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# Alliance for Competitive Taxation

## Comments on the House Ways and Means Committee Reconciliation Tax Bill

## for Submission to

## The House Ways and Means Committee

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**ACT COMMENTS ON HOUSE WAYS AND MEANS COMMITTEE RECONCILIATION TAX BILL**

## 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 best promote a strong U.S. economy with more jobs and higher wages for American workers.

While the House Ways and Means Committee (W&M) bill makes several welcome technical changes that would remove distortions in the operation of present law, these are outweighed by policy changes included in the legislation that would make the U.S. tax system less internationally competitive and place U.S. companies on a much more unlevel playing field with their foreign competitors.

The United States is the only country in the world to levy a foreign minimum tax on its companies – the Global Intangible Low-Taxed Income (GILTI) regime. The Penn Wharton Budget Model estimates that the changes to GILTI in the W&M bill would triple the U.S. tax burden on foreign income, greatly increasing the competitive imbalance against U.S. companies.[1] Very importantly, the greater competitive imbalance caused by changes to GILTI and other international provisions in the bill would hamper the ability of U.S. companies to grow and add jobs in the United States.

A more unlevel tax playing field would result in U.S. companies losing global market share to their lower-taxed foreign competitors; encourage U.S. companies to sell their foreign operations to foreign companies in whose hands they would produce higher after-tax returns and greater cash flow; increase 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 incentivize more start-up companies to form outside the United States to avoid the high U.S. tax burden on their foreign income.

ACT's comments compare provisions in the W&M bill with the international standard, that is, how other major economies tax companies headquartered in their countries. Where the bill deviates from the international standard, our comments identify the changes that would be needed to establish a level playing field for U.S. companies.

U.S. tax rules that create a more unlevel playing field for U.S. companies relative to their foreign competitors would reduce domestic employment, wages, and investment. The foreign operations of U.S. companies are critical to serving foreign markets and result in greater exports and a stronger domestic economy, including increased domestic employment and higher earnings for American workers; greater U.S. investment in equipment, technology, and R&D; and increased U.S. exports.

[1] Penn Wharton Budget Model, "Effective Tax Rates on U.S. Multinationals' Foreign Income under Proposed Changes by House Ways and Means and the OECD," Sept. 28, 2021, available at https://budgetmodel.wharton.upenn.edu/issues/2021/9/28/effective-tax-rates-multinationals-ways-and-means-and-oecd.

**II. Specific Provisions of the Ways and Means Committee Bill**

ACT's comments below focus on the corporate tax rate and the major international tax provisions of the W&M bill approved by the Committee on September 15, 2021.

As an overarching comment, to the extent that Congress enacts revenue-increasing provisions, adequate transition relief should be provided to taxpayers and all tax increases should only have prospective effect. Retroactive legislation not only reverses prior decisions by Congress, but it establishes new uncertainties going forward as to whether future Congresses will reverse laws presently in effect. This uncertainty imposes unnecessary costs on business and dulls any incentive effects intended by present law.

**1. Corporate Tax Rate**

***A. W&M Provision:*** The W&M bill increases the federal top statutory corporate tax rate from 21% to 26.5%. Including average state tax rates, the combined U.S. corporate tax rate would be 30.9%, up from 25.8% under present law.

***B. International Standard:*** The average corporate tax rate of the other 37 OECD countries in 2021 is 23.0%.[2] A 30.9% rate would result in the U.S. having the highest corporate tax rate among G7 countries. Only two OECD countries, Colombia (31.0%) and Portugal (31.5%), would have higher tax rates. The present-law combined U.S. corporate tax rate of 25.8% ranks the U.S. 13$^{th}$ highest in the OECD, with 25 OECD countries having lower combined corporate tax rates.

***C. Recommendation:*** ACT recommends no increase in the present-law corporate tax rate as the current combined U.S. corporate rate already exceeds the international standard. This will avoid the damage to the competitiveness of the U.S. as a location for innovation, investment, and job creation that would occur from setting the corporate rate significantly higher than the average of the other developed countries.

