ACT Alliance for Competitive Taxation

February 2, 2022

The Honorable Janet L. Yellen
Secretary of the Treasury
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Re: OECD Pillar Two Model Rules on Minimum Taxation

Dear Secretary Yellen:

We are writing to you as a matter of urgency to express our serious concerns regarding the recently released OECD Pillar Two Model Rules on Minimum Taxation ("Model Rules").[1] As described below, significant mismatches between the Model Rules and the analogous U.S. tax rules threaten the competitiveness of globally engaged U.S. companies. Of equal concern, certain aspects of the Model Rules intrude upon U.S. sovereignty by undermining long-standing tax incentives designed by Congress to achieve broad, important and bipartisan domestic policy goals.

We respectfully urge you to address these matters before they irreparably harm the competitive position of U.S. companies and intrude upon the sovereignty of the United States by frustrating Congressionally designed tax incentives.

Specifically, we urge the following:

1. The United States should not make any changes to our existing Global Intangible Low-Taxed Income (GILTI) regime until, at a minimum, all other G-7 countries and India and China have implemented minimum taxes that align with the Model Rules.[2] Several EU member countries have warned that implementation of Pillar Two in 2023, as called for in the draft EU Directive, is too ambitious a timeline, while other countries have urged implementation of Pillar Two be conditioned on implementation of Pillar One.[3] It is increasingly clear that it will take years before China and most European countries adopt a foreign minimum tax, and some may never do so. Moreover, tax treaty modifications may be required before implementation of Pillar Two, and the interaction of Pillar Two with tax treaty obligations will require careful consideration and consultation with the Senate.[4] Unilateral action by the United States to further tighten the GILTI regime before other countries adopt global minimum taxes of their own would further damage the competitive position of U.S. companies.[5]

2. Changes to the U.S. GILTI regime should not make the U.S. tax system more stringent than the Model Rules. The appendix to this letter highlights several GILTI changes currently being considered by Congress that would tax U.S. companies more heavily than their foreign competitors would be taxed under the Model Rules. Imposing an even heavier tax burden on U.S. companies would undermine U.S. competitiveness.

3. Modifications must be made to the Model Rules to prevent them from undercutting broad, bipartisan and long-standing tax incentives adopted by Congress to strengthen the U.S. economy and achieve important social, economic, and environmental objectives (e.g., tax credits for research and experimentation, low-income housing, disadvantaged workers, and renewable energy, and the exemption for state and local bond interest and the deduction for foreign-derived intangible income, to name a few).[6] The Model Rules authorize other countries to impose additional foreign tax on U.S. multinational companies that make investments in the United States in reliance on these tax incentives as intended by Congress. The imposition of these additional foreign taxes on U.S. companies utilizing these tax incentives would result in less investment in the activities targeted by Congress. These foreign taxes would infringe upon U.S. sovereignty, undermine the effectiveness of federal tax incentives designed to achieve important social, environmental, and economic policy goals, and (to the extent U.S. companies continue to invest in these activities) enrich foreign governments at the expense of the United States. The appendix to this letter illustrates this perverse result.

4. To reduce the burden on taxpayers and tax administrators, Pillar Two should be greatly simplified through the use of safe harbors, per se lists, and other similar approaches to address the vast majority of fact patterns in which tax is not distorting the economic decisions of companies. Otherwise, many taxpayers, especially U.S. businesses owing to the size and scope of their international operations, will suffer unnecessary compliance costs and, more importantly, become embroiled in numerous tax disputes among governments.

The agreement by 137 countries on the Model Rules for a global minimum tax has the potential to usher in a new and welcome era of international tax cooperation. However, uncoordinated and inconsistent implementation of the rules, including by the United States, would undermine U.S. competitiveness and threaten the long-term stability of the international tax regime. Further, the United States must not allow the Model Rules to undermine its sovereign right to utilize targeted tax incentives to stimulate economic growth, investment, and job creation in the United States and to advance important social and environmental goals.

ACT's recommendations are intended to secure the long-term success of the OECD/G20 project while protecting vital U.S. interests and assuring a level global playing field for U.S. companies.

