The Administration's Proposed Changes to the GILTI Regime Would Harm American Workers by Making U.S. Companies Less Competitive in Foreign Markets

- U.S. companies competing in foreign markets would be taxed on more income, and at a higher rate, under the Administration's FY 2025 Budget than under the global minimum tax agreed by the Administration (the so-called Pillar Two agreement). Moreover, the Budget proposes to retain the existing limitations on the foreign tax credit that double tax the foreign earnings of U.S. companies. This America last approach would hinder the ability of U.S. companies to gain market share abroad to the detriment of their American workers.
- The Budget proposal would impose more tax on US companies than Pillar Two due to:
  - **Higher rate.** The Budget proposal would require U.S. companies to pay at least 21%[1] on their foreign income compared to just 15% for foreign companies under the Pillar Two rules.[2] The foreign earnings of U.S. companies would face a higher minimum tax burden than would identical foreign income of a foreign-parented competitor and higher than the minimum taxes imposed on the U.S. earnings of a foreign-parented company.[3]
  - **Broader base.** Pillar Two allows a substance-based income exclusion equal to 10% of payroll (phasing down to 5% in 2033) and 8.0% of tangible assets (phasing down to 5% starting in 2033), while the Administration's proposal would eliminate the current substance-based income exclusion for 10% of qualified business asset investment.
  - **Double taxation by design.** Pillar Two gives full credit for taxes paid to the country where the income is earned, while the Administration's proposal allows only a partial foreign tax credit.
  - **Timing differences.** Pillar Two generally provides more generous (and yet still incomplete) relief for book-tax timing differences by recognizing deferred taxes, yielding a better result than the Administration's 10-year foreign tax credit carryforward.
  - **Expense allocation.** Pillar Two does not require expense allocation for domestic research and development, stewardship, or interest expense. The Administration's proposal both retains expense allocation for foreign tax credit purposes and doubles down on this uniquely uncompetitive feature of U.S. law by introducing a new restriction with respect to expenses associated with controlled foreign corporation ("CFC") stock.[4] Due to expense allocation U.S. companies that pay foreign tax at rates above 22.1% may nevertheless have to pay GILTI under the Budget proposal.
- The Budget proposal would separately calculate tax on GILTI for each country, rather than the current blended calculation, thereby creating an incentive to shift more profit from high-tax to lower-tax jurisdictions.[5]
- The Administration's budget proposal would reduce domestic investment because economic research finds that policies (such as the Administration's GILTI proposal) that reduce foreign investment of multinationals headquartered in a country result in less investment in their home countries.[6]

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[1] The proposal would raise the tax rate on global intangible low-taxed income ("GILTI") from 10.5% to 21%. After credit for 95% of foreign tax under the Administration proposal, companies would have incremental tax liability if the foreign rate is below 22.1% (21% = 95% of 22.1%).

[2] In many cases the rate differential would be worse under the Administration's proposal than under present law, even if other countries implement global minimum taxes. Under present law, assuming a 10% foreign effective tax rate, U.S. companies face a 2.5% rate disadvantage (12.5% rate for the U.S. company (10.5% plus (1-0.8) x 10%) and a 10% rate for the foreign company), or <u>25%</u> of the tax paid by the foreign company (2.5%/10% foreign effective tax rate with no minimum tax). Under the proposal, U.S. companies would face a 6.75% rate disadvantage (21.75% rate for the U.S. company (21% plus (1-.95) x 15%) and a 15% rate for the foreign company), or <u>45%</u> of the tax paid by the foreign company (6.75%/15% foreign effective tax rate under Pillar Two).

[3] Foreign companies with U.S. operations are subject to corporate alternative minimum tax at 15% and, under the Administration's proposal, would be subject to domestic minimum top-up tax at 15% and undertaxed profits rule at 15%.

[4] The Administration not only would allocate certain expenses to income in the GILTI basket (reducing the foreign tax credit limit) but also would deny a deduction for expenses related to a portion of this income.

[5] A country-by-country determination perversely would create a greater incentive to shift income subject to Pillar Two from higher tax foreign jurisdictions (i.e., those with a foreign effective tax rate above the global minimum rate) to

lower-tax foreign jurisdictions than does a minimum tax determined under the current blended method. Even assuming other countries enact Pillar Two minimum taxes, the country-by-country proposal would give U.S. companies an incentive to move income subject to Pillar Two out of any jurisdiction with an effective tax rate above 21% to jurisdictions with tax rates below 21%. Under a blended system, any incentive to shift investment stops when the average effective tax rate hits 21%. As a result, a country with a tax rate above the global minimum tax rate faces a stronger incentive to lower its tax rate under a jurisdiction-by-jurisdiction regime than it faces under a global averaging regime. Chris William Sanchirico, "Should a Global Minimum Tax Be Country-by-Country?" *Tax Notes Federal*, April 25, 2022; and Chris William Sanchirico, "A Game Theoretic Analysis of Global Minimum Tax Design: Country-by-country vs. Global Averaging," University of Pennsylvania, Institute for Law and Economics Research Paper No. 22-19, March 25, 2022.

[6] Ruud de Mooij and Sjef Ederveen, "Corporate Tax Elasticities: A Reader's Guide to Empirical Findings," Oxford Review of Economic Policy, February 2008; 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; Antonio De Vito, Martin Jacob, Dirk Schindler and Guosong Xu. "How Do Corporate Tax Hikes Affect Investment Allocation within Multinationals?" CESifo Working Paper No. 10272, February 2023; and Gabriel Chodorow-Reich, Matthew Smith, Owen M. Zidar, and Eric Zwick, "Tax Policy and Investment in a Global Economy," National Bureau of Economic Research, Working Paper 32180, March 2024, https://www.nber.org/papers/w32180.