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# Alliance for Competitive Taxation

# Comments on the August 25, 2021

# International Tax Discussion Draft of

# Senate Finance Committee Chair Senator Ron Wyden,

# Senator Sherrod Brown, and

# Senator Mark Warner

September 3, 2021

The 46 members of the Alliance for Competitive Taxation are: 3M, Abbott Laboratories, ADP, Alcoa Corporation, Alphabet Inc. / Google LLC, American Express Company, Bank of America Corp., Boston Scientific Corp., Carrier Global Corp., Caterpillar Inc., Cisco Systems, Inc., The Coca-Cola Company, Corteva Inc., Danaher Corporation, Dell Technologies, Inc., The Dow Chemical Company, DuPont, Eli Lilly and Company, Emerson Electric Co., Exxon Mobil Corporation, General Electric Company, General Mills Inc., The Home Depot Inc., Honeywell International Inc., IBM Corporation, International Paper Company, Johnson & Johnson, Johnson Controls, Inc., JPMorgan Chase & Co., Kellogg Company, Kimberly-Clark Corp., MasterCard Inc., McCormick & Company, Inc., Morgan Stanley, Oracle Corporation, Otis Worldwide Corp., PepsiCo, Inc., Procter & Gamble Co., Prudential Financial Inc., Raytheon Technologies Corp., S&P Global Inc., State Street Corporation, Texas Instruments, Inc., United Parcel Services, Inc., Verizon Communications Inc., and The Walt Disney Company.

## EXECUTIVE SUMMARY

The United States is the only country that has enacted a minimum tax on the active foreign income of its companies. According to an independent study by the Penn Wharton Budget Model, the U.S. Treasury's budget proposals would increase the tax burden on income subject to the U.S. foreign minimum tax (GILTI) by six times.[1] Increasing this unique tax paid only by American companies would further impede their ability to compete in global markets.

A significantly higher tax burden on the foreign income of U.S. companies would cause a contraction in U.S. jobs and investment resulting from:

- U.S. companies losing global market share to their lower taxed foreign competitors,
- U.S. companies being encouraged to sell their foreign operations to foreign companies in whose hands they would produce higher after-tax returns and greater cash flow,
- Foreign takeovers of U.S. companies or "inversions" in which U.S. companies relocate their headquarters abroad by merging with foreign companies located in more favorable tax jurisdictions, and
- More start-up companies being formed outside the United States to avoid the high U.S. tax burden on their foreign income.

While anti-inversion legislation can stop certain inversion transactions, it cannot slow the inevitable and adverse consequences to the U.S. economy of a significantly higher tax burden on the foreign income of U.S. companies.

ACT would welcome the potential adoption of foreign minimum taxes by other countries, as outlined in the July 1, 2021, statement of the G20/OECD Inclusive Framework. However, the proposed foreign minimum tax (Pillar Two) is a voluntary standard that has not yet been adopted by any country and the important aspects of this proposal remain to be agreed. Moreover, based on publicly available information, the current U.S. GILTI tax is more burdensome than the OECD's proposed Pillar Two minimum tax, so that even foreign minimum taxes were to be adopted by other countries, U.S. companies would remain at a competitive disadvantage.

Before the United States makes changes to increase GILTI taxes on U.S. companies, we should wait for other countries – at a minimum all other G7 countries and China – to adopt their own global minimum taxes. Raising the GILTI minimum tax before other countries have implemented a minimum tax comparable to the present-law GILTI would put the United States even further out of step with our international competitors, harming U.S. businesses and American workers.

Only after our major trading partners have enacted their own minimum taxes should Congress assess whether changes to present-law GILTI are advisable to better align it with the rules in other countries.

[1] Penn Wharton Budget Model, Profit Shifting and the Global Minimum Tax, July 21, 2021 at https://budgetmodel.wharton.upenn.edu/issues/2021/7/21/profit-shifting-and-the-global-minimum-tax.

## I. INTRODUCTION

The Alliance for Competitive Taxation (ACT) is a coalition of leading American companies across a broad array of industries whose principal mission is securing an internationally competitive tax system for the United States. ACT believes a corporate tax system that is aligned with the tax systems of our major trading partners will promote greater U.S. investment, increased employment, and higher wages. ACT welcomes this opportunity to offer comments on the discussion draft released by Senate Finance Committee Chairman Ron Wyden together with Senators Sherrod Brown and Mark Warner on August 25, 2021 ("the W-B-W discussion draft").[2]

U.S. businesses have been instrumental in lifting the U.S. economy in both good times and bad times, and our companies look forward to doing our part to restore full employment as the nation recovers from the job losses caused by the pandemic. After enduring a global pandemic for the past 18 months and with troubling signs that it will continue, policymakers should avoid any action that would risk the economic recovery. Increasing taxes on employers in these uncertain times would slow economic growth and risk the Nation's recovery.

ACT's comments on the W-B-W discussion draft are intended to ensure that any new proposals achieve the objective of increased U.S. employment, wages, and investment. Any U.S. tax rules that create an unlevel playing field for U.S. companies relative to their competitors in China, Europe, and other countries would directly counter this objective by favoring foreign-headquartered companies over U.S. companies. The foreign operations of U.S. companies are critical to serving foreign markets and result in a stronger domestic economy. The foreign operations of U.S. companies contribute to more jobs and higher earnings for American workers; greater U.S. investment in equipment, technology, and R&D; and increased U.S. exports.

Congress should recognize that the United States cannot design the U.S. international tax system in a vacuum. If U.S. international rules are out of step with those of other countries, U.S. companies will lose global market share to the detriment of domestic jobs, wages, R&D, and investment.

## II. SUMMARY COMMENTS ON THE WYDEN-BROWN-WARNER DISCUSSION DRAFT

A summary of ACT's comments on the W-B-W discussion draft is provided in this section, with greater detail provided as an appendix.