A high corporate tax rate deters high-value investments and depresses U.S. jobs and wages. A high corporate tax rate makes U.S. companies less competitive relative to foreign-headquartered companies by (i) advantaging imported goods and services, (ii) disadvantaging exports from the U.S., and (iii) disadvantaging U.S. companies operating in foreign markets. A competitive corporate tax rate also encourages business activities to be undertaken in the U.S.

**2. Changes to Global Intangible Low-Taxed Income (GILTI) Regime**

***A. W&M Provision:*** The W&M bill makes several changes to the computation of GILTI, the combined effect of which results in a significant increase in U.S. tax on the foreign operations of U.S. companies that their foreign competitors do not bear. Specific changes made in the W&M bill include:

i. Country-by-country GILTI calculation and section 250 GILTI deduction: GILTI would be calculated separately for each country rather than under the present-law aggregate calculation.

In addition, the bill would accelerate a scheduled reduction in the GILTI deduction from 50% to 37.5% (accelerating the reduction to 2022 from 2026), increasing the amount of GILTI subject to tax by

[2] OECD Statistics available at https://stats.oecd.org/Index.aspx?DataSetCode=CTS_CIT.

25%. Together with the increase in the corporate tax rate from 21% to 26.5%, the minimum tax rate under GILTI would increase from 10.5% to 16.5625%, a 58% increase. Accounting for the haircut on foreign tax credits (described below), GILTI would be owed in any country that had an effective rate of tax of 17.43% or less.

ii. GILTI foreign tax credit: The bill would allow a 5-year carryforward of GILTI foreign tax credits (a welcome increase from no carryforward under present law, but a reduction relative to present-law foreign tax credit rules applicable to other foreign income that provide a one-year carryback and a 10-year carryforward).

The present-law aggregate calculation of GILTI reduces the need for GILTI foreign tax credit carryforwards or carrybacks. However, under a country-by-country calculation, a robust system of foreign tax credit carrybacks, carryforwards, and other adjustments for timing differences is a necessary change to GILTI to reduce the double taxation of foreign income. While the bill introduces limited carryforward concepts, these would be insufficient to address the wide variety of common fact patterns that would result in double taxation if the bill were enacted.

The bill also reduces the "haircut" of foreign taxes that may be credited against U.S. tax on GILTI from 20% to 5% and eliminates GILTI expense allocation, both welcome changes. However, the bill would impose a significant new limitation on interest expense (see description of section 163(n), below).

iii. Preventing domestic losses from increasing GILTI cost: In another positive change, the bill repeals the taxable income limitation under section 250 and allows for the deduction under section 250 to be taken into account for purposes of determining the net operating loss (NOL) of the taxpayer.

iv. Net tested loss carryforward: The bill allows post-enactment foreign losses to be carried forward to future years, a favorable change, but restricts eligible losses to those incurred in post-enactment years, even though prior-year losses may give rise to future GILTI tax liability.

v. Qualified Business Asset Investment (QBAI): The bill reduces an exemption from GILTI from 10% of QBAI to 5% of QBAI, resulting in an increased amount of foreign income attributable to tangible assets being included in GILTI.

***B. International Standard:*** No other country in the world has a minimum tax on the foreign business income of its companies. While the G20/OECD Inclusive Framework is presently discussing guidelines for establishing a foreign minimum tax that countries could voluntarily adopt, these discussions are ongoing, and many critical determinations on the design of the foreign minimum tax remain undecided. It remains a long way from discussions about the design of minimum taxes at the OECD and the actual enactment of those taxes by individual countries.

