ACT Alliance for Competitive Taxation

BR Business Roundtable

March 28, 2019

The Honorable Steven Mnuchin
United States Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Secretary Mnuchin:

The Tax Cuts and Jobs Act (TCJA) was a historic achievement and has proved very successful in achieving its intended purpose of greater domestic economic growth and more jobs in the United States. The evidence is compelling: 3.1 percent GDP growth rate, 7.2 percent increase in real private investment, 2.6 million new private sector jobs, an unemployment rate below four percent, and faster wage growth all achieved in 2018.

We write to express our concern that Treasury's proposed foreign tax credit regulations extend the new minimum tax on Global Intangible Low-Taxed Income ("GILTI") to U.S. companies that are paying high rates of foreign tax. This result runs directly counter to the TCJA's purpose. As explained below, this consequence is contrary to Congressional intent and would weaken the positive effect the TCJA has had on the domestic economy and U.S. job creation.

Subjecting U.S. companies to the GILTI minimum tax even though they are paying high rates of foreign tax – even above the 21 percent U.S. corporate rate – would make U.S. companies less competitive in global markets; encourage a shift of jobs, R&D, and other activities abroad; and create a new tax incentive to locate company headquarters overseas either voluntarily or by being acquired by a foreign company.

One of the primary purposes of the TCJA was to "allow U.S. companies to compete on a more level playing field against foreign multinationals when selling products and services abroad by eliminating an additional level of tax."[1] Yet imposing the GILTI minimum tax on U.S. companies with high foreign tax rates would slant the playing field against U.S. companies to the advantage of their foreign competitors, since no other country imposes a minimum tax like GILTI on the global income of their companies.

[1] S. Prt. 115-20, "Reconciliation Recommendations Pursuant to H. Con. Res. 71," p. 358. The Finance Committee further described the prior law bias against U.S. companies led to incentives to move headquarters overseas and made U.S. companies less competitive in competing for foreign acquisitions and made them takeover targets of foreign-headquartered companies: "Moreover, the [prior law] U.S. international tax system [makes] foreign ownership of almost any asset or business more attractive than U.S. ownership. This unfairly favor[ed] foreign-headquartered companies over U.S.-headquartered companies, creating a tax-driven incentive for foreign takeovers of U.S. firms. Furthermore, it … created significant financial pressures for U.S.-headquartered companies to re-domicile abroad and shift income to low-tax jurisdictions." (p. 396)

Congress enacted GILTI to ensure U.S. companies pay a minimum rate of tax on foreign intangible income, if not to foreign governments then to the United States. This new minimum tax was paired with a reduced tax rate on certain domestic intangible income (Foreign-Derived Intangible Income, or "FDII") that works in tandem to remove the pre-TCJA U.S. system's tax bias against the ownership of intangible assets in the United States.

Congress set the GILTI minimum tax rate at half the 21 percent U.S. corporate rate (i.e., 10.5 percent) to mitigate the competitive disadvantage this new minimum tax would impose on U.S. companies whose foreign competitors do not face comparable minimum taxes in their home countries. As stated in the Senate Finance Committee Report:

> "[T]he Committee recognizes that taxing that income at the full U.S. corporate tax rate may hurt the competitive position of U.S. corporations relative to their foreign counterparts, and has decided to tax that income at a reduced rate (with a portion of foreign tax credits available to offset U.S. tax)."[2]

Because Congress permitted only 80 percent of foreign taxes to offset the 10.5 percent U.S. minimum tax, Congress expressly stated in the conference report accompanying the final bill that no minimum tax would be owed when foreign tax rates exceed 13.125 percent (since 80 percent of 13.125 equals 10.5):

> "At foreign tax rates greater than or equal to 13.125 percent, there is no residual U.S. tax owed on GILTI, so that the combined foreign and U.S. tax rate on GILTI equals the foreign tax rate."[3]

However, Treasury's proposed foreign tax credit regulations would apply prior-law expense allocation rules to limit the foreign tax credit that may be claimed against the GILTI minimum tax, resulting in U.S. companies being subject to GILTI even when their foreign income has been subject to high rates of foreign tax.