### A. GILTI

The Global Intangible Low-Taxed Income (GILTI) regime was enacted by the United States almost four years ago, and no other country has followed the United States in enacting a comparable tax on their companies. The W-B-W discussion draft envisions further increasing taxes on GILTI.

Some contend that U.S. changes to GILTI are required to conform to an outline of a global minimum tax being discussed within the OECD/G20 Inclusive Framework. This is not accurate for three reasons. First, many, including the OECD itself, recognize that present-law GILTI is a harsher minimum tax than the

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[2] ACT submitted comments on the earlier discussion draft released by Senators Wyden, Brown, and Warner ("Overhauling International Taxation," April 5, 2021). Those comments are available here: https://actontaxreform.com/media/kv0px1av/act-sfc-international-tax-framework-comments-april-23-2021.pdf.

minimum tax being considered by the OECD.[3] Second, there is not any agreement by countries to adopt a global minimum tax; indeed, the fundamental design elements of the OECD global minimum tax are still being discussed and are not yet ready for implementation. Third, regardless of any agreement that might be reached at the OECD, minimum taxes will not become effective unless and until they are enacted by individual countries. Other countries may be quite happy to let the United States aggressively lead in uncompetitive international tax policies and then pursue their own self-interest rather than follow the U.S. tax policy lead.[4] The U.S. government advocated as early as 2013 that all countries adopt a foreign minimum tax, and none have. Even the much-heralded July 1, 2021, statement by the OECD on a global minimum tax was not an agreement that countries would adopt such taxes, merely an agreement that if they did adopt such a minimum tax it would be "consistent with the outcomes" outlined by the Pillar Two plan.[5]

Before the United States makes changes to increase GILTI taxes on U.S. companies, we should wait for other countries – at a minimum all other G7 countries and China – to adopt their own global minimum taxes. Raising the GILTI minimum tax before other countries have implemented a minimum tax comparable to the present-law GILTI would put the United States even further out of step with our international competitors, harming U.S. businesses and American workers.[6] Only after our major trading partners have enacted their own minimum taxes should Congress assess whether changes to present-law GILTI are advisable to better align it with the rules in other countries.

ACT's position on the specific changes proposed to GILTI in the W-B-W discussion draft are summarized below:

1. Replacement of Overall GILTI Calculation with a Country-by-Country Determination. ACT supports retention of the current overall approach to calculating GILTI and maintaining the present-law regulations providing for an elective high-tax exclusion. However, to the extent that Congress is determined to modify GILTI to provide a country-by-country calculation, ACT strongly urges Congress to defer such a change until other major U.S. competitors, including all other G7 countries and China, enact their own country-by-country minimum taxes. In addition to deferring such a change, if Congress modifies

[3] See, OECD, Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, 2020, p. 19; and Cody Kallen, "Expense Allocation: A Hidden Tax on Domestic Activities and Foreign Profits," Tax Foundation, August 26, 2021.

[4] Even though the United States already has a foreign minimum tax, other countries may be reluctant to adopt such a tax out of concern for harming the global competitiveness of their companies unless foreign minimum taxes are broadly adopted. A recent report from the Government of Japan's Ministry of Economy, Trade, and Industry recognizes that if Japan implements a global minimum corporate tax rate "before its principal foreign competitors do, the ability of its multinational companies to compete in overseas markets could be adversely affected." (William Hoke, "Japanese Panel Issues Report on Taxation of Digital Economy," Tax Notes Daily International, August 23, 2021).

[5] OECD, Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, July 1, 2021.

[6] Even though the United States already has a foreign minimum tax, other countries may be reluctant to adopt such a tax out of concern for harming the global competitiveness of their companies unless foreign minimum taxes are broadly adopted. A recent report from the Government of Japan's Ministry of Economy, Trade, and Industry recognizes that if Japan implements a global minimum corporate tax rate "before its principal foreign competitors do, the ability of its multinational companies to compete in overseas markets could be adversely affected." (William Hoke, "Japanese Panel Issues Report on Taxation of Digital Economy," Tax Notes Daily International, August 23, 2021).

GILTI to provide a country-by-country calculation, Congress should ensure that U.S. implementation of these rules is not harsher than the minimum tax rules adopted by our major trading partners so that U.S. companies can compete on a level playing field.

2. The GILTI Section 250 Deduction. ACT opposes an increase in the GILTI tax rate – either directly as a result of increasing the statutory corporate tax rate or indirectly by reducing the Section 250 deduction – until our major trading partners, including all G7 countries and China, have enacted minimum taxes on the foreign business income of their companies. If other countries ultimately enact minimum taxes of their own, Congress should ensure that the U.S. minimum tax does not impose a greater tax burden than the minimum tax rules as adopted by these other countries to allow U.S. companies to compete on a level playing field with their foreign competitors.

3. The GILTI Foreign Tax Credit Disallowance. ACT supports 100% of foreign taxes being taken into account in determining the GILTI foreign tax credit. Disallowance of any foreign tax credits results in double taxation of the same income: once by the foreign country and a second time by the United States. Systematic and intentional double taxation is an impediment to cross-border investment and disadvantages American companies in global markets. The G20/OECD foreign minimum tax proposal allows a full offset for foreign taxes paid.

4. GILTI Expense Allocation. ACT commends the W-B-W discussion draft for eliminating expense allocation for U.S. research and stewardship expenses. ACT further recommends eliminating expense allocation rules for interest expense so that GILTI operates as a true top-up tax. Expense allocation rules under GILTI deny foreign tax credits when foreign income is relatively highly taxed, not when it is low-taxed. Thus, expense allocation rules have no rationale in the context of a minimum tax. In the same manner that expense allocation under GILTI raises the cost of performing domestic R&D and stewardship activities, interest expense allocation increases the cost of U.S. investment in property, plant, and equipment. As expense allocation rules are not warranted in GILTI and can lead to adverse effects for the U.S. economy, ACT recommends no expense allocation for any expenses under GILTI. The G20/OECD foreign minimum tax proposal does not allocate domestic R&D, stewardship, or interest expense.