To date, notable deviations of the W&M bill to the current G20/OECD proposal for a foreign minimum tax include:

- Tax rate: The G20/OECD proposal is for a 15% tax rate. The W&M bill would assess minimum tax in any country with a tax rate of less than 17.4% given the operation of the section 250 deduction and the haircut on foreign tax credits.
- Foreign tax credit carryforwards: The G20/OECD proposal provides a more expansive system of foreign tax credits. Through operation of a foreign minimum tax credit, the G20/OECD

proposal effectively provides an unlimited foreign tax credit carryback against foreign minimum tax and allows the excess foreign taxes paid in one country to reduce foreign minimum tax on income in another country. The G20/OECD proposal also recommends a lengthy carryforward period of foreign tax credits and accounting for other timing differences between foreign country tax law and the minimum tax base to mitigate the effect of these timing differences from giving rise to foreign minimum tax.

- Domestic losses and loss carryforwards: The proposed G20/OECD loss carryforward includes losses incurred prior to the effective date of the legislation. Further, the G20/OECD proposal does not include any concept of a domestic loss impacting the foreign minimum tax.
- Qualified Business Asset Investment (QBAI): The G20/OECD proposal includes a substance-based carve out that exempts *at least* a 7.5% deemed return on both tangible capital investment and payroll for the first 5 years. After the first 5 years, the deemed return is to be *at least* 5%. The G20/OECD proposal does not reduce the deemed return for net interest expense, unlike present law and the W&M proposal.

***C. Recommendations:*** As the U.S. is the only country to have enacted a foreign minimum tax, ACT recommends that no changes be made that would increase the burden of GILTI on U.S. companies, further disadvantaging them in global markets.

ACT supports U.S. efforts to encourage other countries to adopt foreign minimum taxes of their own, as this would put U.S. companies on a more level playing field.

Specific comments on the various changes to GILTI in the W&M bill are provided below.

i. Recommendation on country-by-country GILTI calculation and section 250 deduction: ACT supports retention of the current overall approach to calculating GILTI and maintaining the present-law regulations providing for an elective high-tax exclusion. Additionally, ACT opposes an increase in the GILTI tax rate resulting either from an increase in the statutory corporate tax rate or by reducing the section 250 deduction.

While the G20/OECD proposal for a foreign minimum tax adopts a country-by-country approach, the OECD is continuing work on how to ensure that business cycles and timing differences do not result in minimum tax being owed on income that is not lightly taxed. The modifications to GILTI in the W&M bill with respect to foreign tax credits and losses are inadequate to prevent U.S. companies from incurring GILTI tax on income that is not lightly taxed. In addition, neither the G20/OECD proposal nor the W&M bill has considered how to address the administrative complexity of companies tracking a hundred or more separate country-by-country baskets, each with their own attributes and timing differences. Under the W&M proposal, not only would such baskets be needed for GILTI, but separate baskets would also be required for general basket income and subpart F income, creating the need for some U.S. companies to track 300 or more separate baskets.

ii. Recommendation on GILTI foreign tax credit: ACT supports 100% of foreign taxes being taken into account in determining the GILTI foreign tax credit and providing a robust system of foreign tax credit carryforwards and carrybacks, including unlimited carryforwards and at least a one-year carryback. 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 U.S. Systematic and intentional double taxation is an impediment to cross-border investment and disadvantages American companies in global markets. The need for no haircut of foreign taxes and for extended carryforwards of foreign tax credits is even greater under the W&M proposed country-by-country foreign tax credit limitation and higher GILTI tax rate. The G20/OECD foreign minimum tax proposal – as a "top up" tax – allows a full offset for foreign taxes paid, an unlimited carryback of excess foreign taxes through a foreign minimum tax credit, and a lengthy carryforward of excess foreign taxes.[3]

ACT welcomes the elimination of expense allocation for GILTI but opposes new limitations on net interest expense deductions included in the W&M bill discussed further below (new code sections 163(n) and 163(o)).

iii. Recommendation on domestic losses: ACT supports the repeal of the taxable income limitation on the deduction under section 250 and the allowance of the deduction under section 250 to be taken into account for purposes of determining the NOL of a taxpayer. These changes prevent an increased GILTI effective tax rate on U.S. companies that have domestic NOLs, and remove a disincentive to incurring expenses (whether for wages or investment) in the U.S. that could give rise to NOLs.

