NATIONAL FOREIGN TRADE COUNCIL

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THE HOUSE COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON TAX
HEARING
ON
BIDEN'S GLOBAL TAX SURRENDER HARMS
AMERICAN WORKERS AND OUR ECONOMY

July 19, 2023

Good afternoon, Chairman Kelly and Ranking Member Thompson and members of the Tax Subcommittee. Thank you for holding this hearing today about one of the most important matters in international taxation and inviting me to testify. I am the Vice President for International Tax Policy at the National Foreign Trade Council ("NFTC").

The NFTC, organized in 1914, is an association of nearly 100 U.S. business enterprises engaged in all aspects of international trade and investment. Our membership covers the full spectrum of industrial, commercial, financial, and service activities, and we seek to foster an environment in which U.S. companies can be dynamic and effective competitors in the international business arena. To achieve this goal, American businesses must be able to participate fully in business activities throughout the world by the export of goods, services, technology, and entertainment, and through direct investment in facilities abroad. NFTC members play an important role in ensuring a healthy national economy and promoting U.S. global leadership. It is vital to the health of U.S. enterprises and to their continuing ability to contribute to the U.S. economy that they be free from discriminatory foreign taxes, double taxation, and other non-tax barriers to the flow of capital that impede full participation in the international marketplace. NFTC, therefore, seeks to foster a level playing field in which U.S. businesses can be dynamic and effective competitors in the domestic and international business arena.

On balance, the work of the Inclusive Framework on Pillars One and Two fails to achieve this in several respects, and in too many instances specifically harms the competitiveness of American businesses. While some of that harm has been mitigated by recently announced delays in implementation, these delays do not provide fundamental changes to the policy. American businesses have been deeply engaged with the Inclusive Framework through Organization for Economic Co-operation and Development ("OECD") consultations and other discussions with U.S. and foreign officials, with a significant expenditure of time and resources. The business community's deep concerns about these policies are well known and understood. American businesses have also been building systems to comply with impending tax systems that are not yet even fully developed. And while the goal of this work is to bring stability to the international tax system, in reality, the work at its core is destabilizing and increasing uncertainty for U.S. businesses. The continued engagement of Congress is essential to creating that stability and protecting American interests.

As our time today is limited, I won't delve into the technical tax issues and problematic policies which NFTC and other business groups have enumerated in countless comment letters and discussions with the OECD, the U.S. Treasury and Foreign Governments. Instead, I will focus on the high-level impacts on the U.S. business community and how this process has hurt American workers by disadvantaging employers with U.S. headquarters or significant U.S. operations.

Pillar One

At the outset, Pillar One was created to provide a global framework that ensures greater allocation of income tax revenue to "market jurisdictions" for cross-border remote sales in exchange for countries agreeing not to impose their own digital services taxes ("DSTs") and other unilateral policies to impose new taxes on the gross income of (almost exclusively) U.S. technology firms. The deal promised tax certainty for taxpayers potentially subject to DSTs and additional income tax revenue for the market jurisdictions. Pillar One comprises two parts. The first part is Amount A, which is a new taxing right applicable to market countries irrespective of physical presence, and reflects the amount of additional revenue to be taxed by these "market jurisdictions." The second part is Amount B, a safe harbor for returns on certain routine distribution activities which would provide a significant increase in certainty for both taxpayers and tax administrations because controversy over distribution profits comprises the lion's share of controversy between authorities and taxpayers globally. The current consensus requires that countries cease enforcement of existing DSTs and refrain from introducing new DSTs (commonly referred to as "standstill"). DSTs, however, are proliferating around the world – sometimes with slightly different labels but always with the same impact. The initial DST moratorium until the end of 2023 was a welcome development. However, the recent extension until the end of 2024 by most countries is essentially contingent upon the U.S. agreeing to a yet to be finalized plan by signing an Amount A Multilateral Convention (MLC) before the end of 2023. This is the case despite the fact that key elements of the agreement have not been shared with the business community or, indeed, with Congress.