5. Repeal of Net Deemed Tangible Income Return and Qualified Business Asset Investment (QBAI). ACT supports retention of the QBAI rules as they are intended to level the playing field with our major competitors who have territorial tax systems by exempting from GILTI the ordinary return to foreign investments in plant and equipment, income that is not prone to income shifting. QBAI has been mischaracterized as an incentive to invest outside the United States rather than at home, but foreign investments in plant and equipment are disadvantaged even with QBAI relative to the ability to expense the costs of these investments at home. Further, even in the absence of expensing of U.S. capital investments, pre-tax operational considerations for factory site investment decisions almost always outweigh any tax differences that would arise from the QBAI exemption. The G20/OECD foreign minimum tax proposal includes a substance-based carve out that exempts a deemed return on both tangible capital investment and payroll.

**B. FDII**

Financial statement data show that the Foreign-Derived Intangible Income (FDII) provision of present law has been successful in its objective to repatriate foreign intellectual property (IP) and retain domestic IP, and should not be repealed.[7] Importantly, FDII provides a level playing field for U.S. companies relative to their foreign competitors, whose countries, including China, provide similar (or lower) rates of tax on IP income. As U.S. companies increase their sales to foreign markets, they hire more skilled workers in their U.S. headquarters locations to manage international supply chains, logistics, marketing, and other valuable functions. Further, valuable development, enhancement, maintenance, protection, and exploitation (DEMPE) functions that would be connected with foreign IP ownership are instead kept in the United States. Importantly, IP in the United States also means that associated mobile income remains in the United States, along with first rights of taxation, increasing the U.S. tax base. Repeal of FDII would have the unintended consequence of encouraging the migration of IP ownership and development to foreign countries.

**C. Modifications to Subpart F Income and Foreign Branch Income**

ACT believes foreign taxes paid on Subpart F income and foreign branch income should remain fully creditable to avoid international double taxation. Because Subpart F income and branch income are both subject to U.S. tax at the full U.S. statutory rate, any reduction in the foreign tax credit would result in a combined U.S. plus foreign tax burden that exceeds the tax imposed on this income if it had been earned in the United States. No other country in the world has adopted such a rule, and imposing a double tax on U.S. companies would further tilt the playing field against them in favor of their foreign competitors. Any concerns about tax credit planning are adequately addressed by the separate foreign tax credit baskets for GILTI, subpart F, and branch income enacted in 2017.

ACT believes that requiring a country-by-country determination of foreign tax credits for Subpart F income and branch income, as proposed by the W-B-W discussion draft, will inevitably result in double taxation on income that is already taxed currently at the full U.S. rate. This change would also add enormous complexity to these calculations without providing any incremental base erosion protection and should be avoided.

**D. Modifications to Base Erosion and Anti-Abuse Tax (BEAT)**

ACT supports allowing both general business credits and foreign tax credits to reduce BEAT. General business credits are provided to encourage activities expressly deemed to be desirable by Congress, and their disallowance under BEAT counters the incentive they are intended to provide. Foreign tax credits are provided to mitigate U.S. double taxation of income. In the absence of an allowance of foreign tax credits against BEAT, foreign earnings of U.S. companies are double taxed, including foreign income that may have been taxed at foreign rates in excess of the U.S. domestic tax rates.

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[7] Recent analysis shows that FDII has been responsible for an increase in the U.S. share of global profits of U.S. multinational companies. See, Martin Sullivan, "Big Tech Is Moving Profit to the United States," Tax Notes Federal, August 23, 2021.

## APPENDIX. ACT'S DETAILED COMMENTS ON THE WYDEN-BROWN-WARNER DISCUSSION DRAFT

### A. GILTI

The comments in this section relate to the legislative changes proposed in the W-B-W discussion draft to GILTI.

#### 1. Replacement of Overall GILTI Calculation with a Country-by-Country Determination

The W-B-W discussion draft would replace the overall GILTI calculation with a country-by-country determination.[8] ACT supports retention of the current overall approach to calculating GILTI and maintaining the present-law regulations providing for an elective high-tax exclusion.

The OECD has acknowledged that a variety of factors in the manner that GILTI is calculated frequently result in it being more burdensome than the minimum tax in the OECD's 2020 proposal, which was scoped to apply at a 12.5% tax rate using a country-by-country determination.[9] Recent analysis finds present-law GILTI is more burdensome on U.S. companies than would be the OECD's now-proposed 15% minimum tax rate and country-by-country determination.[10]

So while there is no justification for moving to a country-by-country determination to implement a minimum tax as rigorous as that being discussed within the OECD, there are strong policy arguments for retaining the present-law overall GILTI calculation.

The present-law design of GILTI, with all GILTI income in a single foreign tax credit basket (the "overall" or "aggregate" calculation), is intended to reflect the integrated nature of the foreign operations and global supply chains of multinational companies.[11] The overall calculation also reduces the complexity of complying and administering GILTI, and makes the absence of certain multi-year averaging features (which simplifies the GILTI calculation) less prone to the double taxation that would arise under a per-country system (see below). These tax policy reasons favor retention of the overall GILTI calculation.

Apart from these policy considerations, a country-by-country foreign tax credit calculation would result in severe <u>overtaxation</u> of foreign income earned by U.S. companies unless substantial additional modifications were made to GILTI. For example, the OECD/G20 Inclusive Framework blueprint recognizes

[8] The W-B-W discussion draft proposes a mandatory high-tax exclusion, but as the effective rate of income tax to determine eligibility for the exclusion is calculated separately for each tested unit and on an annual basis, it is simply a manner to achieve a country-by-country determination.

