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December 9, 2021

The Honorable Ronald L. Wyden
Chairman
Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Michael D. Crapo
Ranking Member
Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Richard E. Neal
Chairman
Committee on Ways and Means
United States House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

The Honorable Kevin P. Brady
Ranking Member
Committee on Ways and Means
United States House of Representatives
1139 Longworth House Office Building
Washington, D.C. 20515

Re: Comments on Pending Corporate and International Tax Reform Proposals

Dear Sirs:

On behalf of Tax Executives Institute, Inc. ("TEI"), I am pleased to present the enclosed comments and recommendations concerning select corporate and international tax reform proposals included in H.R. 5376, the Build Back Better Act. As the preeminent association of in-house tax professionals worldwide, TEI represents a cross-section of the business community and is well positioned to provide practical, consensus-based input on significant issues of corporate tax policy and administration. TEI members possess deep experience with the day-to-day application and consequences of the federal tax laws and thus represent a valuable source of balanced, objective information for policymakers during this critical time.

The enclosed comments were developed by members of several TEI standing committees under the aegis of TEI's Tax Reform Task Force, whose chair is Jason Weinstein. Principal responsibility for drafting TEI's comments was exercised by Watson M. McLeish, TEI Tax Counsel. TEI would welcome the opportunity to engage with committee members or their staffs to discuss any of our comments in further detail. To that end, please do not hesitate to contact Mr. Weinstein at [redacted] or [redacted], or Mr. McLeish at (202) 470-3600 or wmcleish@tei.org. I encourage you, your colleagues, and your staffs to view TEI as an important, unbiased resource in your ongoing tax policy deliberations.

Respectfully submitted,

Mitchell Trager

Mitchell S. Trager
International President

Enclosure

Copies: Thomas A. Barthold, Chief of Staff, Joint Committee on Taxation, United States Congress
The Honorable Lily L. Batchelder, Assistant Secretary (Tax Policy), U.S. Department of the Treasury
The Honorable Charles P. Rettig, Commissioner, Internal Revenue Service
William M. Paul, Principal Deputy Chief Counsel and Deputy Chief Counsel (Technical), Internal Revenue Service
Shamik Trivedi, Deputy Associate Counsel & Senior Tax Counsel, The White House

TAX EXECUTIVES INSTITUTE, INC.
COMMENTS ON H.R. 5376, BUILD BACK BETTER ACT
CORPORATE AND INTERNATIONAL TAX REFORM PROVISIONS

As the preeminent association of in-house tax professionals worldwide, Tax Executives Institute, Inc. ("TEI") is pleased to provide our comments and recommendations concerning select corporate and international tax reform provisions included in H.R. 5376, the Build Back Better Act ("BBBA"), as passed by the House of Representatives on November 19, 2021. TEI members are responsible for administering the tax affairs of their companies and must contend daily with the provisions of federal tax law relating to the operation of business enterprises. The diversity and experience of our membership enables TEI to bring a balanced, practical perspective to some of the most challenging issues facing business taxpayers—and policymakers—today, which we hope will inform your ongoing deliberations.

ABOUT TEI

TEI was founded in 1944 to serve the professional needs of in-house tax professionals. Today, the organization has 57 chapters with over 6,000 members representing 2,800 of the leading companies across North and South America, Europe, and Asia. TEI represents a cross-section of the business community and is dedicated to the development of sound tax policy, compliance with and uniform enforcement of tax laws, and minimization of compliance and administrative burdens to the mutual benefit of taxpayers and government. As a professional association, TEI is committed to fostering a tax system that works—one that is easily administrable and with which taxpayers can comply in a cost-efficient manner.

DISCUSSION

TEI commends the House Committee on Ways and Means ("Committee") for recommending a thoughtful and reasonably balanced package of reforms to the U.S. international tax system pursuant to its mandate to responsibly fund the Biden administration's legislative priorities.[1] The Committee's recommendations include several important, long-sought technical corrections and other improvements to current law that are laudably consistent with TEI's *Guideposts for Tax Policy*.[2] At the same time, however, TEI has identified several areas of significant concern among the proposed corporate and international tax reforms that warrant further attention. The following discussion articulates the most acute and widespread of these concerns, and offers constructive recommendations to address them.

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[1] As formally articulated in the House Committee on the Budget's report to accompany H.R. 5376, the BBBA would "make[] the transformative investments at the scale necessary to meet the needs of the American people, address dangerous deficits in our society, improve our economic outlook, and set America up to compete and win in the decades ahead." H.R. Rep. No. 117-130, at 4 (2021).

[2] Tax Exec. Inst., *Guideposts for Tax Policy in the 117th Congress* (May 11, 2021), https://www.tei.org/advocacy/submissions/tei-issues-guideposts-tax-policy-117th-congress.

Corporate Alternative Minimum Tax

TEI members from across the industry spectrum were taken aback by the post-Committee addition of a proposed book-based alternative minimum tax ("AMT") on corporations. Unlike other legislative proposals discussed herein, this new book-based corporate AMT proposal would directly contravene all three of TEI's *Guideposts of Tax Policy*. Its introduction would be neither simple nor administrable and would pose a competitive disadvantage to U.S.-headquartered businesses while increasing the incidence of unrelieved double taxation.

TEI questions the underlying policy rationale for tax reform legislation where some provisions would grant or otherwise preserve certain investment incentives but another would eliminate or significantly limit them. Apart from tax policy considerations, TEI is deeply concerned about the substantial administrative costs and compliance burdens that the proposed book-based corporate AMT would impose on taxpayers and the government alike. Accordingly, TEI respectfully urges Congress to reconsider its decision to include this proposal in the BBBA. Should Congress opt to retain the proposal, however, the following discussion raises important issues for Congress's consideration.