iv. Recommendation on net tested loss carryforward: A foreign minimum tax should fully account for timing differences and losses to avoid double taxing income. The W&M bill should expand the net tested loss carryforward to include losses incurred prior to the effective date of the legislation, since otherwise these losses will create a deviation between foreign taxable income as determined under foreign law and U.S. law and result in mischaracterizing "high tax" income as "low tax" income. Failure to account for prior-year losses would effectively impose tax on losses rather than on income, including the significant losses incurred by U.S. companies during the global pandemic. The G20/OECD proposal includes an unlimited loss carryforward of both pre-effective date and future year losses.[4]

v. Recommendation on Qualified Business Asset Investment (QBAI): ACT supports retention of the QBAI rules as they are intended to help level the playing field with our major competitors who have territorial tax systems. QBAI exempts 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, but even with QBAI at current rates, domestic investment is favored by the tax code due to immediate expensing. Moreover, even in the absence of expensing of U.S. capital investments, pre-tax operational considerations for factory site investment decisions outweigh any tax differences that would arise from the QBAI exemption. Further, 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.[5]

**3. Changes to Foreign Tax Credits for General Basket and Passive Income**

***A. W&M Provision:*** The W&M bill changes the foreign tax credit calculation for the general basket and subpart F income to a country-by-country determination rather than the overall foreign tax credit calculation that has been in place for over 60 years. In addition, the bill would eliminate the one-year foreign tax credit carryback and reduce the 10-year foreign tax credit carryforward to 5 years.

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[3] See, chapter 4, "OECD, Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint, 2020.
[4] Ibid.
[5] Ibid.

***B. International Standard:*** The purpose of the foreign tax credit is to relieve double taxation of income once by the foreign country and a second time by the home country. In contrast to the U.S. foreign tax credit approach, nearly all OECD countries use participation exemption systems as the primary method for providing double tax relief. The participation exemption systems exempt from tax 95% to 100% of foreign earnings remitted as dividends, resulting in domestic tax rates on this income of zero to 1%. Many OECD countries provide similar treatment for foreign branches by statute or treaty.

***C. Recommendations:*** ACT supports retention of the current overall calculation of foreign tax credits and the one-year carryback and 10-year carryforward periods for foreign tax credits.

Relief from double taxation of foreign earnings by the U.S. is primarily through foreign tax credits, rather than through the exemption system used by most other advanced economies. Limiting the use of foreign tax credits by applying country-by-country limitations or relatively short carryback and carryforward periods imposes double taxation on U.S. companies, a burden not faced by their foreign competitors. Many industries face long business cycles, with periods of profitability followed by extended periods of loss. A short 5-year carryforward period will result in many businesses being unable to utilize foreign tax credits across the full business cycle. To provide a more level playing field for U.S. companies with their foreign competitors, double taxation on the foreign operations of U.S. companies should be avoided.

**4. New Limitations on Net Interest Expense: New Code Sections 163(n) and 163(o)**

***A. W&M Provision:*** The W&M bill limits net interest expense to the more restrictive of the limitation under present law section 163(j) – a fixed ratio test of 30% of earnings before interest, taxes, depreciation, and amortization (EBITDA) prior to 2022 and 30% of earnings before interest and taxes (EBIT) beginning in 2022 – and new section 163(n), which provides a group ratio test. The proposed group ratio test would limit the deduction for U.S. net interest expense to 110% of global net interest expense multiplied by the U.S. share of global EBITDA as reported for financial statement purposes.

New section 163(o) provides that net interest expense denied under either section 163(j) or section 163(n) could be carried forward, but for only 5 years. Under present law, net interest expense limited under section 163(j) can be carried forward indefinitely.