[9] OECD, Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, 2020, p. 19.

[10] See Cody Kallen, "Expense Allocation: A Hidden Tax on Domestic Activities and Foreign Profits," Tax Foundation, August 26, 2021.

[11] As described by the Senate Finance Committee explanation of GILTI in the 2017 Act, "The Committee believes that calculating GILTI on an aggregate basis, instead of on a CFC-by-CFC basis, reflects the interconnected nature of a U.S. corporation's global operations and is a more accurate way of determining a U.S. corporation's global intangible income." Senate Finance Committee Explanation of the 2017 Act, included in Senate Budget Committee, Reconciliation Recommendations Pursuant to H. Con. Res. 71, S. Prt. 115-20. A description of the operating models of multinational companies and their integration of supply chains across countries is presented in Ronald B. Davies and James R. Markusen, "The Structure of Multinational Firms' International Activities," in Global Goliaths: Multinational Companies in the 21st Century Economy (eds. C. Fritz Foley, James R. Hines, Jr., and David Wessel), The Brookings Institution, 2021.

the need for a global minimum tax with a country-by-country determination to include loss and credit carryovers to prevent double taxation due to losses and timing differences.

While ACT strongly encourages Congress not to increase the present-law tax on GILTI, to the extent that Congress is determined to modify GILTI to provide a country-by-country calculation, ACT strongly urges Congress to defer such a change until other major countries, including all other G7 countries and China, enact their own country-by-country minimum taxes. In addition to deferring such a change, if Congress modifies GILTI to provide a country-by-country calculation, Congress should ensure that U.S. implementation of these rules is not harsher than the minimum tax rules adopted by our major trading partners so that U.S. companies are able to compete on a level playing field.

This section addresses some of the issues that arise with the country-by-country calculation of GILTI in the W-B-W discussion draft.

**a. An overall approach reflects the global structure of multinational companies**

The global structure of a multinational company is determined by many different operational factors: the local markets in which it sells its products and provides its services, the advantages of operating regionally versus locally, whether it sources its supplies and inputs within the company or from unrelated suppliers, and the location of its internal supply chains.

The current overall foreign tax credit calculation for GILTI reflects the global integration of all of a company's foreign operations. It is intended to result in equal GILTI tax for any U.S. companies that have the same total amount of foreign income and the same total amount of foreign taxes, independent of the specific foreign countries in which they operate and the share of foreign income earned in each country.

In addition to reflecting the reality of how multinational companies operate, the overall approach treats similar companies equitably, and it reduces the need for more complex mechanisms to adjust for mismeasurement of income that arises under a country-by-country approach, discussed in the next section.

**b. An overall approach reduces the need for carryovers and carrybacks and other measures to provide for more accurate multi-year averaging of tax rates**

The present-law GILTI calculation is based on a single year's "snapshot" of foreign tax paid relative to a U.S. measure of taxable foreign income in the year. For a business, a single year is an arbitrary period over which to measure taxable income given the long-term investment horizon of its owners and the timespan between when costly new investments are made and when those investments will generate returns. For this reason, for domestic taxes, taxpayers are provided the opportunity to carry forward net operating losses to offset future income. Similarly, the foreign tax credit calculation for foreign tax credit baskets other than GILTI (i.e., the general, passive, and foreign branch baskets) provides that foreign tax credits may be carried back one year and carried forward 10 years. In contrast, GILTI provides no loss carryover and no foreign tax credit carryback or carryforward.

The indefensible lack of these carryover provisions in GILTI would be magnified considerably under a country-by-country calculation, causing GILTI tax to be paid on income that is already highly taxed. Any GILTI tax collected on highly taxed income evidences that GILTI is not serving its objective of taxing "low-taxed" foreign income. We recognize that the W-B-W discussion draft has acknowledged the need for "timing issues" in GILTI to be addressed, but adequately addressing these issues is not a simple matter.[12, 13] Indeed, the OECD/G20 Inclusive Framework has been examining how to address timing issues for over two years and while it has developed conceptual approaches, it has not yet provided a precise explanation for how these solutions would operate in the real world, let alone provide the type of statutory language needed for actual legislation. In the absence of these very important details, it is impossible to determine whether mechanisms for addressing timing issues will provide meaningful relief from double taxation. For legislation to be voted upon by Congress within weeks, it is simply not possible to address the range of issues and consider potential alternative approaches in a manner that would allow a country-by-country GILTI determination to function in an appropriate manner.

Under the current overall GILTI calculation, the lack of carryover provisions to address fluctuations in business income and taxes within one country is partly ameliorated by the aggregation of the company's operations in all foreign countries. Adopting a country-by-country determination without smoothing and carryover mechanisms, however, would cause typical year-to-year variations in a company's tax payments in a country to give rise to GILTI tax even if the company pays more than the minimum tax rate in that country averaged over several years, contrary to GILTI's purpose of taxing "low-taxed" foreign income.[14]

The draft proposal for a minimum tax at the OECD (i.e., the Pillar Two Blueprint) provides for loss carryforwards and carryforwards of excess taxes.[15] The OECD also suggests deferred tax accounting as an alternative way to address timing effects. Any U.S. adoption of a country-by-country calculation would necessitate adopting one or more of these averaging mechanisms to avoid inequitable results arising from income fluctuations and timing differences. Calculating foreign tax credits and tracking loss and credit carryovers for every country in which a company operates – while necessary to prevent the inequitable application of U.S. tax on income that is taxed above the minimum tax rate – would greatly increase the cost to taxpayers and tax administrators of complying with and administering GILTI. The additional compliance burden that a country-by-country application would entail is disproportionate to the additional base protection benefit that is asserted.[16]

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[12] "Timing issues," i.e., differences between a foreign rate of tax measured in a single year and the tax rate measured over a period of years can arise due to differences in the timing of deductions for foreign country tax purposes and U.S. tax purposes and mismatches between tax years for foreign local tax purposes and GILTI calculations.