Background

Section 138101 of the BBBA would generally impose a new 15% minimum tax on the adjusted financial statement income of corporations with such income in excess of $1 billion. Under the proposal, an applicable corporation's minimum tax would equal the amount by which the tentative minimum tax exceeds the corporation's regular tax for the year. Tentative minimum tax would be determined by applying a 15% tax rate to the adjusted financial statement income of the corporation for the taxable year (after taking into account financial statement net operating losses and the AMT foreign tax credit, as discussed below).

Adjusted Financial Statement Income

As currently proposed, the new corporate AMT would be based on "adjusted financial statement income," defined as the net income or loss of the taxpayer set forth on the taxpayer's applicable financial statement—generally, a corporation's Form 10-K filed with the Securities and Exchange Commission, an audited financial statement, or other similar financial statement—with certain adjustments. The legislative text enumerates no fewer than ten "general adjustments" for this purpose and authorizes the Secretary of the Treasury to prescribe additional adjustments by regulation. As history and the following comments demonstrate, however, using adjusted financial statement income as the base for a new income tax regime would be the antithesis of sound tax policy and administration.

Special Rules for Related Entities

Special rules for determining adjusted financial statement income would apply in the case of related corporations included on a consolidated financial statement and taxpayers filing a consolidated return. If the financial results of a taxpayer are reported on the applicable financial statement for a group of entities ("consolidated book group"), that group financial statement would be treated as the applicable financial statement of the taxpayer. And if the taxpayer files a consolidated return for any taxable year, the taxpayer's adjusted financial statement income for the taxable year would take into account items on the taxpayer's applicable financial statement that are "properly allocable" to members of the group included on the consolidated return ("consolidated return group").

TEI is concerned that numerous, extremely complex adjustments would be required to conform the consolidated book group to the consolidated return group for purposes of determining the taxpayer's adjusted financial statement income. Notable categories of adjustments that would be particularly complex include adjustments relating to intercompany transactions, to various members of the consolidated book group having different year-ends, and to the presence in the consolidated book group of foreign subsidiaries that would not be included on the consolidated return. Furthermore, many TEI members employed by private (i.e., non-publicly traded) and inbound (i.e., foreign-parented) corporations indicate that they do not currently have audited or other similar financial statements for one or more domestic corporations within their organizational structures, in part due to cost, and would presumably be required to start preparing such statements in order to comply with the new corporate AMT proposal.

Similar to the old corporate AMT regime, which Congress repealed in 2017,[3] the proposed book-based corporate AMT would impose significant administrative costs and compliance burdens on corporations by requiring them to maintain at least three sets of books and records—to calculate income for financial statement, regular corporate income tax, and corporate AMT purposes. Indeed, it was only four years ago that the Committee characterized the requirement that taxpayers compute their income for purposes of both the regular income tax and the AMT as "one of the most far-reaching complexities of the Code."[4] This characterization would apply equally—if not more so—to the proposed book-based corporate AMT, which would also require the exceedingly complex adjustments described above.

Treatment of Dividends and Other Amounts

A separate special rule would apply with respect to the earnings of a related corporation that is not included on the taxpayer's consolidated return. In the case of any such corporation, the taxpayer's adjusted financial statement income would take into account the sum of dividends received and certain other amounts required to be included in gross income for tax purposes

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[3] Act of Dec. 22, 2017, Pub. L. No. 115-97, § 12001, 131 Stat. 2054, 2092–94.

[4] H.R. Rep. No. 115-409, at 224 (2017).

from the other corporation. In other words, for purposes of determining the taxpayer's adjusted financial statement earnings, the proposal would generally disregard the undistributed earnings of related corporations that are not included on the taxpayer's consolidated return.

TEI is concerned that the proposed rule may not apply as intended in cases where a long-term, strategic investment, such as a less-than-20% investment in another corporation's capital stock, is accounted for under the fair value method of accounting for financial reporting purposes. As a general rule, investments representing less than 20% of the investee corporation's voting stock are accounted for at either amortized cost or fair value, in accordance with the Financial Accounting Standards Board's Accounting Standards Codification ("ASC") Topic 320, *Investments—Debt and Equity Securities*, and ASC Topic 321, *Investments—Equity Securities*.[5] These pronouncements establish essentially a mark-to-market valuation approach whereby investments in equity securities generally must be accounted for at their fair values, with annual unrealized changes in fair value recognized in the year's net income.[6]

If a taxpayer accounts for its investment in a lower-tier corporation under the fair value method for financial reporting purposes, the taxpayer would use a mark-to-market method to report the change in value of the lower-tier corporation. This generally would not match, or perhaps even correspond with, the lower-tier corporation's earnings during such period. And because the fair value method is not tied to the earnings of the lower-tier corporation, it appears that the proposed rule would not, as currently drafted, apply to disregard the fair value method for purposes of determining the taxpayer's adjusted financial statement income.

TEI sees no policy justification for the disparate treatment of taxpayers that apply the equity method of accounting versus the fair value method of accounting for financial reporting purposes. A more rational, simpler approach would be one that treats mark-to-market investment gains in parity with the equity method of accounting. Any such gains would be disregarded for purposes of determining the taxpayer's adjusted financial statement income, which would take into account any recognized capital gains, dividends received, or other amounts required to be included in gross income for tax purposes as the proposal contemplates.

Deduction for Financial Statement Net Operating Loss

Similar to the rules for computing regular taxable income, a taxpayer's adjusted financial statement income would be reduced by financial statement net operating losses subject to an 80% adjusted-financial-statement-income limitation. Unlike the current tax rules, however,

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[5] 1 D. Edward Martin, *Attorney's Handbook of Accounting, Auditing & Financial Reporting* § 5.03 (2021). At levels of 20% to 50%, however, generally accepted accounting principles ("GAAP") require that certain investments in capital stock be accounted for under the equity method of accounting. *See id.* at § 4.06. And while application of the equity method results in the investor's including in net income its proportionate share of the income or losses of the investee corporation for financial reporting purposes, the proposed rule would generally disregard this equity method accounting treatment for purposes of determining the taxpayer's adjusted financial statement earnings.