***B. International Standard:*** The W&M bill would impose the most restrictive third-party interest deductibility rules of any G7 country. This will raise the cost of capital for new investment in plants and equipment in the U.S. OECD/G20 BEPS Action 4 sets forth a best practice standard under which countries may adopt a group ratio test as a *safe harbor* to a fixed ratio test. In other words, taxpayers may deduct the *greater* of net interest allowed under the fixed ratio test and group ratio test. In contrast, section 163(n) limits the deduction for net interest expense for U.S. taxpayers to the *lesser* of the fixed ratio test and group ratio test.

Regarding new section 163(o), many other countries – including France, Germany, Italy, and the United Kingdom – provide an indefinite carryforward of denied net interest expense. Further, these and other countries provide a carryforward of unused capacity to deduct interest expense, i.e., the difference between 30% of EBITDA and actual net interest expense. Thus, in addition to a much more restrictive limitation on net interest deductions, the U.S. would have a more restrictive limitation on carryforwards than major competing countries.

***C. Recommendations:*** ACT recommends that the proposals to add a new group limitation on net interest expense be removed from the bill. ACT further recommends that the present-law indefinite carryforward of net interest expense under section 163(j) be retained. The more restrictive interest limitations proposed in the W&M bill would raise the cost of capital for U.S. companies and create an unlevel playing field for U.S. companies since other countries do not have similar rules limiting the deduction of interest expense. In addition to raising the cost of capital on investment in the U.S., since other countries do not impose comparable restrictions on interest deductibility, U.S. companies would have an incentive to locate new debt-financed plant and equipment outside the U.S. in countries where they could fully deduct their interest expense. Furthermore, the incentives to move debt issuance offshore would weaken U.S. capital markets and likely lead to the loss of U.S. employment in corporate treasury operations and the financial sector.

**5. Changes to Foreign-Derived Domestic Income (FDII)**

***A. W&M Provision:*** The W&M bill would accelerate a scheduled reduction in the section 250 deduction for FDII from 37.5% to 21.875% (to 2022 from 2026), increasing the amount of FDII subject to tax by 25%. Together with the increase in the corporate rate from 21% to 26.5%, the tax rate on FDII would increase from 13.125% to 20.7%, an increase of 58%, and would be higher than the bill's proposed tax rate for GILTI.

The bill also makes a "technical amendment" that would exclude certain royalty income from deduction eligible income, retroactively to tax years beginning after 2017.

***B. International Standard:*** Approximately half of OECD countries (including France, Italy, Spain, and the United Kingdom), China, and numerous other countries have special low rates for intellectual property (IP) income.[6] These tax rates range from the single digits to as high as 15%. The 20.7% rate in the W&M bill would be higher than any other IP regime. Including average state income tax rates, the combined U.S. tax rate on this IP income would be 25.1%, exceeding the *regular* corporate tax rate in 25 of the other 37 OECD countries.

***C. Recommendations:*** ACT recommends that the present-law FDII tax rate and its present-law parity with the tax rate on GILTI of 13.125% be maintained. FDII is intended to level the playing field for U.S. companies relative to their foreign competitors, including China, which provide special low tax rates on intellectual property income. A more level playing field will allow U.S. companies to compete and win in international markets, resulting in more high-value jobs in the U.S. The W&M proposal is not an effective means to incentivize U.S. development and ownership of intellectual property.

The proposed "technical" change may have had an unintended effect of removing royalty income from FDII – one of the major income categories with respect to which Congress clearly intended to provide FDII benefits. Not extending FDII to royalty income also would dramatically weaken FDII compared to the intellectual property regimes of other countries. The Budget Committee report on the legislation notes that the intent of the provision is to exclude passive income, not active income. The statutory language should be revised to clarify that active trade or business income derived from intellectual property owned in the U.S. continues to be eligible for FDII treatment.

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[6] See the OECD dataset on IP regimes https://qdd.oecd.org/data/IP_Regimes.