[13] While the W-B-W proposal suggests rules should be adopted to address the use of foreign losses, it does not address the inexplicable policy of GILTI offsetting domestic losses. The OECD's Pillar Two proposal avoids this policy result since it is a true top-up tax that does not impact the taxation of domestic income or losses. In contrast, the current and proposed GILTI rules provide that GILTI may offset domestic NOLs. This punitive policy should be changed since it devalues U.S. NOLS and could discourage U.S. investment.

[14] For example, a taxpayer with a 30% tax rate in year 1 and a 12% tax rate in year 2 would owe GILTI in year 2, even though the taxpayer has an average tax rate of 21% across both years that exceeds the 13.125% GILTI threshold. Had the taxpayer been able to smooth its income or taxes across each year, it would not have owed any GILTI.

[15] The OECD draft proposal describes the need for mechanisms to smooth taxes over time: "The first adjustment described in Section 4.2 allows an MNE to carry-forward losses incurred or excess taxes paid in prior periods into a subsequent period in order to smooth-out any potential volatility arising from the mix of taxes imposed under local law or resulting from timing differences. This adjustment is intended to ensure that Pillar Two does not result in the imposition of additional tax where the low ETR in a jurisdiction in a particular period is simply a result of the timing of the imposition of covered taxes on items of GloBE income or differences in the timing of the recognition of income under financial accounting and local tax law." OECD, Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, 2020.

[16] By further limiting the ability to utilize foreign tax credits, a country-by-country approach is almost certain to encourage outcomes that are contrary to Congressional intent. Under the W-B-W discussion draft, for example,

In short, moving to a country-by-country determination without including robust (and highly complex) mechanisms for addressing timing differences virtually guarantees that companies will face significant double taxation in common everyday fact patterns. A country-by-country minimum tax without these smoothing mechanisms cannot be justified from a policy perspective and should not be given serious consideration by Congress.

**c. A country-by-country calculation adds substantial complexity**

Determining GILTI on a country-by-country basis would impose heavy compliance and administrative costs on taxpayers and the IRS alike. Companies do not maintain their books of account or their tax compliance systems on the "tested unit" basis described in the W-B-W discussion draft. In addition, the W-B-W discussion draft envisions a country by country analysis across a taxpayer's entire group of companies, without regard to the relevant foreign rules relating to consolidation, etc. The important details needed for these determinations will be enormously complex to draft, and even more challenging for companies and the IRS to implement and audit. Further, applying this "one size" tested unit approach across the numerous foreign tax systems that apply to globally engaged companies will inevitably result in additional double taxation – a result that cannot be defended as a policy matter and that will put U.S. companies at a severe competitive disadvantage.

Each time that Congress has expanded the number of foreign tax credit baskets in the past it has subsequently decided to reduce the number of baskets. The United States repealed the country-by-country calculation of the foreign tax credit in 1976 and Congress chose to not re-enact the country-by-country calculation included in President Reagan's 1985 "Tax Proposals to the Congress for Fairness, Growth and Simplicity" due to its complexity. In 2004, Congress reduced the number of foreign tax credit baskets from nine to two, noting the complexity the prior-law baskets for different categories of income created:

> "The Congress believed that requiring taxpayers to separate income and tax credits into nine separate tax baskets created some of the most complex tax reporting and compliance issues in the Code. The Congress believed that reducing the number of foreign tax credit baskets to two would greatly simplify the Code and undo much of the complexity created by the Tax Reform Act of 1986. The Congress believed that simplifying these rules would reduce double taxation, make U.S. businesses more competitive, and create jobs in the United States."[17]

**d. Foreign government incentives with a country-by-country calculation**

Some argue that under a country-by-country calculation a low-tax country would derive no advantage from a low tax rate below the minimum tax threshold and would therefore raise its tax rate. While this might occur if a sufficient amount of foreign direct investment in the country was covered by the minimum tax, this argument neglects to consider that the foreign country could raise its tax rate and use the revenue to provide non-income tax incentives to attract investment, such as direct government subsidies or reductions in non-income taxes. This would reduce U.S. tax revenue because foreign taxes paid to the country would eliminate any GILTI liability.

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foreign tax credits would not be available for foreign withholding taxes imposed on distributions of high-taxed income, with the result that taxpayers would be discouraged from repatriating such earnings back to the United States for reinvestment at home.

[17] Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in the 108th Congress (JCS–5–05), May 2005.

Already countries have begun to consider how they could provide direct grants and reduce taxes other than income taxes to attract foreign direct investment in the presence of a foreign minimum tax.[18]

### 2. The GILTI Section 250 Deduction

The W-B-W discussion draft provides an unspecified value for the Section 250 deduction, which jointly with the statutory corporate tax rate determines the minimum GILTI tax rate.[19] Under present law, the Section 250 deduction is 50 percent for tax years through 2025 and 37.5 percent for tax years beginning in 2026.

An increase in the U.S. statutory corporate tax rate on its own – with no other changes to GILTI – would automatically increase the tax on GILTI given the operation of the Section 250 deduction. For example, if the corporate rate were increased to 25%, at the existing Section 250 deduction of 50%, the GILTI rate would increase to 12.5%. Moreover, if the 20% foreign tax credit haircut is retained, GILTI would apply whenever the foreign tax rate was less than 15.625% (vs. 15% under the OECD/G20 Inclusive Framework proposal).