[6] *See* Martin, *supra* note 5, at § 5.03.

financial statement net operating loss for this purpose would be determined by taking into account only the amount of the net loss (if any) set forth on the corporation's applicable financial statement for taxable years ending after December 31, 2019.

TEI questions the policy rationale for limiting the carryover of financial statement net operating losses to only those appearing on the corporation's applicable financial statements for taxable years ending after December 31, 2019. Indeed, the legislative record does not appear to offer any justification for limiting a taxpayer's ability to take into account pre-2020 financial statement net operating losses, which would represent a drastic departure from the rules for computing regular taxable income. Those rules, to which the legislative record refers,[7] generally permit the indefinite carryforward of net operating losses arising in taxable years beginning after December 31, 2017.[8] At a minimum, therefore, Congress should revise the proposal to define "financial statement net operating loss" for this purpose as the amount of the net loss (if any) set forth on the corporation's applicable financial statement for taxable years ending after December 31, 2017.

Deduction for Depreciation

Beyond the concerns raised with the proposal's treatment of net operating losses above, TEI remains deeply concerned about the potential imposition of a new corporate AMT that is based on adjusted financial statement income. Enacting such a policy would have the perverse effect of negating the benefits of certain investment tax incentives and thereby undermining one of the Biden administration's overarching policy objectives for the BBBA—increasing private sector development and investment in clean energy, efficiency, and electrification.[9] For instance, financial accounting generally employs straight-line depreciation over the useful lives of assets, under which an investment's cost is recorded in the same accounting period as the income earned from the asset. Federal income tax law, in contrast, has long sought to promote capital investment and stimulate economic growth through accelerated (bonus) depreciation deductions.[10] Thus, using adjusted financial statement income as the base for a new corporate AMT would effectively nullify the intended tax benefits from bonus depreciation because depreciation is not accelerated for financial statement purposes.[11] In other words, accelerated

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[7] *See* Staff of H.R. Comm. on the Budget, 117th Cong., *Build Back Better Act – Rules Committee Print 117-18 Section-by-Section Summary* 159 (Comm. Print 2021), https://rules.house.gov/sites/democrats.rules.house.gov/files/Section_by_Section_BBB_RCP117-18__.pdf.

[8] *See* I.R.C. § 172(a)(2). Unless otherwise indicated, all references to "section" herein are to sections of the Internal Revenue Code of 1986, as amended ("Code" or "I.R.C.).

[9] *See* H.R. Rep. No. 117-130, at 5 (2021).

[10] *See, e.g.*, Gary Guenther, Cong. Rsch. Serv., *RL31852, The Section 179 and Section 168(k) Expensing Allowances: Current Law and Economic Effects* (2018) (examining the current status, legislative history, and main economic effects of the section 168(k) bonus depreciation allowance).

[11] *See, e.g.*, Made in America: Effect of the U.S. Tax Code on Domestic Manufacturing, Hearing Before the S. Comm. on Fin., 117th Cong. (2021) (statement of Michelle Hanlon, Howard W. Johnson Professor, Sloan Sch. of Mgmt.,

depreciation deductions that would otherwise be available to incent private sector development and investment in renewable energy projects, for example, would not be protected from the proposed corporate AMT.

TEI's Recommendations

For all the reasons discussed above, TEI respectfully—and strongly—urges Congress to reconsider its decision to include this new book-based corporate AMT proposal in the BBBA. If Congress ultimately believes, however, that adopting a new corporate AMT is critical to achieving its policy aims, then it should at least consider revising the current proposal to more closely resemble the pre-2018 corporate AMT regime—which was based on alternative minimum *taxable* income.

Corporate AMT Foreign Tax Credit

Should Congress elect to retain the problematic book-based corporate AMT proposal in final legislation, TEI would implore congressional taxwriters to revisit the proposed treatment of foreign tax credits thereunder, as discussed immediately below.

Under the current proposal, tentative minimum tax could be reduced by a corporate AMT foreign tax credit, which would apply for foreign income taxes that are paid or accrued (for U.S. federal income tax purposes) and taken into account on an applicable financial statement. Foreign income taxes paid or accrued by controlled foreign corporations ("CFCs"), however, would be subject to a single global limitation equal to 15% of the net aggregate adjusted financial statement income of all CFCs, with a five-year carryover for excess foreign tax credits.[12] TEI unequivocally opposes this limitation because its adoption would increase the incidence of unmitigated international double taxation on applicable corporations.

Since 1918, Congress has repeatedly recognized the perils of double taxation in enacting and amending the foreign tax credit—a non-incentive credit specifically intended to mitigate the incidence of international double taxation.[13] The legislative history of the foreign tax credit evidences Congress's belief not only that American prosperity depends on the competitiveness of U.S. companies operating abroad but also that double taxation would unfairly impede this

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Massachusetts Inst. of Tech.). Depending on how the rules are written, the effect of the proposed corporate AMT could be very harsh. For example, during periods of accelerated depreciation the corporate AMT would apply to deny the deduction, while in later periods with no remaining taxable depreciation, the higher taxable income would be the tax base. *Id.*

[12] Conversely, foreign income taxes paid or accrued directly by a domestic corporation, such as withholding taxes or the taxes paid on income of a foreign branch, would not subject to a limitation. The policy rationale for this disparate treatment of creditable foreign income taxes is unclear.

