years beginning after 1986, over (2) the amount allowable as a credit under section 53(a) for the prior tax years.

Section 53(c) limits the allowable amount of the credit under section 53(a) for any tax year to the excess of: (1) the regular tax liability of the taxpayer for the tax year reduced by the sum of the credits allowable under subparts A, B, D, E, and F of this part,[25] over (2) the TMT for the tax year. Further, section 53(d)(2) was amended for tax years beginning after December 31, 2017, to provide that the term "tentative minimum tax" has the meaning given to it by section 55(b), except that in the case of a corporation, the tentative minimum tax shall be treated as zero.

AMT credits are calculated on Form 8827, *Credit for Prior Year Minimum Tax – Corporations*. The allowable AMT Credit flows from Form 8827, line 8b; to Form 1120, Schedule J - Tax Computation and Payment, Part I - Tax Computation, line 5; to Form 1120, Schedule J – Tax Computation and Payment, Part I - Tax Computation, line 5d.

AMT credits can be utilized only to the extent of regular tax (minus allowable nonrefundable credits including the FTC) in excess of TMT. If an individual taxpayer has reduced tax to the level of TMT with GBCs, there will be no AMT credit allowed for the year. For corporate taxpayers, because for tax years beginning after December 31, 2017, there is no longer a corporate AMT (repealed pursuant to Public Law 115-97 so only credit carryovers from prior years are applicable) and by extension no corporate TMT, AMTs credits for corporations can further reduce taxes down to zero after both FTCs and GBCs have been used to the extent that they are allowable (for example, if GBCs have been used to offset the first $25,000 of taxable income and then the next 75 percent of taxable income in excess of $25,000, AMT credits can then be used to reduce the remaining 25 percent of taxes in excess of $25,000). Note that section 15 rate blending applies with respect to AMT for fiscal year taxpayers whose tax years straddle December 31, 2017.[26]

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24 Section 53 is contained in subtitle A - Income Taxes, chapter 1 - Normal Taxes and Surtaxes.

25 Section 53 is contained in subtitle A - Income Taxes, chapter 1 - Normal Taxes and Surtaxes, subchapter A - Determination of Tax Liability, part IV - Credits Against Tax, subpart G – Credit Against Tax for Prior Year Minimum Tax Liability. The section 38 general business credit is contained in chapter 1 - Normal Taxes and Surtaxes, subchapter A - Determination of Tax Liability, part IV - Credits Against Tax, subpart D – Business Related Credits. So, because both section 53 and section 38 are both part of part IV - Credits against Tax, they are part of the same part. In addition, since section 38 is a credit allowable under subpart D – Business Related Credits, the GBC is one of the credits referred to by section 53(c)(1) and it therefore gets used before the section 53(a) AMT credit.

26 *See* Notice 2018-38.

Because of section 53(c), of the Big 3 credits, prior year AMT credits come third in usage ordering, this is because section 53(c) limits the allowable amount of the credit under section 53(a) for any tax year to the excess of: (1) the regular tax liability of the taxpayer for the tax year reduced by the sum of the credits allowable under subparts A, B [which includes the section 27 FTC), D [which includes the section 38 GBC], E, and F of this part.

Example: Prior Year AMT Credit Example

The facts are the same as in Example One from above, except that the taxpayer now has a credit for prior year AMT for the current tax year of $50,000.