The present-law GILTI tax rate is also scheduled to increase above the 15% tax rate being considered at the OECD even with no change in the U.S. statutory corporate tax rate. Under present law, GILTI is imposed on foreign income taxed below a 13.125% rate as a result of allowing a foreign tax credit for only 80% of foreign taxes.[20] However, after 2025, GILTI is scheduled to be imposed on foreign income taxed below a 16.4% rate – a tax rate that would be 9 percent higher than the 15% minimum tax rate currently being debated in the OECD/G20 Inclusive Framework and more than 30 percent higher than the 12.5% minimum tax rate that would align with Ireland's statutory corporate tax rate, a rate which is often considered a possible compromise minimum tax rate that other countries might propose. If Congress were to raise the corporate tax rate to 25% and maintain the 20% haircut on the foreign tax credit, GILTI would apply whenever the foreign tax rate was less than 19.53%. Even if other countries adopted the 15% rate in the OECD minimum tax proposal, the U.S. rate would be 30% higher than the rest of the world (before taking account of expense allocation).

For these reasons, an increase in the GILTI tax rate – either resulting from an increase in the statutory corporate tax rate or from a reduction in the Section 250 deduction – should be avoided by Congress until other countries have enacted minimum taxes on the foreign business income of their companies.[21]

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[18] See, "Switzerland plans subsidies to offset G7 corporate tax plan," Financial Times, June 10, 2021, and "The global minimum corporate tax rate is coming our way and will change how Singapore attracts MNCs," Channel News Asia, May 31, 2021. Both articles discuss the use of capital grants and reductions in taxes other than income taxes as ways to attract foreign direct investment without such investment being subject to a foreign minimum tax.

[19] The Framework discussion draft released in April 2021 stated that prior Democratic proposals recommended the minimum tax rate should be 60-100% of the U.S. rate. Under present law, after accounting for the limitation that only 80% of foreign taxes are eligible for the GILTI foreign tax credit, the current 13.125% GILTI rate is 62.5% of the regular rate and is scheduled to increase to 78.125% of the regular rate after 2025.

[20] As a result of U.S. expense allocation rules, the GILTI regime imposes minimum tax even when foreign tax rates are far above 13.125%.

[21] The discussion draft also proposes reducing the Section 250 deduction for GILTI to that of FDII. The April 2021 Framework discussion draft implied that GILTI is tax-favored relative to FDII under present law, since GILTI has a 50% Section 250 deduction while FDII has a 37.5% Section 250 deduction. However, the tax rates on GILTI and FDII are already effectively equalized under present law. This is because GILTI allows only 80% of foreign taxes to be

### 3. The GILTI Foreign Tax Credit Disallowance

The W-B-W discussion draft provides an unspecified percentage between 80% and 100% for the amount of foreign taxes that may be included in the GILTI foreign tax credit calculation. Under present law, only 80% of foreign taxes on GILTI are allowed in calculating the allowable GILTI foreign tax credit.

ACT supports 100% of foreign taxes being taken into account in determining the GILTI foreign tax credit. Disallowance of any foreign tax credits results in double taxation of the same income: once by the foreign country and a second time by the United States. It should be noted that the form of minimum tax being discussed within the OECD/G20 Inclusive Framework would apply with a 100% allowance for foreign taxes paid. Both as a matter of policy and to protect the competitiveness of U.S. companies, double taxation of foreign income should be avoided.

### 4. GILTI Expense Allocation

Under present law, Treasury regulations require U.S. expenses for research, stewardship, and interest to be allocated against foreign income in determining the GILTI foreign tax credit, which results in an additional reduction in the GILTI foreign tax credit. The W-B-W discussion draft proposes eliminating expense allocation requirements for U.S. research and stewardship expenses , but it would continue to allocate expenses for U.S. interest expense.

ACT commends the W-B-W discussion draft for eliminating expense allocation for U.S. research and stewardship expenses. ACT further recommends eliminating expense allocation rules for interest expense to eliminate GILTI expense allocation completely.[22] It should be noted that the Pillar Two minimum tax proposal of the OECD does not limit foreign tax credits through allocation of any expenses, as it is a top-up tax with no foreign tax credit mechanism.

In the same manner that expense allocation under GILTI raises the cost of performing domestic R&D and stewardship activities, interest expense allocation increases the cost of U.S. investment in property, plant, and equipment that is partly financed with debt.

Importantly, and contrary to the purpose of a minimum tax, the expense allocation rules deny foreign tax credits when foreign income is relatively highly taxed; expense allocation has no effect on income that is untaxed by foreign countries or taxed at only a low rate.[23] Expense allocation creates GILTI tax liability for companies with foreign tax rates in excess of the 13.125% threshold and even with tax rates in excess of the 21% U.S. statutory corporate tax rate.[24] Present-law expense allocation is estimated to increase the effective tax rate on GILTI an additional 2 to 3 percentage points based on a survey of ACT's membership.

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creditable. As a result (ignoring impacts from expense allocation described in Appendix A.4, below), GILTI is turned off when foreign taxes exceed 13.125% (since 80% of 13.125% is the 10.5% rate arising from the 50% Section 250 deduction for GILTI). After 2025, the Section 250 deductions for both GILTI and FDII are scheduled to be reduced, resulting in GILTI turning off when foreign taxes exceed 16.4%, the same rate as applying for FDII at that time

[22] Section 163(j) is directly targeted at limiting the deductibility of net interest expense in excess of 30 percent of adjusted taxable income. In contrast, expense allocation is unnecessary as a separate interest expense limitation, which by its functioning only applies under the GILTI regime to companies with high-tax foreign income.

[23] This expense allocation requirement reduces the foreign tax credit a company is permitted to claim when U.S. tax on GILTI net of the 50% Section 250 deduction and net of allocated expenses is less than 80% of foreign taxes.

[24] Under present law, no expense allocation arises with respect to income for which the high-tax exclusion is elected. Likewise, no expense allocation would arise for income determined to be high-taxed income and excluded from GILTI under the W-B-W discussion draft.