A recent survey of the Alliance for Competitive Taxation (ACT), a group of 40 major U.S. multinational companies across a wide range of industries – most of which are also members of the Business Roundtable – illustrates the profound negative effect of the proposed regulations on U.S. companies with high-taxed foreign income.[4]

The ACT survey found:[5]

- All companies with foreign tax rates at or above the 21 percent U.S. corporate tax rate expect to be subject to the GILTI minimum tax, despite paying foreign taxes above the U.S. rate on this income.

---

[2] S. Prt. 115-20, "Reconciliation Recommendations Pursuant to H. Con. Res. 71," p. 365. The Committee further explained that the base protection concerns that motivated the minimum tax were not applicable to higher taxed foreign intangible income: "if intangible income is located in a jurisdiction with a sufficiently high tax rate, the Committee believes there is limited base erosion concern." (p. 370)

[3] H.R. Conf. Rep. No. 115-446, Conference Report, pp. 626-7.

[4] The member companies of ACT are listed on its website: www.actontaxreform.com.

[5] Based on 36 responses. One-third of these companies reported foreign tax rates at or above 21 percent and two-thirds reported foreign tax rates at or above 13.125 percent.

- Similarly, all companies whose foreign tax rates are at or above 13.125 percent expect to be subject to the GILTI minimum tax despite paying foreign taxes above the stated threshold.
- On average, more than 80 percent of the foreign income of companies surveyed is subject to current U.S. taxation (74.8 percent under GILTI and 8.7 percent under subpart F).
- The proposed expense allocation rules increase by about four times the average rate of GILTI tax paid by the companies surveyed.

Indeed, under the proposed foreign tax credit regulations, every U.S. multinational company with domestic expenses arising from interest, research and/or expense (essentially all U.S. companies doing business abroad) will be subject to the GILTI minimum tax, regardless of their foreign tax rate.

Even the name of the new minimum tax – "Global Intangible Low-Taxed Income" (emphasis added) – indicates Congress did not intend to apply the GILTI minimum tax to high-taxed foreign income. Simply put, if Congress intended the new global minimum tax to apply to high-taxed foreign income, the words "Low-Taxed" would not have been used to describe this new tax.

Because no other country imposes a minimum tax like GILTI on their companies, U.S. companies will be disadvantaged relative to their foreign competitors, harming American workers and putting U.S. jobs at risk:

- U.S. companies will be less competitive in selling their products and services in global markets than their foreign competitors
- U.S. companies will lose global market share
- U.S. companies will be outbid by foreign companies in pursuing cross-border acquisitions because of their higher U.S. tax costs
- U.S. companies will become the target of foreign takeovers because their foreign operations can be conducted more tax efficiently by foreign-headquartered companies.

Limiting foreign tax credits that may be claimed against the GILTI minimum tax by requiring expenses to be allocated to GILTI exacerbates the anti-competitive effects of GILTI and would create a new tax incentive for moving jobs, investment, and activities abroad, including:

- R&D, headquarters jobs, and other activities giving rise to domestic expenses that would be subject to the proposed expense allocation rules, and
- Construction of new manufacturing plants and other debt-financed facilities outside the United States so that the interest expense would not be subject to the proposed expense allocation rules.

We therefore respectfully request that Treasury, in its final foreign tax credit regulations, not require allocation of domestic expenses for purposes of calculating the foreign tax credit limitation on GILTI.

The expense allocation rules were designed under prior law for an entirely different purpose. The Internal Revenue Code expressly vests the Secretary with broad authority not to apply the

interest expense allocation rules where its application would be inappropriate.[6] Moreover, the allocation of research and stewardship expenses is solely governed by Treasury regulations.

The Tax Cuts and Jobs Act was an important step in strengthening the domestic economy and creating more jobs in the United States. We urge Treasury not to weaken the positive economic impact of this historic legislation by requiring U.S. companies to pay additional GILTI minimum tax on their high-taxed foreign income.

Sincerely,

Alliance for Competitive Taxation

Business Roundtable

[6] Internal Revenue Code, Sec. 864(e)(7)(G).