Item	**Amount**	**Formula Legend**	**Formula Notes**
Total Regular Tax Liability	$225,000	A	Not applicable
Current credit year orphan drug tax credit determined	$300,000	B	Not applicable
First $25,000 of regular tax	$25,000	C	= MIN of B or $25,000
Amount of Tax Liability in Excess of first $25,000	$200,000	D	= MAX of (B – C) or $200,000
75% of excess of total tax over $25,000	$150,000	E	= D x 75%
Total GBCs allowed	$175,000	F	= C + E
Remaining tax liability that orphan drug GBCs cannot be used to pay	$50,000	G	= A – F
GBCs not allowed to be used this year and may be carried back one year and if not used then carried forward to next 20 years	$125,000	H	= B – F
Credit for prior Year AMT	$50,000	I	Not applicable
Credit for prior Year AMT that is allowed	$50,000	J	MIN G or J
Remaining regular tax liability	Zero	K	= G – J

B. New Refundability of Corporate Credits for Prior Year AMT

New section 53(e) became effective for tax years beginning after December 31, 2017, and it provides as follows:

> (e) PORTION OF CREDIT TREATED AS REFUNDABLE.—
>
> > (1) IN GENERAL. — In the case of any taxable year of a corporation beginning in 2018, 2019, 2020, or 2021, the limitation under subsection (c) shall be increased by the AMT refundable credit amount for such year.
> >
> > (2) AMT REFUNDABLE CREDIT AMOUNT.— For purposes of paragraph (1), the AMT refundable credit amount is an amount equal to 50 percent (100 percent in the case of a taxable year beginning in 2021) of the excess (if any) of—
> >
> > > (A) the minimum tax credit determined under subsection (b) for the taxable year, over
> > >
> > > (B) the minimum tax credit allowed under subsection (a) for such year (before the application of this subsection for such year).
> >
> > (3) CREDIT REFUNDABLE. — For purposes of this title (other than this Section), the credit allowed by reason of this subsection shall be treated as a credit allowed under subpart C (and not this subpart).[27]
> >
> > (4) SHORT TAXABLE YEARS. — In the case of any taxable year of less than 365 days, the AMT refundable credit amount determined under paragraph (2) with respect to such taxable year shall be the amount which bears the same ratio to such amount determined without regard to this paragraph as the number of days in such taxable year bears to 365.

Therefore, for years beginning after December 31, 2017, if all the allowable corporate credits for prior year AMT have been utilized, and there is a corporate credit for prior year AMT remaining, these excess credits are refundable. Changes made by the CARES Act including to accelerate the recovery of remaining minimum tax credits of a corporation for its 2019 tax year from its 2021 tax year—allow a corporation to elect, instead, to recover 100 percent of any of its remaining minimum tax credits in its 2018 tax year. If a CARES Act election to accelerate recovery of prior year AMT credits is **not made**, the schedule for refundability of corporate prior year AMT credits is as illustrated in the below table. Note that the table assumes a calendar year end taxpayer and that none of the beginning corporate credit for prior year AMT is otherwise allowed:

[27] Section 53(e) is nominally part of subtitle A - Income Taxes, chapter 1 – Normal Taxes and Surtaxes, part IV – Credits Against Tax, subpart G – Credit Against Regular Tax for Prior Year Minimum Tax Liability. Subpart C is Refundable Credits.

Calendar Year	Beginning Corporate AMT Credit Carryover	Percentage Refundable	Amount Refunded	Amount Carried Forward to the Next Year
2018	$1,000	50%	$500	$500
2019	$500	50%	$250	$250
2020	$250	50%	$125	$125
2021	$125	100%	$125	Zero

Note: The IRS has announced that for tax years beginning after December 31, 2017, refund payments and credit elect and refund offset transactions due to refundable minimum tax credits under section 53(e) will not be subject to sequestration.[28]

VII. International Tax Implications

A. Section 965 Deemed Repatriation Income

H.R. 1 made fundamental changes to the taxation of multinational entities. In general, the new law shifts the U.S. from a system of worldwide taxation with deferral to a participation exemption regime with current taxation of certain foreign income. To accomplish this, the new law includes several features beyond the scope of this article but one of which is a new section 965 resulting in "deemed repatriation" of previously untaxed "old earnings." This resulted in additional income in calendar year 2017 for many taxpayers and therefore often resulted in additional tax liability. Section 965(h) allows taxpayers to pay the net tax liability resulting from deemed repatriation in annual installments. Section 965(h)(1) provides that in the case of a United States shareholder of a deferred foreign income corporation, the United States shareholder may elect to pay the net tax liability under this section in eight annual installments of the following amounts:

(A) 8 percent of the net tax liability in the case of each of the first 5 of the annual installments;

(B) 15 percent of the net tax liability in the case of the 6th installment;

(C) 20 percent of the net tax liability in the case of the 7th installment; and

(D) 25 percent of the net tax liability in the case of the 8th installment.