[13] *See generally* Michael J. Graetz & Michael M. O'Hear, *The Original Intent of U.S. International Taxation*, 46 Duke L.J. 1021 (1997).

competitiveness.[14] In favorably reporting the Tax Reform Act of 1976, the Senate Committee on Finance summarized the crux of the matter:

> This foreign tax credit system embodies the principle that the country in which a business activity is conducted (or in which any income is earned) has the first right to tax the income arising from activities in that country, even though the activities are conducted by corporations or individuals resident in other countries. Under this principle, the home country of the individual or corporation has a residual right to tax income arising from these activities, *but recognizes the obligation to insure that double taxation does not result*. . . . For U.S. taxpayers . . . the foreign tax credit system, providing a dollar-for-dollar credit against U.S. tax liability for income taxes paid to a foreign country, is the mechanism by which double taxation is avoided.[15]

More recently, in 2004, the House Committee on Ways and Means confronted a similar issue under the former corporate AMT regime, which had a far more permissive 90% limitation on the utilization of the alternative minimum foreign tax credit. In favorably reporting the legislation that would repeal this limitation,[16] the Committee provided its reason for the change: "The Committee . . . believes that taxpayers should be permitted full use of foreign tax credits in computing the AMT."[17] TEI echoes the Committee's belief and respectfully urges Congress to amend the current AMT proposal accordingly.[18]

Modifications to Deduction for Foreign-Derived Intangible Income and Global Intangible Low-Taxed Income

TEI members overwhelmingly identified the BBBA's proposed reduction in the deduction percentages for foreign-derived intangible income ("FDII") and global intangible low-taxed income ("GILTI") as a source of significant concern, given the prospect of creating a competitive disadvantage for U.S.-headquartered businesses relative to their non-U.S. headquartered competitors.[19]

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[14] *See, e.g.*, H.R. Rep. No. 65-767, at 91 (1918), *reprinted in* 1939-1 C.B. (pt. 2) 86, 93.

[15] S. Rep. No. 94-938, at 233 (1976) (emphasis added).

[16] American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 421, 118 Stat. 1418, 1514.

[17] H.R. Rep. No. 108-548, at 137 (2004).

[18] If Congress ultimately declines to adopt this important recommendation, then it should at least clarify the language of proposed section 59(*l*)(1)(A)(ii) to ensure the proposed corporate AMT foreign tax credit limitation would actually apply to the net aggregate adjusted financial statement income of all CFCs by taking into account any adjustments to disregard certain taxes (e.g., any foreign income, war profits, or excess profits taxes within the meaning of section 901 that are taken into account on the taxpayer's applicable financial statement) under proposed section 59A(c)(5).

[19] GILTI means, with respect to any U.S. shareholder for the shareholder's taxable year, the excess (if any) of the shareholder's net CFC tested income over the shareholder's net deemed tangible income return, I.R.C. § 951A(b)(1),

Background

Under current law, domestic corporations are subject to reduced effective rates of U.S. tax on their FDII and their GILTI by means of a deduction in section 250. For a domestic corporation's taxable years beginning before January 1, 2026, section 250 generally allows as a deduction an amount equal to the sum of 37.5% of its FDII and 50% of its GILTI (including the corresponding section 78 gross-up amount).[20] As a result, the current effective tax rates on FDII and GILTI generally equal 13.125%.[21]

This congruity in effective tax rates on FDII and GILTI was intentional and reflects Congress's goal of removing the tax incentive to locate intangible income abroad while encouraging U.S. taxpayers to locate intangible income, and potentially valuable economic activity, in the United States.[22] As the Senate Committee on Finance explained at the time of GILTI's enactment, "offering similar, preferential rates for intangible income derived from serving foreign markets, whether through U.S.-based operations or through [controlled foreign corporations], reduces or eliminates the tax incentive to locate or move intangible income abroad, thereby limiting one margin where the Code distorts business investment decisions."[23] TEI views this parity among effective tax rates as an essential tenet of today's U.S. international tax system—one worthy of preserving through 2025 and beyond.

Reduction in Deduction Percentages for FDII and GILTI

Section 138121 of the BBBA would reduce the section 250 deduction percentages for FDII to 24.8% (from 37.5%) and for GILTI to 28.5% (from 50%). Combined with the BBBA's proposal to reduce the GILTI foreign tax credit "haircut" in section 960(d)(1), this proposal would yield an effective tax rate on FDII of approximately 15.792% and an effective tax rate on GILTI of approximately 15.805%.[24]

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while a domestic corporation's FDII is the portion of its intangible income, determined on a formulaic basis, that is derived from serving foreign markets, *see* I.R.C. § 250(b).

[20] I.R.C. § 250(a)(1). Under section 78, a taxpayer claiming the foreign tax credit with respect to foreign-source income generally must include in income the amount of the related foreign taxes paid.

[21] Because only 80% of foreign tax credits are allowed to offset U.S. tax on GILTI, the minimum foreign tax rate on GILTI at which no U.S. residual tax is owed by a domestic corporation is 13.125%. H.R. Rep. No. 115-466, at 626 (2017) (Conf. Rep.).

[22] S. Comm. on the Budget, 115th Cong., *Reconciliation Recommendations Pursuant to H. Con. Res. 71*, S. Prt. No. 115-20, at 375 (Comm. Print 2017).

[23] *Id.*

[24] *See, e.g.*, KPMG LLP, *KPMG Report: 'Build Back Better Act' Tax Proposals in Pending House Bill* 49–50 (Nov. 11, 2021), https://assets.kpmg/content/dam/kpmg/us/pdf/2021/11/tnf-bbba-tax-proposals-pending-house-bill-nov11-2021.pdf.

