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Alliance for Competitive Taxation

Comments on

"Overhauling International Taxation"

International Tax Framework Proposal of

Senate Finance Committee Chair Senator Ron Wyden,

Senator Sherrod Brown, and

Senator Mark Warner

April 23, 2021

The 46 members of the Alliance for Competitive Taxation are: 3M, Abbott Laboratories, ADP, Alcoa Corporation, 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., Google, 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.

ACT COMMENTS ON SENATORS WYDEN, BROWN AND WARNER INTERNATIONAL TAX FRAMEWORK

I. Introduction

The Alliance for Competitive Taxation (ACT), a coalition of leading American companies from a wide range of industries, welcomes this opportunity to offer comments on the International Tax Framework (the "Framework") released by Senate Finance Committee Chairman Ron Wyden together with Senators Sherrod Brown and Mark Warner on April 5, 2021.

ACT shares the objectives of the Framework that U.S. international tax rules should increase U.S. investment, employment, and wages. U.S. multinational companies 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 now to restore full employment as the nation recovers from the job losses caused by the pandemic.

It is most important at this time to return the economy to a position of strength as soon as possible. A tax increase on employers now would inevitably slow economic growth. For many companies, it would dampen plans to expand hiring; for others, it would slow re-hiring. A reduced demand for workers and stalled investment would suppress wages.

A tax increase would withdraw funds from the economy at a precarious time and would directly counter the federal government's actions to inject funds into the economy. As we seek to recover millions of lost jobs, now is the worst time to raise corporate taxes.

We urge you to consider the benefits of a strong economic recovery, built on the success of American businesses. We believe America can be the best place in the world for a company to expand its workforce, increase wages, undertake new capital investment, develop new technologies, and manage a global enterprise. But higher taxes now on America's employers, especially taxes that make it harder for American companies to compete in global markets, would put a sustainable recovery at risk.

<u>Benefits to the U.S. economy from globally engaged American companies</u>

U.S. multinational companies directly employed 26.6 million American workers and paid average compensation of $84,730, for total U.S. compensation of $2.3 trillion in 2018, the most recent year released by the Bureau of Economic Analysis.[1] U.S. multinational companies directly and indirectly supported approximately half of all private sector jobs in the United States.[2] Technological innovation and capital investment of U.S. multinational companies have contributed more than 40 percent of the increase in U.S. labor productivity in recent decades.[3] The global engagement of U.S. companies allows American workers to sell their goods and services to consumers around the world.

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[1] Bureau of Economic Analysis, "Activities of U.S. Multinational Enterprises, 2018," News Release BEA 20- 40, August 21, 2020.

[2] Indirect jobs include those supported through the supply chains and by the consumer spending of employees of U.S. multinational companies and the employees of their supply chains. See, Economic Impacts of Globally Engaged U.S. Companies: Employment, Labor Income, and GDP (May 2016), available at: http://businessroundtable.org/sites/default/files/Economic Impacts of Globally Engaged US Companies_FINAL for Distribution_0.pdf.

[3] McKinsey Global Institute, Growth and Competitiveness in the United States: The Role of its Multinational Companies, June 2010.

American workers, including those who work directly for U.S. multinational companies and those employed elsewhere in the economy, benefit from globally competitive American-headquartered companies.

Creating a level playing field for U.S. companies in foreign markets

American ownership of multinational companies is critical if we want our country's economy to grow and our people to thrive. American-headquartered companies support our economy by providing good, high-paying jobs, productivity enhancing and wage-increasing capital investment, innovative research operations, vast American supply chains, and deep connections to the local communities in which they are based. For American companies to successfully compete on an increasingly crowded world stage, they need a tax code that acknowledges the global competition they face.

Other advanced economies recognize this competition, as well as the benefits that accrue to their citizens in terms of the jobs and income that arise from the success of the multinational companies that are headquartered in their countries. They have built tax codes that encourage jobs and investment through success in foreign markets. These countries have aligned around international tax rules that universally exempt active foreign business income from home country taxation.[4] Companies pay tax in the countries where they do business but do not pay additional tax to their home country on their foreign earnings. As a result multinational companies headquartered in these countries compete head-to-head on a level tax playing field with respect to their foreign operations, unlike U.S. companies that are subject to home country taxation on their active foreign business income.