The first installment shall be paid on the due date (determined without regard to any extension of time for filing the return) for the return of tax for the tax year and each succeeding installment shall be paid

[28] *See* Effect of Sequestration on the Alternative Minimum Tax Credit for Corporations (fiscal year 2019), www.irs.gov/newsroom/effect-of-sequestration-on-the-alternative-minimum-tax-credit-for-corporations-fiscal-year-2019 .

on the due date (as so determined) for the return of tax for the tax year following the tax year with respect to which the preceding installment was made.

Section 965(h)(6) provides that the net tax liability under this section with respect to any United States shareholder is the excess (if any) of: (1) Taxpayer's net income tax[29] for the tax year in which an amount is included in the gross income of the United States shareholder under section 951(a)(1), over (2) Taxpayer's net income tax for the tax year determine without regard to this section, and without regard to any income or deduction properly attributable to a dividend received by the United States shareholder from any deferred foreign income corporation.

Thus, the amount of the amount of tax eligible for installment payments can be illustrated as follows:

A	B	C = A – B	
Tax with repatriated income	Credits against tax with repatriated income	Net tax with repatriated income	D
Tax without repatriated income	Credits against tax without repatriated income	Net tax without repatriated income	E
		Tax eligible for installments; Subsequent satisfaction of the installment payments cannot be reduced by subsequently generated tax credits	F = D - E

Note: It is unclear how the section 39(a)(1) one-year carryback rule for credits generated in 2018 may affect these calculations.

Section 965 also includes a special rule disallowing credits under section 901. Section 965(c) generally provides a participation exemption mechanism that allows a deduction for U.S. shareholders with deemed repatriation inclusions. The amount of the deduction is calculated in order to result in an effective rate of tax of 15.5 percent for the U.S. shareholder's "aggregate foreign cash position" and 8 percent for the remainder of the inclusion. Section 965(g) disallows a credit under section 901 for taxes with respect to any amount for which a deduction is allowed under section 965(c).

Since the section 965 deemed repatriation taxable income is included in the last tax year beginning before 2018 as a subpart F inclusion, and since this tax is imposed under chapter 1 of the Code, the

29 The term "net income tax" means the regular tax liability reduced by the credits allowed under subparts A, B, and D of part IV of subchapter A.

above rules regarding use of credits also apply to taxes related to section 965 deemed repatriated income for 2017.

B. Base Erosion Anti-Abuse Tax ("BEAT")

The TCJA added new section 59A that generally is intended to prevent erosion of the U.S. tax base by imposing an additional tax (the "base erosion and anti-abuse tax" or "BEAT") on certain large corporations ("applicable taxpayers"[30]) that reduce their regular U.S. tax liability below a certain threshold through the use of "base erosion tax benefits." In general, base erosion tax benefits are the deductions allowable with respect to "base erosion payments," which include, among other things, deductible payments made to related foreign persons.[31] The BEAT generally does not apply to payments to related foreign persons that are included in cost of goods sold.[32] The BEAT applies to base erosion payments paid or accrued in tax years beginning after December 31, 2017.

The BEAT applies to corporations that are not taxed on a flow through basis (that is, not S Corps, RICs or REITs), are part of a group with at least $500 million of average annual domestic gross receipts (including income of foreign affiliates that is effectively connected with the conduct of a U.S. trade or business ("ECI") over the prior three tax years, and which have a "base erosion percentage" of three percent or higher for the tax year (or two percent for groups with certain banks or securities dealers).[33] The BEAT provision also applies to foreign corporations that have ECI.