We would be pleased to meet with you or your staff to discuss these urgent concerns with Pillar Two as well as those raised by the ongoing work on Pillar One.

Sincerely,

Alliance for Competitive Taxation

cc: Rep. Richard Neal, Chairman of the Ways and Means Committee
Sen. Ron Wyden, Chairman of the Senate Finance Committee
Rep. Kevin Brady, Ranking Member of the Ways and Means Committee
Sen. Mike Crapo, Ranking Member of the Senate Finance Committee

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[1] 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. 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.

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[2] The six other G-7 countries plus China and India collectively account for over 75% of the non-U.S. multinationals in the Fortune Global 500 list of the largest public companies ranked by sales.

[3] It has been reported that Sweden, Finland, Estonia, Malta and Bulgaria believe the timeline for implementation of Pillar Two is too ambitious and that Poland, Hungary, Estonia, Bulgaria and Malta want Pillar Two implementation linked to Pillar One.

[4] *See*, Prof. dr. M.F. (Maarten) de Wilde, "Why Pillar Two Top-Up Taxation Requires Tax Treaty Modification," Jan. 12, 2022.

[5] Parity between the effective tax rates on foreign-derived intangible income and GILTI should continue to be maintained and the per-country limitation on the foreign tax credit should not apply to any other limitation categories until it applies to GILTI.

[6] Other U.S. tax incentives such as bonus depreciation will also be undermined by Pillar Two. Although the Model Rules rely on deferred tax accounting to limit the extent to which timing differences can result in double taxation, the rules include arbitrary limitations that will result in the imposition of tax in common fact patterns, including those involving a taxpayer benefitting from accelerated depreciation on new U.S. capital investment. See January 6, 2022, letter from Business at OECD (BIAC) to OECD Working Party 11.

APPENDICES

I. Alignment of GILTI with Pillar Two

The modifications to the GILTI regime in the House-passed Build Back Better (BBB) bill are intended to ensure GILTI is consistent with the Model Rules. To assure a level global playing field, the U.S. GILTI regime should not be harsher than the Model Rules, nor should any changes be made to GILTI prior to the adoption of comparable minimum taxes by the countries of our major foreign competitors. In a number of material respects, however, as described in the table below, the changes to GILTI made by BBB would be more stringent than the Model Rules.

Comparison of GILTI (as would be amended by BBB) with Pillar 2 Model Rules

Provision	GILTI under BBB bill	Pillar 2 Model Rules
Offset for foreign taxes	95%	100%
Effective tax rate	15.8% (15%/95%)	15%
Substance-based carveout: general rules	5% of tangible <u>depreciable</u> property	8% of <u>tangible</u> property plus 10% of payroll (phasing down over 10 years to 5% of tangible property and payroll)
Substance-based carveout: interest	Carveout is reduced by certain interest expense	No provision
Book-tax timing differences	GILTI tax initially is imposed on timing differences, but may be reversed in later years due to a 5-year carryforward of tax credits	No tax initially is imposed on timing differences, but may be imposed later for certain differences (e.g., excluding depreciation) if not reversed within 5 years
Business tax credits	Tax credits that reduce foreign tax liability, whether or not refundable, are treated as a reduction in foreign tax payments	Refundable credits are treated as an addition to income rather than a reduction in tax payments, reducing the minimum tax impact compared to BBB
Pre-effective date losses	Pre-effective date loss carryforwards are not excluded in determining minimum tax liability, including potentially significant Covid-related losses	Pre-effective date loss carryforwards are excluded in determining minimum tax liability (due to a reduction in deferred tax assets)
Interest allocation	Rules allocating interest expense to GILTI would be repealed but a new interest deduction limitation (Code sec. 163(n)) would be imposed on interest expense allocable to GILTI	No requirement to allocate interest expense

ACT recommends modifications be made to the BBB to assure U.S. companies are not subject to a greater tax burden than their foreign competitors.