U.S. adoption of a unilateral base protection measure like the global intangible low-taxed income (GILTI) provision puts U.S. companies at a significant tax disadvantage in global markets because the foreign companies they compete with are not subject to a similar tax in their home countries. For example, consider a U.S. multinational company that to be cost competitive must produce in the foreign markets it serves, owing to transportation and raw material costs. All companies operating in that market will pay income tax in the local country, including the U.S. company. But only the U.S. company will at the same time owe additional tax to its home country. The additional U.S. tax under GILTI on the company's foreign earnings places the U.S. company at a disadvantage.

GILTI imposes an added cost for a U.S. company that is not faced by foreign companies. This has the effect of causing the U.S. company to lose global market share. Sales that would have been profitable to make are no longer so. As a result, the U.S. company's domestic operations – hiring, capital expenditures, and more – also contract. The company's reduced profitability limits its ability to invest and hire at home, and its reduced scale requires fewer U.S. employees. This, in turn, reduces U.S. income, wages, and employment, both directly within the company and through its supply chains.[5]

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[4] Within the OECD, 30 of the 36 other countries have territorial tax systems that exempt between 95% and 100% of active foreign business income. Countries with worldwide systems in the OECD are Chile, Colombia, Ireland, Israel, the Republic of Korea and Mexico. Ireland has a 12.5% corporate tax rate, which effectively results in a dividend exemption system for foreign earnings taxed at a rate of 12.5% or higher.

[5] Mihir Desai, C. Fritz Foley and James R. Hines, Jr., "Domestic Effects of the Foreign Activities of U.S. Multinationals," American Economic Journal: Economic Policy, February 2009. This study finds a strong positive relationship between a company's foreign employment and its domestic employment: for every 10-percent

An even higher-rate, broader-based GILTI would exacerbate these adverse effects. This is not speculation. Beginning in 1975, the United States taxed a portion of the foreign earnings of the U.S. shipping industry on a current basis and in 1986 expanded this regime to all foreign shipping income. The resulting increase in current U.S. taxation of the industry's foreign earnings led to a substantial decline of the U.S. shipping industry, both in absolute terms and relative to the growth of foreign-headquartered shipping fleets. In 2004, Congress reversed these changes and restored deferral of U.S. tax on foreign shipping income. Data indicate the industry began to grow again as a result of this change.[6]

The adverse effects of the pre-2017 U.S. worldwide tax system on U.S. competitiveness were widely recognized by Congress. The high U.S. rate of tax on foreign earnings of U.S. companies relative to their competitors made it disadvantageous for U.S. companies to own foreign assets. This tax difference meant, everything else equal, the value of foreign assets in the hands of a U.S. company was less than if held by a foreign company. This reduced the ability of U.S. companies to acquire foreign assets as the assets would be more highly valued by a foreign-headquartered company. The disparity in tax codes was one of the factors that caused some U.S. companies to sell their foreign assets to foreign-headquartered companies and, in some cases, led to the foreign acquisition of entire U.S. companies. And it contributed to redomiciliation transactions – so-called "inversions" – in which a U.S. company merged with a foreign company in order to reincorporate outside the United States.

These transfers of assets are not abstract M&A transactions – they affect who will make the decisions of global multinational companies, where they will employ their workers, and where their suppliers will be based. If a foreign-headquartered company can expand through acquisitions more readily than its U.S. competitor, the foreign-headquartered company's growth will provide it economies of scale that allow it to out-compete the U.S. company, both in foreign markets and in the United States. A contraction of U.S. companies hurts American workers.

While anti-inversion legislation can prevent some transactions of this type from occurring in the same form as they did previously, such legislation <u>cannot</u> overcome the competitive disadvantage placed on the foreign operations of U.S. companies. At the margin, the tax disadvantage to U.S. companies makes them less competitive than foreign-headquartered companies in the same market. Ultimately, assets will end up in the hands of owners where they earn the highest after-tax returns. Anti-inversion legislation won't stop U.S. companies from selling their foreign assets to foreign companies or prevent start-ups from being formed outside the United States. Anti-inversion legislation cannot stop foreign multinational companies from growing more quickly than American companies, both organically and through outbidding U.S. companies to acquire other companies. All of these effects of an uncompetitive U.S. international tax system will ultimately lead to a decline of U.S. businesses caused by their declining global market share. Termed "invisible inversions" by Professor James Hines, this loss in U.S. business activity has the same effect on the U.S. economy as the more visible, explicit inversions. Hines concluded, "While not as visibly dramatic as a corporate inversion or a foreign takeover of a U.S. company, they [invisible inversions] had the same economic impacts in shrinking the size of the U.S.

increase in a foreign employment by a U.S. company, on average, U.S. employment increases by 6.5%. Given that globally engaged American companies employ twice as many workers in the United States as they do abroad, this implies that a decrease in 100 workers abroad is associated with a decrease of 129 workers in the United States.