The mechanics of the BEAT liability calculation are very complicated and the BEAT tax rate depends on the tax year and taxpayer's industry. The BEAT tax is determined through a multi-step formula used to derive the "base erosion minimum tax amount."[34] For tax years 2019 through 2025, this amount generally equals the excess of 10 percent of the taxpayer's modified taxable income ("MTI") for the year over an amount equal to the taxpayer's pre-credit regular income tax liability reduced (but not below zero) by all credits other than the research credit and up to 80 percent[35] of the amount of "applicable section 38 credits" allowed for the year. The BEAT calculation thus allows taxpayers to retain the full benefit of research credits and a portion of the benefit of applicable section 38 credits, against regular

income tax. For tax years beginning after December 31, 2025, however, an applicable taxpayer must reduce its regular tax liability by all credits—including the research credit and applicable section 38

30 An applicable taxpayer is defined in section 59A(e).

31 Sections 59A(c)(2) and 59A(d)(1).

32 *See* section 1.59A-3(b)(2)(viii) ("any amount resulting in a reduction to determine gross income under section 61, including an amount properly treated as cost of goods sold under the Code, is not a base erosion payment"). *But see* section 1.59A-3(a)(1)(iv) (in the context of certain expatriated entities, payments to related foreign persons for cost of goods sold can be subject to the BEAT).

33 *See* section 59A(e). The base erosion percentage generally reflects the percentage of deductions allowed for the year that are attributable to base erosion payments. *See* section 59A(c)(4). Section 59A(e)(3) provides aggregation rules for purposes of determining the $500 million gross receipts test and base erosion percentage.

34 *See* section 59A(a).

35 Applicable section 38 credits are excluded to the extent of 80 percent of the lesser of the credits or the base erosion tax amount otherwise computed. Section 59A(b)(1)(B)(ii)(II).

credits—thus unfavorably increasing the likelihood that the taxpayer will have a BEAT liability (or increasing the taxpayer's BEAT liability).

Applicable section 38 credits are the low-income housing credit, renewable energy production credit, and energy credits allowed in that year.[36] MTI is the taxpayer's regular taxable income for the year increased by the amount of base erosion tax benefits for the year and the base erosion percentage of a net operating loss ("NOL") deduction for the year.[37] The BEAT tax rate generally increases to 10 percent for tax years beginning after December 31, 2018 and before January 1, 2026 (it was five percent in 2018), and 12.5 percent for tax years beginning after 2025.[38]

Because FTC, GBC, and AMT credits can only offset taxes imposed under chapter 1 and because section 26(b) treats the BEAT tax as not being imposed by chapter 1, FTC, GBC, and AMT credits generally cannot be used to offset the BEAT liability. Recall, however, that corporate AMT carryforwards are refundable now. Three simplified examples are illustrated below.

<u>BEAT Example 1</u>

Taxpayer A is a calendar year U.S. Corporation that is an applicable taxpayer for BEAT purposes. For its 2020 tax year, Taxpayer A has a pre-credit regular tax liability of $125,000. Taxpayer A's section 41 R&D Credit determined using Form 6765 is $325,000, and Taxpayer A has no GBC credits carried forward into 2020 from prior years. Assume that none of the 2020 R&D credit may be carried back and used in 2019 under the applicable rules of section 39. The amount of the $325,000 of determined R&D credit allowed as a GBC for 2020 is calculated using Form 3800. The amount allowed as a GBC is calculated based on the first $25,000 of pre-credit regular tax liability plus 75 percent of the excess over $25,000 of pre-credit regular tax liability, which is $75,000 ((75 percent x ($125,000 - $25,000)).[39] Thus, the amount of R&D Credit allowed is $100,000 and the remaining $225,000 of the credit that was determined for 2020 may be carried forward for 20 years. Taxpayer A must pay the remaining $25,000 of regular tax liability ($125,000 less $100,000 of allowed credits = $25,000). Further, as illustrated below, Taxpayer A has a BEAT liability of $225,000 that it cannot offset with the $225,000 of unused R&D credits from 2020. Thus, the total amount of the check that Taxpayer A must pay to the IRS for 2020 is $250,000 ($25,000 of regular tax liability plus $225,000 of BEAT liability.