TEI commends the House of Representatives for advancing a proposal that would generally maintain the complimentary nature of these two regimes. TEI's concern with this proposal involves its compatibility with two of Congress's principal aims in advancing the BBBA itself—namely, improving our economic outlook and setting America up to compete and win in the decades ahead (i.e., U.S. economic competitiveness).[25] The OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting ("BEPS"), of which the United States is a leading member, recently announced having reached a long-sought agreement on a two-pillar solution to address the tax challenges arising from the digitalization of the economy ("OECD/G20 Agreement").[26] Pillar Two of this agreement includes a global minimum tax that would apply a minimum rate of 15% on a jurisdictional basis—a measure the Biden administration describes as intended to help end the "race to the bottom" on corporate tax rates in a manner that puts the United States and other countries on a more level playing field.[27] In view of this agreement, TEI is concerned that the proposed 15.805% effective tax rate on GILTI would pose a competitive disadvantage for U.S.-headquartered businesses relative to their non-U.S. headquartered competitors.

TEI Recommendation

TEI respectfully recommends that Congress revise section 138121 of the BBBA to ensure U.S. economic competitiveness through the retention of complimentary effective tax rates on GILTI and FDII that do not exceed 15%.

Modifications to Inclusion of GILTI and Modifications to Foreign Tax Credit Limitations

Two other areas of significant, widespread concern among TEI members involve the BBBA's proposed modifications to the GILTI regime and parallel modifications to the Code's foreign tax credit limitation rules. If enacted in their current form, TEI believes the following proposals would not only impose unnecessarily harsh compliance burdens on taxpayers but also be extraordinarily difficult, if not impracticable, for the Internal Revenue Service ("IRS") to administer, imposing additional strain on our self-assessment tax system. TEI is also concerned that these proposals would risk needlessly encumbering U.S. economic competitiveness abroad by exceeding the pace and scope of the OECD/G20 Agreement. The recommendations set forth below are intended to mitigate both of these undesirable consequences in a manner consistent with longstanding principles of sound tax policy.

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[25] H.R. Rep. No. 117-130, at 4 (2021).

[26] OECD/G20 Base Erosion and Profit Shifting Project, *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (Oct. 8, 2021), https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf [hereinafter "OECD/G20 Statement"].

[27] U.S. Dep't of the Treas., *General Explanations of the Administration's Fiscal Year 2022 Revenue Proposals* 5–6 (May 2021).

Background

Under section 951A of the Code, a U.S. shareholder of any CFC must include in gross income for a taxable year its GILTI in a manner generally similar to inclusions of subpart F income. GILTI is calculated at the U.S. shareholder level after aggregating both certain income (net CFC tested income) and adjusted basis in tangible depreciable property (net deemed tangible income return) on a pro rata basis across each CFC with respect to which it is a U.S. shareholder.[28] Congress enacted section 951A in 2017 as an anti-base erosion measure aimed at highly mobile intangible income subject to low effective tax rates.[29] This novel, complex regime is intended to ensure a global minimum effective tax rate on GILTI in the range of 10.5% to 13.125% through the imposition of a residual U.S. tax.[30]

Enacted as part of Public Law 115-97,[31] informally known as the Tax Cuts and Jobs Act ("TCJA"), section 951A became effective for taxable years beginning after December 31, 2017. But despite the provision's near-immediate effect, the Department of the Treasury ("Treasury") was able to issue only one of five final regulations under section 951A within the 18 months the agency generally has to issue regulations that are retroactive to the date of a law's enactment or before taxpayers were required to file tax or information returns affected by section 951A.[32] More broadly, of the 51 planned final regulations to implement the TCJA's business and international provisions, Treasury issued only five within this critical 18-month time frame.[33]

The significant, costly challenges encountered by the IRS and taxpayers in attempting to implement and comply with the TCJA's international provisions—many of which were either retroactively or immediately effective on the law's enactment—are well documented.[34] For

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[28] GILTI means, with respect to any U.S. shareholder for the shareholder's taxable year, the excess (if any) of the shareholder's net CFC tested income over the shareholder's net deemed tangible income return. I.R.C § 951A(b)(1). And a shareholder's net deemed tangible income return generally equals 10% of the aggregate of the shareholder's pro rata share of the qualified business asset investment of each CFC with respect to which it is a U.S. shareholder. I.R.C. § 951A(b)(2).

[29] *See* S. Comm. on the Budget, 115th Cong., *Reconciliation Recommendations Pursuant to H. Con. Res. 71*, S. Prt. No. 115-20, at 370 (Comm. Print 2017).

[30] *See* H.R. Rep. No. 115-466, at 626–27 (2017) (Conf. Rep.) (explaining the legislative intent that "[a]t 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").

[31] Act of Dec. 22, 2017, Pub. L. No. 115-97, 131 Stat. 2054.

[32] *See* U.S. Gov't Accountability Off., GAO-21-277, *Tax Cuts and Jobs Act - Future Rulemaking Should Provide Greater Detail on Paperwork Burden and Economic Effects of International Business Provisions* 16–19 (2021). Section 7805(b)(2) allows for the retroactive application of Treasury regulations filed or issued within 18 months of the date of the enactment of the statutory provision to which the regulation relates.

[33] U.S. Gov't Accountability Off., GAO-20-103, *Tax Cuts and Jobs Act - Considerable Progress Made Implementing Business Provisions, but IRS Faces Administrative and Compliance Challenges* 34 (2020).

[34] *See, e.g.*, TIGTA, Ref. No. 2019-34-064, *Tax Cuts and Jobs Act: Assessment of the Implementation of the International Provisions* (2019).