[6] Ken Kies, "A Perfect Experiment: 'Deferral' and the U.S. Shipping Industry," Tax Notes, October 1, 2007.

business sector relative to what it would be otherwise, and distorting the pattern of asset ownership. This in turn reduced the demand for U.S. labor, and thereby depressed wages and employment opportunities in the United States."[7]

Achieving the dual objectives of base protection and U.S. competitiveness

Given the intended purposes of GILTI as a base protection measure and the adverse competitive effects from its imposition, one must evaluate the tradeoffs between these two objectives. How much of a competitive disadvantage should the United States impose on its own companies? The consensus answer from other advanced economies is that no self-imposed competitive tax disadvantage is worth foregoing the benefits to their citizens of higher income and more employment from the success of their companies in global markets.[8] Even if well intended as a base protection measure, a broadly applied minimum tax like GILTI will reduce U.S. income and employment by reducing the ability of U.S. companies to compete in global markets. To the extent base protection measures are needed, they should be narrowly targeted to specific types of activities where the base protection benefits clearly outweigh the economic losses from impairing U.S. competitiveness.

The adoption of a "quasi-territorial" tax system in 2017 that included GILTI was the outgrowth of decades of bipartisan study and Congressional working groups.[9] The 2015 Senate Finance Committee International Tax Bipartisan Working Group co-chaired by Senators Portman and Schumer stated:

> "In order to move the U.S. international tax system in a direction that keeps the U.S. economy globally competitive with their foreign rivals, the co-chairs believe that it is imperative to adopt a dividend exemption regime in conjunction with robust and appropriate base erosion rules."[10]

The Working Group also recommended legislation to encourage the development and retention of intellectual property (IP) in the United States, which was implemented in the 2017 legislation as the foreign-derived intangible income (FDII) provision:

> "The co-chairs agree that we must take legislative action soon to combat the efforts of other countries to attract highly mobile U.S. corporate income through the implementation of our own innovation box regime that encourages the development and ownership of IP in the United States, along with associated domestic manufacturing."

The base erosion measures discussed by the Working Group were intended to prevent loss of the U.S. tax base to <u>tax havens</u> without interfering with the competitiveness of U.S. companies in foreign markets:

> "The co-chairs are committed to designing base-erosion proposals that protect the U.S. tax base and address the proliferation of <u>tax havens</u>, while not undermining the ability of

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[7] Statement of James R. Hines, Jr., U.S. Senate, Committee on Finance, How U.S. International Tax Policy Impacts American Workers, Jobs, and Investment, March 25, 2021.
[8] Mihir Desai and Janes R. Hines, Jr., "Evaluating International Tax Reform," National Tax Journal, September 2003.
[9] For example, support for a move to a territorial system was included in recommendations of several commissions established by President Obama, including the National Commission on Fiscal Responsibility and Reform (Simpson-Bowles), the President's Export Council, and the President's Council on Jobs and Competitiveness.
[10] United States Senate Committee on Finance, The International Tax Bipartisan Working Group Report, July 2015.

American companies to compete abroad. This means creating clear, manageable standards that take into account the fact that losses can cause low effective tax rates in particular years and designing rules that dissuade companies from shifting money to tax haven jurisdictions." [emphasis added]

GILTI as enacted is far more encompassing than necessary to target income shifting to tax havens: Active foreign business earnings in excess of a routine rate of return in all countries, not just in tax havens, are subject to tax. And this income is subject to double tax – once in the country where it is earned and again under GILTI. The foreign tax credit system adopted for GILTI only provides limited relief from this double taxation because it only partially gives credit for foreign taxes paid, further reduces the foreign tax credit limitation for U.S. expenses, and provides no mechanism to account for prior year business losses or for higher foreign taxes paid in prior years. As a result, U.S. companies end up paying GILTI tax on foreign earnings that are subject to foreign taxes far greater than the GILTI minimum tax rate, and even on earnings taxed at foreign rates in excess of the U.S. 21% rate.