36 Section 59A(b)(4).

37 Section 59A(c); section 1.59A-4(b).

38 Section 59A(b)(2). The BEAT tax rate is one percentage higher for groups that include certain banks and securities dealers.

39 *See* section 38(c).

Taxpayer A's regular tax liability and BEAT liability for its 2019 tax year are calculated as follows:

BEAT Example 1 Tax Calculations	**Amount**	**Ref**
Sales	$ 8,000,000	**A**
Base erosion payments	$ 2,904,760	**B**
Other deductible expenses	$ 4,500,000	**C**
Regular Taxable Income	$ 595,240	**D = (A – B) - C**
Pre-credit Regular Tax Liability (@ 21%) ("RTL")	$ 125,000	**E = D * 21%**
R&D Credits allowed against RTL[40]	$ 100,000	**F**
Other credits allowed against RTL (there are no other credits allowed against RTL in this example)	N/A	**G**
Post-credit RTL	$25,000	**H = (E – F) - G**
BEAT Liability Calculation		
Modified taxable income ("MTI")	$ 3,500,000	**I = D + B**
MTI @ 10%	$350,000	**J = I * 10%**
Regular tax liability reduced by credits other than R&D credit and applicable section 38 credits ("adjusted RTL")	$125,000	**K = E - G**
BEAT liability = MTI @ 10% - adjusted RTL	$225,000	**L = J - K**

[40] In this simplified example, we have assumed there are no section 59A(b)(4) applicable section 38 credits to account for.

<u>BEAT Example 2</u>

The facts are the same as BEAT Example 1, except that Taxpayer A also has a section 45Q Carbon Sequestration Credit generated and determined for 2020 of $200,000. Under the section 38 credit ordering rules for credits generated in the same tax year, the R&D credit from 2019 is used first.[41] The amount of the GBC allowed for the year remains limited to $100,000 (all of which is attributable to the R&D Credit) and the remaining $425,000 of allowable credits ($225,000 of unused R&D credit plus $200,000 of Carbon Sequestration credit) may be carried forward into 2020. Thus, Taxpayer A's regular tax liability and BEAT tax liability are the same as in Example 1.

Global Intangible Low-Taxed Income ("GILTI")

Effective for tax years beginning after December 31, 2017, the TCJA added a new category of income, global intangible low-taxed income ("GILTI"), to the Code as contained in new section 951A. Section 951A states that each person who is a United States shareholder of any controlled foreign corporation for any tax year, the United States shareholder shall include in gross income the shareholder's GILTI amount for the tax year.

Thus, GILTI is an item of income, not a separate tax. Section 951A is contained in chapter 1 - Normal Taxes and Surtaxes, subchapter N – Tax Based on Income from Sources Within or Without the United States, part III – Income from Sources Without the United States, subpart F – Controlled Foreign Corporations. Since this income gets taxed under chapter 1 of the Code, the above rules regarding use of credits also apply to taxes related to GILTI income.

VII. Conclusion

As discussed in this article, the rules and regulations regarding calculating and determining various credits, and how much of them are allowed and when, are complex. There is no substitute to the further insights that can be obtained by trying to work through some examples using the applicable forms and reading the instructions. By understanding and being able to explain the applicable rules, you can become the "go to" person in your organization and this will help you throughout your professional career in the tax field.

[41] *See* section 38(d). *Compare* section 38(b)(4) *with* section 38(b)(29).