Treasury and the IRS, implementing a new legislative provision like section 951A involves issuing regulations and other guidance to taxpayers describing the new law and its requirements, developing new tax forms and instructions and modifying existing ones, providing training to IRS employees, and updating the Internal Revenue Manual, among other things.[35] And for taxpayers, the intervening uncertainty about future tax liabilities makes business planning more difficult and can affect their ability to comply with the law. The experience of TEI members in attempting to implement and comply with the TCJA's international provisions bears this out and offers a cautionary tale for Congress as it contemplates the BBBA.

Country-by-Country Application of Section 951A Based on CFC Taxable Units

Section 138126 of the BBBA would fundamentally transform the application of the GILTI regime from one calculated on an aggregate (global) basis into one calculated on a country-by-country basis by incorporating a "CFC taxable unit" concept as the mechanism for identifying each country with respect to which a CFC is subject to tax or in which a CFC has a taxable presence.[36] Notwithstanding the lessons learned from TCJA implementation, however, this provision would apply to taxable years of foreign corporations beginning after December 31, 2022—barely one year from now.

A major impetus for proposing such a seismic change to the application of the GILTI regime—only four years after its enactment—is the imperative to coordinate our international tax rules with those being negotiated by the OECD/G20 Inclusive Framework on BEPS. As previously mentioned, the United States and the international community recently reached a multilateral agreement on country-by-country global minimum taxation that's intended to harmonize international tax rules, stop digital services taxes, and help end the "race to the bottom" on corporate tax rates in a manner that puts the United States and other countries on a more level playing field.[37] Under this agreement, the global minimum tax would apply a minimum rate of 15% on a per-country basis and "should be brought into law in 2022, to be effective in 2023."[38] In describing the work needed to implement the two-pillar solution, however, the annex to the OECD/G20 Agreement reveals that the contemplated effective date of 2023 is overly ambitious.

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[35] *See, e.g.*, TIGTA, Ref. No. 2019-34-033, *Implementation of the TCJA Deemed Repatriation Tax Presented Significant Challenges* 3 (2019). One of these "other things" concerns the IRS's ability to process affected tax or information returns, for which the Tax Forms and Publications function, the Information Technology organization, and the Wage and Investment Division's Submission Processing function typically need at least 18 months to develop and program the intake requirements for a new tax form. *Id.* at 13.

[36] This "CFC taxable unit" concept would generally mirror the BBBA's proposed "taxable unit" standard to be adopted for purposes of applying the Code's foreign tax credit limitation provisions, discussed below.

[37] Press Release, H.R. Comm. on Ways & Means, Neal, Wyden Statement on Upcoming G7 Meetings, Status of OECD Negotiations (June 3, 2021), https://waysandmeans.house.gov/media-center/press-releases/neal-wyden-statement-upcoming-g7-meetings-status-oecd-negotiations; U.S. Dep't of the Treas., *General Explanations of the Administration's Fiscal Year 2022 Revenue Proposals* 5–6 (May 2021).

[38] OECD/G20 Statement, *supra* note 26, at 5.

For instance, the annex provides that an implementation framework will be developed to facilitate the coordinated implementation of the global minimum tax by the end of 2022—effectively leaving no margin for error.[39] Indeed, most experts believe that we are years away from full implementation of the OECD framework by other countries.[40] Switzerland, for example, has already indicated that it will be challenging for it to implement the global minimum tax by 2023.[41]

TEI supports the Committee's effort to level the playing field for U.S. companies to compete globally through legislation that generally reflects the substance of the OECD/G20 Agreement. In the same vein, however, TEI believes it's equally imperative that such legislation also reflect the *realistic* implementation timeline of the OECD/G20 Agreement. Only such a coordinated global approach to international tax policy would avoid the negative impacts of unilateral or preemptive U.S. action in this area.[42]

TEI Recommendation

TEI strongly recommends that Congress revise section 138126 of the BBBA to delay the provision's general effective date by one additional year—applying to taxable years of foreign corporations beginning after December 31, 2023. As recent experience with the TCJA demonstrates, such a delayed effective date would allow for more rational implementation and administration of the new country-by-country regime by the IRS and taxpayers alike. A delayed effective date would also mitigate the competitive disadvantage of subjecting U.S.-based companies to a global minimum tax regime before their foreign counterparts become subject to one. Moreover, it would also preserve Congress's prerogative to react legislatively if needed to protect U.S. economic competitiveness based on the final, implemented OECD/G20 Agreement.[43] For instance, Congress could pursue additional modifications to the GILTI regime to make it more closely resemble a true global minimum tax by allowing taxpayers to use the full value of their foreign tax credits—by eliminating the GILTI foreign tax credit haircut and the inclusion percentage haircut on losses—and carry forward any excess foreign tax credits to offset future minimum tax liability.

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[39] *See id.* at 7.

[40] H.R. Rep. No. 117-130, at 1486 (2021).

[41] KPMG LLP, *KPMG Report: OECD/G20 Inclusive Framework Agreement on BEPS 2.0* 12 (Oct. 9, 2021), https://assets.kpmg/content/dam/kpmg/us/pdf/2021/10/tnf-inclusive-framework-oct9-2021.pdf.

[42] *See, e.g.*, Letter from Hon. Bradley S. Schneider et al. to Hon. Richard E. Neal, Chair, H.R. Comm. on Ways & Means (Aug. 4, 2021), https://www.taxnotes.com/tax-notes-today-international/corporate-taxation/democratic-lawmakers-urge-coordination-oecd/2021/08/13/775j6; *accord* H.R. Rep. No. 117-130, at 1486 (2021) (arguing that in no event should we make GILTI changes that disadvantage Americans in the global economy, nor should we make any changes to GILTI before our trading partners have implemented a global minimum tax of their own).

[43] *See* Letter from Hon. Tom O'Halleran et al. to Hon. Nancy Pelosi, Speaker of the H.R., and Hon. Richard Neal, Chair, H.R. Comm. on Ways & Means (Oct. 8, 2021), https://www.taxnotes.com/tax-notes-today-international/global-intangible-low-taxed-income-gilti/lawmakers-recommend-caution-gilti-changes/2021/10/20/7bcn7.