**6. Changes to the Base Erosion and Anti-Abuse Tax (BEAT)**

***A. W&M Provision:*** The W&M bill makes several welcome changes to rationalize the operation of BEAT, including not treating as base erosion payments any payments (1) subject to U.S. tax under subpart F or GILTI or (2) subject to minimum rates of foreign tax, and allowing foreign tax credits and other credits in the computation of BEAT. The revenue cost of these changes is more than paid for by imposing a higher tax rate, treating certain inventory costs as base erosion payments, and eliminating the exemption from BEAT for taxpayers with base erosion percentages less than 3% (2% in the case of banks and securities dealers).

***B. International Standard:*** There is no analogous international standard, although some countries deny deductions for certain types of related-party payments deemed to be abusive or apply a surcharge to such payments. Ongoing discussions of the G20/OECD Inclusive Framework include a proposal to allow countries to tax certain related-party payments made to a low-tax jurisdiction if the income is not otherwise subject to a foreign minimum tax or controlled foreign corporation tax (i.e., the "undertaxed payments rule").

***C. Recommendations:*** ACT supports the changes to BEAT that would not treat payments subject to U.S. tax or subject to a minimum rate of foreign tax as base erosion payments and the allowance of foreign tax credits and other credits in the computation of BEAT. ACT further recommends that BEAT fully exclude inventory costs from the definition of a base erosion payment as under present law. Taxing these payments would interfere with international trade and impose significant tax impediments on otherwise efficient global supply chains.

ACT also recommends that BEAT maintain the present-law exception for taxpayers with base erosion percentages less than 3% (2% in the case of banks and securities dealers). Given the absence of a "netting" rule in BEAT to subtract inbound related-party payments from outbound related-party payments, the present-law minimum threshold can be viewed as a partial substitute for a netting rule. The present-law exception also helps to reduce administrative and compliance costs for taxpayers with small amounts of related-party payments.

**7. Changes to the Section 245A Dividends Received Deduction for Dividends from Specified 10%-Owned Foreign Corporations**

***A. W&M Provision:*** The W&M bill would limit the section 245A dividends received deduction to controlled foreign corporations (foreign corporations with more than 50% of the vote or value owned by U.S. shareholders). Under present law, the section 245A deduction is available to a U.S. shareholder owning at least 10% of the vote or value of a foreign corporation. The W&M bill requires companies to elect into being treated as a controlled foreign corporation in order for distributions to qualify for the section 245A deduction. In the absence of making this election, U.S. companies owning less than 50% of a foreign corporation would be denied both the section 245A deduction and a deemed paid foreign tax credit on dividend distributions from the foreign corporation.

***B. International Standard:*** Most OECD countries provide a participation exemption to shareholders owning as little as zero to 10% of a foreign corporation. Japan is an exception, requiring a 25% ownership share. The participation exemption systems of other countries are broader than the dividends received deduction of the U.S. as other countries do not have foreign minimum taxes. Further, the G20/OECD proposed foreign minimum tax would apply only to controlled foreign corporations, not entities with minority share ownership.[7]

***C. Recommendations:*** ACT recommends that the section 245A deduction maintain present-law eligibility for dividends received from a 10%-owned foreign corporation that is not a controlled foreign corporation. At a minimum, 10% owners should be permitted to claim a deemed paid foreign tax credit for these dividend distributions.

U.S. companies may own less than 50% of a foreign corporation for a variety of business reasons. Joint ventures with minority ownership may allow the U.S. company to gain knowledge of foreign markets or foreign technology. Minority ownership may help ensure a relationship for the U.S. company as a supplier to the foreign corporation or provide preferential access to the products and services produced by the foreign corporation. If U.S. companies with minority ownership are not eligible for the section 245A participation exemption, they will be at a disadvantage in expanding into foreign markets relative to foreign-headquartered corporations whose foreign earnings are not subject to tax in their home countries.

[7] See, chapter 2, "OECD, Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint, 2020."