Canada, for example, would like to implement a DST and therefore did not join the OECD statement last week. The NFTC opposes this outlier position by Canada to begin imposition of a new DST despite ongoing conversations at OECD about creating a new taxing right under Pillar One. The rest of the world is refraining from implementing new DSTs for an additional year, and we hope that Canada will remain constructively engaged at the negotiating table to develop that system.

During every consultation over the last year and a half, one unified and clear message from the business community was that we needed to see the entire concept pulled together for a final consultation. Unfortunately, there does not seem to be a final consultation on the overall concept which leaves several major problematic issues, including: whether the exclusion for financial services is properly scoped, how to address distribution activities which involve a franchise type arrangement (particularly problematic when the scope expands to the next tranche of companies), and the impact of withholding taxes.

We understand that the Amount A MLC will be released and opened for signature by the end of 2023 – even as Amount B is still in development with a consultation released this week. Amount B seeks to provide a framework for a simplified and streamlined application of the transfer pricing rules to distribution functions. It is worth mentioning that Amount B is not only for large multinational entities ("MNEs") and could apply to any distribution activities – even those of the smallest companies who have operations abroad. Although Amount B could lead to real simplification, the recent request for input suggests that technical consensus may be a long way off. NFTC would like to ensure there is a cohesive workable structure (for both tax administrations and taxpayers) on all of Pillar One – one that can be expected to receive Congressional support – before any MLC is signed by the U.S.

Pillar Two

International Tax is a complicated web of U.S. and foreign laws and bilateral income tax treaties. U.S. companies spend endless hours and hundreds of millions of dollars on tax and accounting services complying with these rules, preparing tax returns, and often defending audits both here and abroad. Double taxation of the same income is a constant concern. Most U.S. companies pay taxes at several levels (local, state, federal and to foreign jurisdictions) and collect thousands of data points to faithfully comply with the obligations that are due. In order for U.S. companies to grow, it often means expanding operations abroad. This is not a detriment to the U.S., rather, these expansions and investments are supported by U.S. employees, leading to more innovation and U.S. jobs, increased wages for workers and a stronger and more resilient U.S. economy. Whereas widespread foreign adoption of this plan could cost more than 370,000 U.S. jobs.[1]

The Biden Administration's approach to the OECD negotiations seems to have been rooted in a world that existed before many of the tax reforms implemented by Congress in the 2017 Tax Cuts and Jobs Act ("TCJA") in which the project began were in place. In TCJA, Congress enacted a new international tax system that ensured that the foreign operations of U.S. companies were subject to a minimum tax (under the first-of-its-kind GILTI framework) and that U.S. tax base erosion was prevented (under the BEAT). Rather than building on these policies by negotiating an agreement that protected the U.S. companies and the U.S. fisc, the Administration has stood by as foreign tax negotiators have orchestrated a collective raid on the U.S. tax base. According to the Joint Committee on Taxation (JCT)[2], Pillar Two will reduce U.S. tax revenue by over $120 billion under current law. Even with the adoption of a compliant regime, nearly $60 billion will still be lost. The United States is not a tax haven. Moreover, the notion that

[1] *See* Ernst & Young US Quest Report on the Estimated impacts of Pillar Two and potential policy responses on US domestic economic activity, prepared by Koch Industries (April 2023), available at https://globaltaxnews.ey.com/Login/ViewNewsAttachment.aspx?AlertID=152953&AttachmentName=jY2Yd0gwZotKdtpSYanQc5K43q1ndmJtGpVhbYJTjfoMU%2FbG%2B5J33ykUimNCL%2FdB&ualertID=null

[2] The Joint Committee on Taxation's report on the Possible Effects of Adopting the OECD's Pillar Two, Both Worldwide and in the United States (June 2023), available at https://www.finance.senate.gov/imo/media/doc/118-0228b_june_2023.pdf

additional foreign minimum taxes are needed to prevent the abusive use of the U.S. tax code is unfounded. The 2017 law also contained the Foreign-Derived Intangible Income rules ("FDII") to keep intangible property ("IP") in the U.S. and foster economic activity here in the U.S. The data post-TCJA shows just that many U.S. companies repatriated IP and increased their domestic investment, including critical research and development investments, in the U.S. This system is at risk as a result of the Pillar Two work.