The expense allocation rules for GILTI were inappropriately borrowed from the prior-law expense allocation rules applicable under the U.S. worldwide tax system. In the prior-law context, expense allocation rules were intended to prevent taxpayers with high foreign income tax rates from claiming foreign tax credits that effectively allowed them to reduce U.S. tax on their U.S. income. The foreign tax credit limitation prevented taxpayers from receiving a subsidy from the United States for paying taxes to other countries at tax rates in excess of the U.S. rate.

In the context of GILTI, however, the foreign tax credit mechanism is intended to turn GILTI off once a minimum threshold of tax has been paid. This is because GILTI is a base protection measure guarding against income shifting to low-tax countries. As a result, expense allocation rules simply do not belong in GILTI.

In addition to giving rise to double taxation under GILTI, without mitigation, expense allocation rules raise the cost of performing domestic R&D and the managerial functions giving rise to stewardship expenses.[25] The higher cost of these activities may reduce U.S. employment.

As expense allocation rules are not warranted in GILTI and can lead to adverse effects for the U.S. economy, ACT recommends no expense allocation for any expenses under GILTI.

### 5. Repeal of Net Deemed Tangible Income Return and Qualified Business Asset Investment (QBAI)

The W-B-W discussion draft repeals the deduction from GILTI equal to a 10% return on depreciable tangible assets.

This deduction has been mistakenly characterized as an incentive to locate tangible assets outside the United States. The deduction for a 10% return on depreciable tangible assets is not an incentive for foreign investment because domestic investments made in the United States are eligible for full expensing – a deduction that is equivalent to exempting the ordinary return of the domestic investment from taxation. Additionally, foreign investments will be subject to foreign tax by the country where the investment is made. As a result, the cumulative tax on the foreign investment exceeds that of the expensed domestic investment.[26] And even if expensing were allowed to expire as scheduled after 2025, non-tax operational costs (e.g., cost of energy, access to natural resources and other raw materials, transportation costs, tariffs, etc.) outweigh potential tax differentials between the United States and a foreign country on an investment with a 10% return on depreciable assets.

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[25] Treasury regulations finalized in 2020 provide that research expense is not allocated to the GILTI foreign tax credit basket. The discussion draft would codify this regulation.

[26] For example, consider a $1,000 investment in equipment that earns a pre-tax internal rate of return of 10% over its life. Thus, before taxes, the stream of income generated by the investment has a present value of $1,000 at a 10% discount rate. If we first assume the investment is made in the U.S. and is eligible for expensing, the tax benefit of the immediate deduction of $1,000 is equal to the present value (at a 10% discount rate) of the taxes paid on the income generated by the investment. As a result, in present value no taxes are paid on the income earned on the asset when invested in the United States. Assuming the same facts but for the case of an investment made outside the U.S. and assuming the QBAI deduction results in no income inclusion under GILTI, the earnings of the investment will pay foreign income taxes. As a result, for any foreign country with a positive tax rate, investment in the U.S. is tax favored.

We are aware of no data that shows QBAI favors foreign investment.[27] There is not a single example of a U.S. company investing abroad because of QBAI.

Territorial tax treatment of the QBAI return helps align U.S. international tax rules with those of other advanced economies, thereby allowing U.S. companies to serve foreign markets on an equal tax basis with their foreign competitors with respect to the limited return on QBAI.

By intent, GILTI is targeted at income of high-return intangible property (IP), which is the most mobile form of investment and whose location is potentially the most sensitive to tax rate differentials.

Current discussions within the OECD/G20 Inclusive Framework on the design of a minimum tax on foreign income include substance based carve outs for a routine return both on tangible assets (including land) and on labor compensation. Eliminating the deduction for QBAI return would be inconsistent with the OECD proposal and would put U.S. companies and, in turn, the American economy at an even greater disadvantage when competing in foreign markets.

For these reasons, the deduction for QBAI should be retained.

**B. FDII**

The W-B-W discussion draft would redefine FDII by scaling the present calculation by the sum of yet-to-be-determined percentages of U.S. R&D expenses and qualified training expenditures.

Present-law FDII is both a base protection measure and an incentive to develop, create, and retain valuable IP in the United States. It reduces the tax incentive to hold IP offshore for the sale of goods and services to foreign customers. In this manner, FDII is the "carrot" paired with the "stick" of GILTI to provide coordinated base protection for high-margin income that might be most responsive to tax rate differentials. Present-law FDII can be viewed as similar to the IP boxes of other countries, which encourage the development and retention of IP.

The enactment of FDII in 2017 followed years of bipartisan efforts on similar proposals to encourage the development and ownership of IP in the United States, including a proposal under consideration by the 2015 Senate Finance Committee International Tax Working Group.

Retaining ownership of IP in the United States contributes to increased manufacturing and associated jobs in the United States, both due to the synergies of co-locating manufacturing and research facilities and also due to U.S. tax impediments that may impose current U.S. tax under Subpart F when IP used in U.S. manufacturing is held by a related foreign affiliate.

Recent analysis shows that FDII has been responsible for an increase in the U.S. share of global profits of U.S. multinational companies, with nine U.S. technology companies alone reporting an additional $60 billion of profit in the United States in 2020.[28] The U.S. share of global profits among 20 U.S. technology companies increased from 32% in 2017 to 56% in 2020, nearly a 75% increase in the U.S. share.

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[27] Bureau of Economic Analysis data show that in 2018, the most recent year for which data are available, U.S. companies with global operations grew faster in the United States than they did abroad – growing their employment, capital expenditures in property, plant and equipment, and R&D investment faster in the United States than they did abroad. (Bureau of Economic Analysis, "Activities of U.S. Multinational Enterprises, 2018," News Release BEA 20- 40, August 21, 2020.)

[28] Martin Sullivan, "Big Tech Is Moving Profit to the United States," Tax Notes Federal, August 23, 2021.