Reduction in Net Deemed Tangible Income Return for Purposes of Determining GILTI

As discussed above, section 951A was enacted as an anti-base erosion measure targeted at highly mobile intangible income subject to low effective tax rates. Understanding that not all asset categories should be treated the same, it included a 10% deduction for qualified business asset investment ("QBAI"), which is meant to approximate a routine return generated by tangible assets such as factories.[44] Congress's rationale was straightforward: tangible property and the associated tangible income are relatively immobile and an indicator of the extent to which a CFC has active business operations and presence in any particular jurisdiction.[45]

On top of requiring country-by-country application of GILTI based on CFC taxable units, section 138126 of the BBBA would generally reduce the deemed rate of return on the aggregate of a U.S. shareholder's pro rata share of the QBAI of each of its CFC taxable units in a country from 10% to 5% for purposes of determining the U.S. shareholder's net deemed tangible income return. This approach contrasts vividly with that of the OECD/G20 Agreement, which provides for a formulaic substance carve-out that would initially exclude an amount of income that is 8% of the carrying value of tangible assets and 10% of payroll.[46]

TEI Recommendation

TEI respectfully recommends that Congress revise the provision to maintain the 10% deemed rate of return under existing law or, at a minimum, harmonize it with the OECD/G20 Agreement's formulaic substance carve-out. Enacting tax policy in the United States that is more burdensome than the policy reflected in the OECD/G20 Agreement would needlessly risk U.S. economic competitiveness. Here again, the tax law should not pose a competitive disadvantage for U.S.-headquartered businesses relative to their non-U.S. headquartered counterparts.

Country-by-Country Application of Section 904 Foreign Tax Credit Limitations

Section 138124 of the BBBA would apply the Code's foreign tax credit limitation rules on a country-by-country basis, based on taxable units, thereby preventing taxpayers from using excess foreign tax credits from foreign taxes paid to high-tax countries to reduce their U.S. tax

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[44] *See* Letter from Hon. Vicente Gonzalez et al. to Hon. Nancy Pelosi, Speaker of the H.R., and Hon. Charles Schumer, S. Majority Leader (Sept. 24, 2021), https://gonzalez.house.gov/sites/gonzalez.house.gov/files/09.24.21%20O%26G%20LTR%20to%20Speaker%20Pelosi%20and%20Majority%20Leader%20Schumer.%20pdf.pdf.

[45] S. Comm. on the Budget, 115th Cong., *Reconciliation Recommendations Pursuant to H. Con. Res. 71*, S. Prt. No. 115-20, at 371 (Comm. Print 2017).

[46] OECD/G20 Statement, *supra* note 26, at 4. The OECD/G20 agreement's formulaic substance carve-out is slated to decline annually by 0.2 percentage points for the first five years, and by 0.4 percentage points for tangible assets and by 0.8 percentage points for payroll for the next five years. *Id.*

liability on income earned in low-tax countries. The provision would require each separate limitation category ("basket"), for purposes of sections 904, 907, and 960, to be applied separately on a per-country basis by taking into account the aggregate income properly attributable or otherwise allocable to the taxpayer's taxable unit(s) that are tax resident(s) of each country. The proposal would also provide a special separate limitation loss ("SLL") rule with respect to income in the GILTI foreign tax credit basket, whereby the amount of the SLLs for any taxable year would reduce income in the GILTI basket for that year only to the extent the aggregate amount of such losses exceeds the aggregate amount of the separate limitation incomes (not including income in the GILTI basket) for the taxable year.

Like the BBBA's modifications to apply GILTI on a country-by-country basis, discussed above, this provision would generally apply to taxable years of foreign corporations beginning after December 31, 2022.

TEI Recommendations

TEI is concerned that, if enacted in its current form, the provision's special SLL rule would expose taxpayers to potential instances of unmitigated international double taxation of income in the GILTI foreign tax credit basket. This exposure would result from the fact that excess SLL in a non-GILTI basket could still offset separate limitation income in the GILTI basket for a *different* country, potentially preventing the taxpayer's use of associated foreign tax credits. In other words, while the proposed country-by-country application of section 904 aims to end the "blending" of jurisdictional foreign tax crediting, such blending would nonetheless continue under the provision's special SLL rule.

To minimize the risk that U.S. taxpayers would be subject to unmitigated double taxation of foreign-source income as described above, TEI recommends that Congress amend section 951A to affirmatively clarify the treatment of CFC income that is subject to a high rate of foreign tax. Such an amendment should expressly allow taxpayers an annual election to exclude income of a CFC taxable unit from treatment as "tested income" under section 951A if such income is subject to an effective foreign tax rate of at least 15%, applying U.S. tax principles. This high-tax exclusion could be modeled on existing Treasury regulations,[47] provided that taxpayers are permitted to make the election annually and on a per-country basis. Such an election would help avoid inequitable results in cases where, due to timing differences between U.S. and foreign law, the effective tax rate with respect to a particular country may vary significantly from year to year and applying the high-tax exclusion could itself expose the taxpayer to double taxation. This approach would more closely align with Pillar Two of the OECD/G20 Agreement while still preventing taxpayers from using excess foreign tax credits from foreign taxes paid to high-tax countries to reduce their U.S. tax liability on income earned in low-tax countries.

[47] *E.g.*, Guidance Under Sections 951A and 954 Regarding Income Subject to a High Rate of Foreign Tax, T.D. 9902, 85 Fed. Reg. 44,620 (July 24, 2020).