The breadth of issues still remaining with a "nearly complete" Pillar Two agreement, as well as its ongoing implementation in countries that are major U.S. partners, is unsettling. The initial rules were created without sufficient, or in some cases directly disregarding input from the business community, and the finalized rules were presented as a *fait accompli*. There are multiple flaws with the "final rules" that will hurt investment in the United States. Many provisions were repurposed and re-proposed by the OECD and Inclusive Framework without any input from business.

The business community has made numerous attempts over the past several years to engage with this process. Several consultations have been held by the OECD after the rules were finalized, but more are needed and, as noted below, some aspects need a fundamental review to align the rules with the facts on the ground as opposed to the unfounded political narratives that appear to be carrying the day.

More than anything else, what is needed is time to create a cohesive set of rules that accommodate U.S. tax policies and ensure that U.S. businesses, U.S. workers, and the U.S. economy are not disproportionately harmed. The recently announced delay in the application of the Under Taxed Profits Rule ("UTPR") is a step in the right direction and is unlikely to have occurred without the attention of the Congress on this project.

Compliance of Current U.S. Rules with Pillar Two Tax Regimes

For many NFTC members, compliance with Pillar Two is a looming reality whether or not the U.S. makes any domestic law changes. The EU Pillar Two directive is in force, and around the world more than 50 countries are moving forward with plans to implement this new regime beginning in 2024, including Korea, the United Kingdom, and Japan, who have enacted legislation. Conversely, other large countries including India, Mexico, Brazil, and China have not yet announced a plan to enact Pillar Two rules. The inconsistent pace of adoption highlights the complexity of the rules that have been developed by the OECD, provides challenges for businesses to comply with inconsistent global rules and increases the risk for double taxation of foreign earnings. The Pillar Two framework must be structured to ensure consistent and transparent adoption. Support from Congress in ensuring the rules do not disadvantage U.S. companies is welcome.

The more compliant the existing U.S. tax system is deemed to be with the Pillar Two rules, the better the result is for U.S. companies and workers. In 2020, it seemed universally accepted that current law GILTI was a more stringent regime than what the proposed Pillar Two rules required and thus would be deemed a compliant foreign minimum tax (in OECD parlance this is called an

Income Inclusion Rule or "IIR"). However, in 2021 the Biden Administration walked back from this agreement and instead conditioned the acceptance of GILTI on a series of changes that required U.S. legislation, most notably raising the minimum rate to at least 15%, if not higher. Foreign governments readily pocketed the U.S. concession and the model rules as they stand today characterize GILTI as a "blended CFC regime," which temporarily gives limited relief to U.S. companies in a worldwide system where GILTI is noncompliant. However, after 2026, our first-of-its-kind minimum tax regime (still the only minimum tax actually in operation anywhere in the world) may not count, and foreign governments will be able to raid the U.S. tax base via foreign UTPRs, while also exposing the foreign subsidiaries and foreign parents of U.S. companies to foreign IIRs and UTPRs.

Application of the UTPR does not require U.S. companies to have economic nexus with the country imposing the UTPR. The UTPR rules conflict with long-standing international tax principles that require a business to have economic nexus with the jurisdiction that is the source of the business profits. The UTPR, if enacted, necessitates a broadly agreed global treaty or negotiated bilateral treaty that clearly defines jurisdictional taxing rights. Foreign jurisdictions should not have the unilateral right to claim taxing rights on U.S. company income earned in the U.S. or in third countries without proper economic nexus.

The most straightforward way to avoid this disastrous result is to return to the earlier agreement that the U.S. tax system is rigorous enough to meet these new international standards. The recently announced two-year delay in the application of UTPRs to income earned in a multinational's home country so long as that country has a statutory income tax rate exceeding 20% is a welcome development, one that would not have been achieved without the attention of Congress to this process. But a more permanent solution is needed to ensure that the U.S. income of U.S. companies is never subject to UTPRs. In addition, we would welcome a return to the earlier global consensus that <u>current law</u> GILTI is a compliant IIR. This would ensure that the foreign operations of U.S. companies are protected from UTPRs and, perhaps more critically, as described further below, dramatically reduce compliance concerns and industrial espionage concerns. This is because a company headquartered in a country with a compliant IIR should be permitted to file their global information return ("GIR") solely with their home tax authority (i.e., the IRS), rather than having to give all that information to every country in which they operate. Finally, more attention is needed to the potential interaction of the technical Pillar Two rules with longstanding U.S. tax rules, including foreign tax credits as well as rules applicable to pass-through entities such as partnerships and S corporations whose income is subject to high rates of U.S. tax at the partner or shareholder level.