Present-law FDII rewards the successful development of IP without regard to the manner in which that IP is developed, whether from research-intensive activities or creative activities. This is somewhat different from an R&D tax credit, which rewards the conduct of R&D at the time it is undertaken, independent of its success. Both approaches to the encouragement of IP creation are effective policy tools to encourage innovation, but countries use both cost and income-based incentives for complementary but different essential policy goals. FDII incentivizes companies to locate mobile income in the United States, which gives the United States first taxing rights to that income, and consequently increases and preserves the U.S. tax base. Also, by incentivizing the return of foreign-held IP to the United States, FDII reduces the need to locate skilled jobs (e.g., engineering and other R&D jobs, strategic marketing, and leadership positions) and investment abroad to meet the substance requirements to support a foreign IP structure. Importantly, FDII provides a level playing field for U.S. companies relative to their foreign competitors, including China, which provide similar (or lower) rates of tax on intellectual property income. With a more level playing field, U.S. companies can compete and succeed in international markets, which then contributes to their creating more high-value jobs in their U.S. headquarters locations to manage their global supply chains, logistics, marketing, strategy, and other activities.

ACT believes that present-law FDII has been successful in its objective to retain IP, including IP associated with the development of creative content, in the United States. The competitive U.S. tax rate resulting from the FDII deduction is an important incentive to increase U.S. jobs, research, and investment and exploit intellectual property in the United States for foreign sales. As a result of the enactment of FDII, leading U.S. companies (including members of ACT) have domesticated foreign-held IP to the United States. With FDII, all U.S. companies are incentivized to retain and expand the amount of IP they exploit in the United States and to bring foreign-held IP to the United States.

Given the success of FDII to date, any modifications to FDII should only seek to strengthen the incentives to retain IP in the United States. Further, any changes to FDII should, unlike the W-B-W discussion draft, recognize that the development and retention of valuable IP in the United States, regardless of whether the IP is developed in a research lab or a design studio, is good for U.S. jobs and economic growth.

**C. Modifications to Subpart F Income and Foreign Branch Income**

The W-B-W discussion draft proposes a possible "haircut" (ranging from 0 to 20 percent) in the foreign taxes that could be taken into account in determining the foreign tax credit on Subpart F income and branch income. Under present law, no haircut applies. As discussed in Appendix A.3, above, any disallowance of foreign taxes in the calculation of the foreign tax credit results in double taxation. For the same reasons that foreign taxes paid on GILTI should be fully creditable, foreign taxes paid on Subpart F income and branch income should be fully creditable to avoid double taxation. Indeed, because Subpart F income and branch income are both subject to current U.S. tax at the full U.S. statutory rate, <u>any</u> haircut on the foreign tax credit for branch income or Subpart F income guarantees that such income will bear a total tax burden that exceeds the tax imposed on this income if it had been earned in the United States. For example, using the present law 21% corporate tax rate but applying a 20 percent haircut on the foreign tax credit would result in additional U.S. tax on Subpart F and branch income bearing foreign tax rates of up to 26.25%. There is no policy justification for this penalty on foreign investment, which, to our knowledge, is unprecedented in the history of the U.S. income tax.

The W-B-W discussion draft also proposes a country-by-country approach, including a mandatory high-tax exception, on the computation of Subpart F income and foreign branch income. Such an approach also would result in a total tax burden that exceeds the tax imposed on this income if it had been earned in the

United States. Additionally, as noted above in the discussion of a country-by-country approach to GILTI, this country-by-country approach greatly increases complexity and will inevitably result in double taxation of foreign income in many common fact patterns. As under GILTI, the same need would arise for smoothing and carryover mechanisms to account for losses and timing differences that could cause operations one year to be excluded from Subpart F and branch income either because it was in a loss position or determined to be high-taxed, but the following year is treated as low-taxed with no credit for the prior year loss or high rate of foreign tax paid.[29] Applying this flawed approach to income that is already subject to current U.S. tax at the full statutory rate increases substantive tax burdens, as well as compliance burdens, without any base erosion or other policy justification. Like the proposed foreign tax credit haircut on such income, it is unnecessary, punitive, and would subject U.S. companies to double taxation, putting them at a severe competitive disadvantage in global markets.[30]

It should be noted that the OECD Pillar Two proposals do not include any changes to rules on the tax treatment of passive income taxed in the United States under Subpart F and under the controlled foreign corporation rules of other countries, nor does Pillar Two alter the use of foreign tax credits on controlled foreign corporation and branch income.

**D. Modifications to Base Erosion and Anti-Abuse Tax (BEAT)**

The W-B-W discussion draft proposes that all general business credits be permitted to reduce BEAT. Unlike the April 2021 Framework discussion draft, it does not consider also allowing foreign tax credits to offset BEAT. ACT supports allowing both general business credits and foreign tax credits to reduce BEAT. In the case of business credits, these are provided to encourage activities deemed to be desirable by Congress: denying them reduces the incentive both for a taxpayer subject to BEAT and for a taxpayer potentially subject to BEAT. Allowing foreign tax credits against BEAT mitigates U.S. double taxation of income. In the absence of an allowance of foreign tax credits against BEAT, foreign earnings of U.S. companies such as GILTI and Subpart F income are double taxed, including foreign income that may have been taxed at foreign rates in excess of the U.S. 21% statutory corporate tax rate.

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[29] Under current law, the "qualified deficit" rules in section 952 provide limited timing relief in certain fact patterns involving losses attributable to activities that generate Subpart F income. These rules and additional mechanisms would be necessary to address some of the commonplace timing issues that would arise under the W-B-W approach.

[30] We note in this regard that businesses in certain industries, such as financial services, regularly make use of branches for non-tax regulatory reasons. Such branches routinely engage in interbranch transactions, which are regarded for non-U.S. tax purposes but disregarded for tax purposes. Stratifying this income into separate baskets for foreign tax credit computation purposes will be highly complex, will regularly result in timing mismatches that produce double taxation, and does not advance any policy goal, because all such income is fully taxed by the United States on a current basis.