ACT agrees with the recommendation proposed in the Framework not to allocate domestic research expense and domestic stewardship expense to GILTI. This issue had been previously identified by Members of Congress to Treasury in its implementation of the 2017 legislation.[11] Allocating these domestic research and managerial expenses to GILTI has the unintended effect of increasing their cost, which in turn may reduce domestic employment to perform these services. A legislative solution is appropriate and should also consider eliminating the requirement to allocate domestic interest expense to GILTI to avoid increasing the cost of domestic investment in plant and equipment financed in part by borrowing. As discussed in more detail below, expense allocation for purposes of determining the foreign tax credit is not appropriate in a base protection measure intended to address income shifting to low-tax countries because it primarily affects companies investing in high-tax foreign jurisdictions.

Although no other country has enacted a minimum tax on active foreign business income, the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting is currently in discussions on the design of a minimum tax that other governments would be encouraged to adopt. It is unclear whether agreement on the design will be reached and, even if it is, whether other countries will actually implement such a minimum tax. The OECD is not a government or legislative body and cannot enact laws either for its member countries or the nearly 100 additional participating countries in the Inclusive Framework. Only individual sovereign nations can adopt tax laws governing the activities of their companies and investment in their countries. Many countries have made clear that the control and design of their tax systems is a sovereign matter, including tax rates and the tax base to measure income.

There is no reason to believe that other countries will choose to adopt the OECD recommendations if doing so is not in the best interests of their citizens. The United States has had a foreign minimum tax for years and not a single foreign country has followed the U.S. example. Nor have other countries followed the expansive U.S. Subpart F rules applying to types of active business income.

Other countries may not agree with the Administration's view that there has been a race to the bottom requiring corrective action through a minimum tax. In direct contradiction to the Administration's view, the data show that there has been no decline in corporate tax revenues in other OECD countries, apart

[11] "Treasury Pressed to Fix Tax Mistake That May Push R&D Offshore," Bloomberg, March 21, 2019.

from recession years. Average corporate income tax revenues as a share of gross domestic product (GDP) (whether unweighted or weighted by GDP) for the rest of the OECD are little changed over the past 20 years notwithstanding a reduction in the average statutory corporate tax rate from 32% to 23.4%.[12] The stability in tax revenues is both a function of corporate base broadening that accompanied the rate reduction, as in the United States, and revenue growth from an improved environment for corporate investment.

While U.S. corporate tax revenues as a share of GDP have declined over the past several decades, this decline reflects the growing share of business income earned by passthrough entities – partnerships, S corporations, and sole proprietors. Business income that in the past would have been earned in the corporate form of organization, and therefore subject to the corporate income tax, has increasingly moved to passthrough ownership form. Owners of passthrough businesses are taxed directly on their income under the individual income tax instead of under the corporate income tax. Between 1980 and 2016, the share of business income earned by passthrough entities increased from 21.7% to 61.8% – today a larger share of business income is earned in passthrough form than in corporate form.[13] Passthrough business income grew from 2.3% of GDP in 1980 to 8.6% in 2016, an increase of 6.3 percentage points, while corporate income declined from 8.3% of GDP to 5.3% of GDP over this period.[14] The increase in the share of business income in passthrough form has contributed to an increase in individual income tax revenues as a share of GDP at the expense of corporate revenues.

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ACT's comments on the Framework are intended to ensure that any new proposals achieve the objective of increased U.S. employment, wages, and investment. This requires that U.S. rules for taxing both domestic investment and foreign investment of U.S. companies be internationally competitive. 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 lead to higher earnings for American workers; greater U.S. investment in equipment, technology, and R&D; and increased U.S. exports.

Congress must 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 employment, R&D, and investment.

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[12] Weighted and unweighted average for other OECD countries computed from country-level data in the OECD tax database.

[13] Net income less deficit reported in Internal Revenue Service, Statistics of Income, Integrated Business Data, 1980-2015. The data presented in the text for 2016 is from other reported Statistics of Income data for these business entities. The amounts reported in the text exclude income earned by regulated investment companies (RICs) and real estate investment trusts (REITs).

[14] Passthrough income relative to GDP increased by 272% between 1980 and 2016 [(8.6-2.3)/2.3], while corporate income as a share of GDP declined by 36% [(8.3-5.3)/8.3].