In addition, and consistent with our recommendations above concerning the BBBA's modifications to apply GILTI on a country-by-country basis, TEI strongly recommends that Congress revise section 138124 of the BBBA to delay the provision's general effective date by one additional year—applying to taxable years of foreign corporations beginning after December 31, 2023. Here again, such a delayed effective date would allow for more rational implementation and administration of the proposed country-by-country regime by the IRS and taxpayers alike.

Modification of Foreign Tax Credit Carryback and Carryforward

Section 138124(c) of the BBBA would repeal the existing one-year carryback of excess foreign tax credits with respect to all baskets while also repealing the current limitation on the carryforward of excess foreign tax credits in the GILTI basket. The provision would temporarily limit, however, the carryforward of excess foreign taxes in the GILTI basket to five succeeding taxable years for any such taxes paid or accrued in taxable years beginning before January 1, 2031. This five-year limitation would no longer apply for taxable years beginning after December 31, 2030, at which point excess foreign tax credits in any basket could be carried forward for up to ten succeeding taxable years under section 904(c).

TEI Recommendation

TEI respectfully recommends that Congress amend this provision to eliminate the temporary limitation on the carryforward of excess foreign taxes in the GILTI basket to only five succeeding taxable years. Adopting this recommendation would eliminate the needless additional complexity associated with implementing and administering such a temporary, GILTI-specific foreign tax credit limitation, consistent with the goals of simplicity and administrability—two of the most fundamental, well-established principles of sound tax policy.

Limitations on Deduction for Interest Expense

Section 138111 of the BBBA would limit the amount of net interest expense deductible by a "specified domestic corporation," defined as a domestic corporation which is a member of an "international financial reporting group," a multinational group that prepares an applicable financial statement, and has average business interest expense for the three-taxable-year reporting period ending with such taxable year in excess of $12 million annually. For such corporations, the deductible amount of interest expense would be capped at the "allowable percentage" of 110% of its net interest expense. The provision would operate concurrently with the existing limitation in section 163(j), and the amount of interest that could be deductible in any tax year would be determined by the more *restrictive* of the two limitations.

Provisions similar to the existing limitation on the deduction for business interest expense in section 163(j) of the Code and the proposed limitation in section 138111 of the BBBA are found in the laws of other countries and are discussed in the OECD's BEPS Action 4 report.[48] Under the OECD's recommended approach, however, taxpayers can deduct interest expense based on whichever of the two limitations allows for a *greater* interest expense deduction.

TEI Recommendation

Consistent with TEI's other recommendations herein, Congress should endeavor to preserve U.S. economic competitiveness by aligning the concurrent operation of both limitations to the OECD's recommended approach, whereby the amount of interest that would be deductible in any taxable year would be determined by the more permissive of the two limitations.

Modifications to Base Erosion and Anti-abuse Tax

Section 138131 of the BBBA would make several important modifications to the base erosion and anti-abuse tax ("BEAT") regime in section 59A of the Code. One of these changes would generally except from the definition of "base erosion payment" an amount paid to a foreign related person if the taxpayer establishes that such amount was subject to an effective rate of foreign income tax that is not less than the lesser of 15% or the applicable BEAT rate. And except as otherwise provided by Treasury, the provision would allow taxpayers to establish the effective rate of foreign income tax with respect to any amount on the basis of applicable financial statements (as defined in section 451(b)(3)). Treasury, in turn, would be granted broad regulatory authority to implement the provision, including to provide procedures for determining the effective rate of foreign income tax to which any amount is subject.

By proposing to incorporate an effective-foreign-tax-rate test into BEAT, the provision seeks to better align the U.S. BEAT regime with Pillar Two of the OECD/G20 Agreement. Pillar Two includes an Undertaxed Payment Rule ("UTPR"), which would deny deductions or require an equivalent adjustment to the extent that low-tax income of a constituent entity is not subject to tax under a qualifying income inclusion rule (e.g., one with a minimum tax rate of 15%).[49] According to the OECD/G20 Statement, the UTPR would use an effective tax rate test that is calculated on a jurisdictional basis and that uses a common definition of covered taxes and a tax base determined by reference to financial accounting income (with certain adjustments).[50]

TEI Recommendations

TEI commends the Committee for advancing a number of constructive recommendations to reform the scope and operation of the BEAT regime, including the proposal to exclude certain payments subject to sufficient foreign tax. Properly structured, this proposal could help

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[48] *See* OECD/G20 Base Erosion and Profit Shifting Project, *Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 - 2016 Update* (2017), http://dx.doi.org/10.1787/9789264268333-en.

[49] OECD/G20 Statement, *supra* note 26, at 3.

[50] *Id.* at 4.

mitigate the overinclusiveness of the existing regime, which generally fails to distinguish between base-eroding payments made to low-tax affiliates and those made elsewhere. At the same time, however, TEI is deeply concerned about the provision's lack of clear legislative rules for establishing the effective rate of foreign income tax to which an amount is subject. Given the provision's apparent cliff effect, whereby an entire amount would be treated as a base erosion payment if the effective rate of foreign income tax were deemed to be insufficient (e.g., 14.9%), it is imperative that Congress revise the proposal to provide clear statutory guideposts in this area. Furthermore, consistent with other recommendations herein, TEI recommends that Congress either adopt or specifically authorize Treasury to issue regulations adopting an approach that conforms to the effective tax rate test used by the UTPR in Pillar Two of the OECD/G20 Agreement.

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The preceding comments were developed by members of several TEI standing committees under the aegis of TEI's Tax Reform Task Force, whose chair is Jason Weinstein. Principal responsibility for drafting TEI's comments was exercised by Watson M. McLeish, TEI Tax Counsel. If you have questions about TEI's comments, please contact Mr. Weinstein at [redacted] or [redacted], or Mr. McLeish at (202) 470-3600 or wmcleish@tei.org.