II. Override of Congressionally Authorized U.S. Tax Incentives

Congress has enacted a number of tax credits to encourage certain economic activities, including investments in research, renewable energy, affordable housing, distressed communities, carbon sequestration, economically disadvantaged workers, and rehabilitation of historic structures. Under the Model Rules, a multinational company (with a U.S. or foreign parent) that reduces its U.S. effective tax rate below 15% as a result of claiming these tax credits would be subject to additional tax by foreign countries, effectively recapturing the U.S. tax benefit provided by these tax incentives. A foreign country would be permitted to tax a local subsidiary of the U.S. company on the difference between 15% and the company's effective U.S. tax rate as reduced by any U.S. tax incentives, regardless of the effective tax rate paid by the subsidiary to the foreign country. As a result, investments in domestic activities or projects that Congress seeks to encourage will be curtailed because the tax benefit intended by Congress to encourage these investments would be captured by foreign governments, rather than the U.S. company making the U.S. investment.

The diagram below illustrates how the U.S. research and experimentation (R&E) credit could end up benefiting foreign governments rather than advancing U.S. policy interests. (Tax credits for investment in other targeted activities like renewable energy and affordable housing projects would lead to the same result.) In this example, a U.S. company earns $800 million of income in the United States and $200 million of income in the UK, and its book and taxable income are assumed to be the same. U.S. corporate income tax is $168 million (21% of $800 million) before credits and $68 million after a $100 million R&E credit (20-percent credit rate x $500 million of assumed credit-eligible R&E expenses).

Under the Model Rules, the global minimum tax on U.S. income is deemed to be $90 million, determined by excluding 5% of tangible property and payroll ($200 million based on assumed tangible property and payroll of $4 billion) from U.S. book income and multiplying the difference ($600 million) by 15 percent. As a result of the R&E credit, U.S. tax is $22 million less than the global minimum tax (the difference between $90 million and $68 million).

U.S. Parent Company	
Book income	$800M
U.S. tax before credit @21%	$168M
R&E credits	$100M
U.S. tax after credits	$ 68M
Global minimum tax rules:	
5% of U.S. tangible property & payroll	$200M
Global minimum tax base	$600M
Global minimum tax at 15%	$ 90M
Under-taxation by U.S.	$ 22M

UK Subsidiary	
Book income	$200M
UK corp. tax @19%	$ 38M
Additional UK Tax (due to UTPR)	$ 22M
Total UK tax	$ 60M

The Pillar Two UTPR (previously referred to as the Under-Taxed Payment Rule in the October 2020 Pillar Two Blueprint[i]) would allow the UK to collect an additional $22 million in UK tax from the U.S. company's UK subsidiary merely because the U.S. tax on the company's U.S. income is below the global minimum rate due to its U.S. research activities.[ii] Unlike the Pillar Two Blueprint, no deductible payment from the UK affiliate to the U.S. parent is required to trigger imposition of UK tax under the UTPR. Consequently, the UK Treasury would receive $22 million of the $100 million R&E credit that Congress intended to benefit the U.S. company. The result would occur if the U.S. company had a subsidiary in any country that adopts the Model Rules.

ACT believes insufficient consideration was given to the interaction of the UTPR and U.S. tax incentives that were designed to promote broadly supported social, environmental, and economic objectives. The Administration and Congress recognized the importance of preserving these tax incentives in the proposed modifications to the Base Erosion and Anti-Avoidance Tax (BEAT) and the proposed 15-percent book minimum tax in the BBB, but implementation of the Model Rules by other countries will undercut these same incentives.

ACT strongly recommends modifications to the Model Rules for Pillar Two to prevent this regime from undercutting broad, bipartisan, and long-standing tax incentives adopted by Congress.

[i] The UK Government's consultation document on implementation of Pillar Two refers to the UTPR as the Undertaxed Profits Rule. The acronym UTPR is not defined in the OECD Model Rules.

[ii] The effectiveness of the UK research tax credit would not similarly be undermined. The UK government's consultation document on implementation of Pillar Two notes: "These rules will ensure the UK's Research and Development Expenditure Credit (RDEC) will be treated as an addition to income rather than a reduction in tax in the ETR calculation, which will ensure RDEC continues to be an effective instrument for promoting R&D activity in the UK."