II. SPECIFIC COMMENTS ON THE INTERNATIONAL FRAMEWORK PROPOSALS

A. GILTI

The comments in this section relate to modifications discussed in the Framework to GILTI.

1. Qualified Business Asset Investment (QBAI)

QBAI provides a deduction from GILTI equal to a 10% return on depreciable tangible assets. This deduction has been mistakenly characterized as an incentive to offshore tangible assets. It 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. 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.

We are aware of no data that shows QBAI favors foreign investment.[15] 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 intangible investments (IP), which is the most mobile form of investment and whose location is potentially the most sensitive to tax rate differentials.

The United States currently is participating in discussions with the OECD/G20 Inclusive Framework on the design of a uniform minimum tax on foreign income. This proposal includes a substance-based carve out, like the deduction for QBAI return, that would provide an exemption from the minimum tax for a routine return on both tangible assets (including land) and 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. Before Congress modifies the GILTI regime it should wait for other countries to adopt their own global minimum taxes, so the United States is not further out of step with international competitors.

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[15] 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.)

2. The GILTI Tax Rate

American workers benefit from U.S. international tax rules that generally align with those of other advanced economies to allow trade and cross-border investment to occur on a level playing field.

The United States is the only advanced economy that taxes the active foreign business income of its multinational companies on a current basis. U.S. companies compete against foreign multinational companies headquartered in countries with territorial tax systems, including companies headquartered in all other G7 countries. In addition to imposing no current tax on active foreign business income, when foreign income is repatriated these countries impose either no tax or a tax of no more than 1.5 percent (resulting from the 95% exemption provided in some territorial tax systems).

A higher GILTI tax rate would further disadvantage American companies at the expense of their foreign-headquartered counterparts.

The United States and over 130 countries are now discussing an OECD proposal to design a uniform minimum tax on foreign income; however, that proposal currently envisions a minimum tax with an effective tax rate of 12.5%, applying to foreign income taxed below that rate.[16]

By contrast, the United States imposes GILTI on foreign income taxed below a 13.125% rate due to providing a foreign tax credit for only 80% of foreign taxes.[17] After 2025, GILTI is scheduled to be imposed on foreign income taxed below a 16.4% rate – this would be 31 percent higher than the 12.5% rate in the OECD draft proposal.

In addition to GILTI applying at higher foreign tax rates relative to the OECD proposal, the U.S. GILTI is more burdensome in a variety of other respects:

- GILTI is assessed on a broader amount of income because the OECD proposed minimum tax exempts a routine return on both tangible assets (including land) and labor compensation;
- GILTI provides only partial foreign tax credits due to U.S. expense allocation rules;
- GILTI provides no carryover of business losses from prior years that may be responsible for a low rate of foreign tax in the current year;
- GILTI provides no carryover of foreign tax credits from one year to the next;
- GILTI imposes tax at an effective 21% rate on companies with no taxable income because they have incurred losses.[18]

The OECD has acknowledged that these factors cause GILTI to be more burdensome than the minimum tax in the OECD proposal.[19]

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[16] The minimum tax in the OECD proposal is referred to as the Pillar 2 income inclusion rule. See OECD, Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, 2020. The proposed rate of tax is not included in this document.
[17] As a result of U.S. expense allocation rules, GILTI imposes minimum tax even when foreign tax rates are far above 13.125%.
[18] Companies with losses do not benefit from the 50% Section 250 deduction, and as a result income included under GILTI reduces future net operating loss deductions dollar-for-dollar.
[19] OECD, Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, 2020, p. 19.

Any increase in the GILTI rate should not be adopted unilaterally. Congress should not act simply on the speculation that an agreement may be reached on the OECD proposal and, if it is, that countries will actually enact legislation comparable to GILTI. Because the United States is the only country that currently applies a minimum tax on active foreign business income, an increase in the GILTI rate would further disadvantage U.S. companies. The Administration has effectively acknowledged that unless other countries implement a foreign minimum tax, U.S. competitiveness would be adversely affected.[20]

Despite favorable statements from one or two countries on reaching an agreement at the OECD on minimum taxes, there are strong political and institutional impediments in many countries to the actual adoption of a global minimum tax. Within the European Union, implementation may be constrained by EU Fundamental Freedoms contained in the EU treaty.[21] Ireland, with a 12.5% statutory corporate income tax rate, and other EU countries may be unwilling to implement such taxes.[22] Beyond the EU, countries as diverse as China and India have expressed concern about how such minimum taxes would affect the welfare of their economies.[23] China by itself is the home country to more of the largest multinational companies than the United States.[24]

Further, a belief that other countries will follow if the United States leads by further increasing the GILTI rate, is belied by the fact that the United States introduced GILTI over three years ago, and not a single foreign country has introduced a similar minimum tax regime since that time.

The adverse competitive effects of an increase in the GILTI rate would be even more severe if accompanied by the elimination of the QBAI deduction, described earlier in Section II.A.1, or moving from the overall foreign tax credit calculation to a country-by-country limitation, discussed below in Section II.A.3.

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[20] In Secretary Yellen's written responses to the Senate Finance Committee, she notes that the competitiveness of U.S. companies would be improved "if a global minimum tax were agreed to at the OECD." (Responses to Follow-up Questions for the Record for Hon. Janet L. Yellen, Jan. 19, 2021). Deputy Secretary Wally Adeyemo stated in an interview "We need to come to an international agreement. We know that's critical to United States' competitiveness." (Interview with Fareed Zakaria GPS, CNN, April 11, 2021). We note, however, that an international agreement is insufficient to protect U.S. competitiveness; implementation of the agreement by the other significant world economies is required.

[21] The Fundamental Freedoms include freedom of establishment, free movement of services, and free movement of capital as provided in the Treaty on the Functioning of the European Union.

[22] The Irish Finance Ministry has stated: ""Small countries, such as Ireland, need to be able to use tax policy as a legitimate lever to compensate for advantages of scale, resources and location enjoyed by larger countries." ("Europe's low-tax nations braced for struggle over US corporate tax plan," Financial Times, April 14, 2021).

[23] For example, the press in India has written: "Apart from the challenges of getting all major nations on the same page, especially since this impinges on the right of the sovereign to decide a nation's tax policy, the proposal has other pitfalls. A global minimum rate would essentially take away a tool that countries use to push policies that suit them. For instance, in the backdrop of the pandemic, IMF and World Bank data suggest that developing countries with less ability to offer mega stimulus packages may experience a longer economic hangover than developed nations. A lower tax rate is a tool they can use to alternatively push economic activity." ("Explained: Joe Biden's radical tax proposal," Indian Express, April 10, 2021.) A Hong Kong press story notes that "The minimum corporate tax concept has potential risks for Hong Kong, through which some 70 per cent of foreign investment from the Chinese mainland is now channelled." ("China quiet on global minimum corporate tax rate backed by G20 as questions over Hong Kong's tax-haven status arise," South China Morning Post, April 8, 2021.

[24] In 2020, China was the home country to 124 companies on the Fortune Global 500; the United States was the home country to 121. All other countries accounted for the remaining 255 companies.

Finally, the Framework states 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. More importantly, competitiveness concerns over the GILTI rate relate to foreign country tax rates. In addition to the ability of foreign-headquartered companies to earn income in countries with lower *statutory tax rates* than the United States, effective tax rates of other countries are also reduced by the availability of tax credits and other incentives, including the use of IP boxes.[25] As a result, the current 13.125% GILTI rate already places U.S. companies at a competitive disadvantage relative to foreign-headquartered companies, and a higher rate would be even more disadvantageous.

3. Overall vs. Country-by-Country GILTI Calculation

Modern multinational companies operate with diverse business models.[26] Some companies rely on highly specialized subsidiaries that are located regionally or globally, each of which is part of a tightly integrated supply chain from production of raw materials to sale of the final good. Other multinational companies have replicated operations across the globe, with operations in each country producing goods and services similar to each other or tailored to meet differing consumer preferences and needs. Multinational companies can achieve economies of scale through specialization or through the ability to manage activities centrally and to scale innovations globally. The structure of every multinational company will vary to some degree based on the products and services it sells, transportation and logistics costs that affect the ability to move inputs and final products across distances, historical presence in certain markets and acquisitions the company has made over time, as well as laws and regulations that may impose local content or other procurement requirements, tariffs, trade treaties, and customs unions.

The 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.[27] The overall calculation also reduces the complexity of the GILTI calculation, and makes the absence of certain multi-year averaging features less onerous.

In contrast, a country-by-country foreign tax credit calculation is not appropriate given the current structure of GILTI and, if such a change were adopted, it would require additional modifications to GILTI.

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[25] Countries with IP boxes include Belgium, China, France, Hungary, India, Ireland, Israel, Italy, Lithuania, Luxembourg, Netherlands, Poland, Portugal, Slovakia, South Korea, Spain, Switzerland, Turkey, and the United Kingdom. IP boxes in compliance with the “modified nexus approach” are permitted under the OECD base erosion and profit shifting (BEPS) project final report, as described in OECD, Action 5: Agreement on Modified Nexus Approach for IP Regimes, 2015.

[26] A description of differing operating models 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.

[27] 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.

This section addresses the issues that arise with a country-by-country calculation of GILTI.

a. Arbitrary impacts across multinational companies with the same overall foreign tax rate

As described in the introduction to this section, the global footprint of a multinational company reflects many different factors: the local markets in which it sells its products and provides its services, its ability to operate regionally versus locally, whether it sources its supplies within the company or from unrelated suppliers, and the locations of its internal supply chains.

Under the current overall foreign tax credit calculation, two multinational companies that otherwise have the same characteristics (for example, QBAI deduction) will have the same amount of tax from GILTI if they have the same average foreign tax rate.

For example, assume Company A has two foreign affiliates in different countries, each earning the same amount of income, one with an effective tax rate of 12.5% and the other with an effective tax rate of 22.5%. Because the average foreign effective tax rate of Company A is 17.5%, it will not owe tax under GILTI (ignoring the effects of expense allocation), because this rate exceeds 13.125%.

Now consider Company B, with two foreign affiliates in different countries, each earning the same amount of income, one with an effective tax rate of 15% and the other with an effective tax rate of 20%. It too has an average foreign effective tax rate of 17.5% and will not owe tax under GILTI (ignoring the effects of expense allocation).

A different result emerges under a country-by-country calculation of GILTI. In this case, holding the tax rate under GILTI unchanged, Company A will owe GILTI on its foreign subsidiary that is taxed at an effective rate of 12.5% (since 12.5% is less than 13.125%). In contrast, Company B will not incur GILTI on its foreign earnings even though it has the same overall foreign effective tax rate as Company A.

The outcome that two companies with the same overall foreign tax rate would pay different amounts of GILTI under a country-by-country calculation would be arbitrary. The current overall calculation results in consistency of GILTI tax burdens among similar taxpayers with the same overall foreign tax rate. This principle of horizontal equity across taxpayers – that two similarly situated taxpayers pay the same amount of tax – is a desirable and long-standing principle of tax policy.

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. 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 lack of these carryover provisions in GILTI results in inequitable treatment for taxpayers. A taxpayer with a 17.5% tax rate in year 1 and a 12.5% tax rate in year 2 owes GILTI, even though the taxpayer has an average tax rate of 15% 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.

The lack of carryover provisions would result in even more severe outcomes – and severe inequities – under a county-by-country calculation. The current overall calculation of GILTI smooths fluctuations in business income across countries. Without any smoothing mechanism, year-to-year variation in tax payments in each country 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. The absence of averaging mechanisms in a country-by-country calculation would impose minimum tax on companies that on average, over time, pay more than the minimum tax rate, contrary to the purpose of the minimum tax.

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.[28] 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 one 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 would greatly increase the cost to taxpayers and tax administrators in 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.

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. The country-by-country approach would increase the number of foreign tax credit "baskets" from the four baskets provided under present law to more than 100 for many companies (one for each country in which a company does business).

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

[28] 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.

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."[29]

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 to 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.

e. Framework consideration of a "low-tax" and "high-tax" GILTI basket

The Framework raises the possibility that the same goals of a country-by-country calculation could be achieved through a simpler "two basket" GILTI calculation, with one basket including all low-taxed income and the other basket including all high-taxed income.

ACT welcomes the Framework's consideration of less complex alternatives to a country-by-country calculation. However, a two-basket approach raises a variety of complex design issues and, contrary to intent, can result in many of the same complexities in actual implementation as a country-by-country approach.

If the categorization of which operations are high-tax or low-tax is on the basis of taxes paid or accrued in a given year, the approach requires a determination to be made separately for each country in each year. It is important to keep in mind that this computed tax rate on operations in any given country will fluctuate over time because of timing differences, tax year mismatches, business cycles, start-up losses, and other factors, and could cause a country to switch between the high-tax and low-tax basket from year to year.

In a year in which the timing differences cause a country to be low-tax, the taxpayer will owe GILTI tax under the two-basket approach. When those timing differences reverse, the country will be high-tax, but the taxpayer apparently would have no ability to credit its high taxes against the prior year low-tax inclusion. One could attempt to address this with multi-year averaging, but multi-year averaging would effectively require taxpayers to maintain country-level accounts and track their tax attributes, year to year, for potentially 100 or more country baskets – resulting in the same complexity as the country-by-country approach.

We commend the Framework authors for recognizing that a country-by-country approach is far too complex but, as currently proposed, the two-basket approach will not produce meaningful simplification.

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

ACT members support retention of the current overall approach to calculating GILTI and maintenance of the present law regulations providing for an elective high-tax exclusion. We would be happy to meet with your staff to discuss our views on this matter further and explore alternatives.

4. Framework Proposal to Add an Incentive for Onshore Research and Management Jobs

Treasury regulations provide that the foreign tax credit calculation for GILTI follow prior-law U.S. rules that require certain U.S. expenses to be allocated against foreign income in determining the foreign tax credit.[30] 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.

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. tax rate. 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.[31] The higher cost of these activities may reduce U.S. employment.

ACT commends the Framework for recommending that expense allocation be eliminated for U.S. research and stewardship expenses. ACT further recommends eliminating expense allocation rules entirely for GILTI, including interest expense.[32] 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.

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 under GILTI.

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[30] 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.
[31] Treasury regulations finalized in 2020 provide that research expense is not allocated to the GILTI foreign tax credit basket. The Framework apparently would codify this regulation.
[32] 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 GILTI to companies with high-tax foreign income.

B. FDII

As referenced in the Introduction (Section I), a construct like FDII had been under consideration by the 2015 Senate Finance Committee International Tax Working Group to encourage the development and ownership of IP in the United States. Retaining ownership of IP in the United States also contributes to increased manufacturing 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. FDII can be viewed as similar to the IP boxes of other countries, which encourage the development and retention of IP.

FDII is also a base protection measure. 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.

ACT recommends FDII be retained. 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, all of which creates an expansion of the U.S. tax base. By incentivizing the return of foreign-held IP, FDII reduces the need to locate R&D, jobs, and investment abroad to meet the substance requirements to support a foreign IP structure. Importantly, FDII enables the competitiveness of U.S. companies against their foreign competitors, including China, which provide similar (or lower) rates of tax on intellectual property income.

1. Proposal to Target Innovation Activities

FDII provides a “back-end” incentive for undertaking research-intensive activities in the United States in a different manner than the “front end” R&D tax credit. Both approaches are desirable and complementary to each other; both approaches are used globally. FDII also encourages the creation and retention of IP in the United States that arises from creative activities other than research. Present law FDII is neutral on the specific types of IP or high-margin income that are encouraged to be developed and retained in the United States.

Any new formula for FDII would need to be evaluated by ACT member companies before ACT could comment on the specific effects of a reorientation suggested in the Framework.

2. Comparison of FDII and GILTI Tax Rates

The Framework states that the FDII and GILTI tax rates should be equalized. However, the tax rates are already effectively equalized under present law. This is because GILTI allows only 80% of foreign taxes to be creditable. As a result (ignoring impacts from expense allocation described in Section II.A.4, above), 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.

If the Section 250 deduction is modified to provide the same percentage deduction for both FDII and GILTI, then all foreign taxes should be allowed in computing the GILTI foreign tax credit, rather than the 80% provided under present law. This would maintain the parity between the FDII and GILTI rates.

C. Base Erosion and Anti-Abuse Tax (BEAT)

The Framework recommends that that all general business credits be permitted to reduce BEAT and suggests foreign tax credits might also be allowed to offset BEAT "based on the availability of additional revenue from the BEAT system." 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 reduces U.S. double taxation of income. In the absence of an allowance for 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 tax rate.

The Administration proposal to replace BEAT with an undertaxed payment rule (UTPR) is also worth considering at a future date. The UTPR in the Administration's proposal (the "SHIELD") would be turned off if a country adopts a globally agreed upon minimum tax. At this time, as there is not yet a globally agreed upon minimum tax nor any implementation of a minimum tax by other countries, it is not necessary to consider circumstances under which the BEAT or UTPR would need to be turned off other than for U.S. companies, all of whom are already subject to a global minimum tax.