More fundamentally, long-term safe harbors that test for a jurisdictional rate of tax above 15% are necessary to mitigate the complexity and compliance burden associated with Pillar Two.

Many jurisdictions, including the U.S., have a rate of tax above 15%. The complex compliance requirements envisioned by the OECD should not be necessary for these jurisdictions.[3]

U.S. Credits & Incentives

The term "legislative grace" is used in case law when describing deductions and credits.[4] Credits are a tool used by Congress to incentivize certain activities. Generally, the U.S. tax code treats business tax credits and other incentives as non-refundable. Non-refundability means that any excess credit can be used against future tax liability – and by default allows businesses that continue to operate and contribute to the economy to utilize excess credits. While not entirely unique, non-refundability, a less generous incentive than the fully refundable credits, is much more prevalent in the U.S. tax code than in the law of other countries. However, in designing the Pillar Two minimum tax, non-refundable credits are disfavored while refundable credits (more commonly used in some other major OECD countries) and outright direct government grants are favored. In short, the use of many bipartisan credits -- including the longstanding research and experimentation (R&E) credit -- could cause a U.S. company to be deemed to pay U.S. tax on U.S. income at a rate below a 15% effective rate, thus allowing other countries to impose additional tax on the U.S. income and therefore claw back some of the value of the U.S. tax credits.

It is extremely troublesome that U.S. negotiators have not succeeded in protecting U.S. credits even while other countries were given specific carve-outs for their incentives and industries, especially considering the vast number of jobs in the U.S. that rely on these credits. Treasury successfully advocated for some of the most recently enacted tax credits (from the 2022 Inflation Reduction Act), which are refundable or transferable, to be Pillar Two compliant – but does not appear to be advocating for the acceptance of all U.S. credits. While the two-year delay on the imposition of UTPRs is helpful, a more permanent solution is needed. Even the "acceptance" of refundable credits for Pillar Two purposes merely adds them to the denominator of the ratio (tax paid over taxable income). While this will be helpful in many fact patterns, it can still result in additional tax due for those considering significant energy investments, because the recently enacted energy tax credits available to companies will be large enough for some companies that even treating these credits as refundable credits will result in these companies falling below the 15% tax threshold. Transferable credits receive preferential treatment similar to refundable credits, but not without numerous complexities which may result in limited practical utility. Confusion also ensues when incentives such as FDII are marked for elimination by the Treasury Department,[5] as they seemingly acquiesce to the OECD's finding that FDII is a harmful tax

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[3] In addition, permanent safe harbors for companies with a global effective tax rate ("ETR") based on audited financial statement data (e.g., Form 10-K data) above 15% also helps mitigate the complexity and compliance burdens.

[4] Interstate Transit Lines v. Commissioner, 319 U.S. 590, 593 (1943); INDOPCO, Inc. v. Commissioner, 503 U.S. 79, 84, 112 S. Ct. 1039, 117 L.Ed.2d 226 (1992);Segel v. Commissioner, 89 T.C. 816, 842 (1987).

[5] *See* Department of the Treasury, General Explanations of the Administration's Fiscal Year 2024 Revenue Proposals, available at https://home.treasury.gov/system/files/131/General-Explanations-FY2024.pdf.

practice.[6] From a business perspective, the practical reality is that if there is significant uncertainty about whether a company will ultimately receive the benefit of Congressionally-enacted tax credits, the company will be less willing to allocate capital to investments that generate these credits. Because capital-allocation decisions must often be made years in advance of the time when a credit will actually be generated, the uncertainty about the treatment of U.S. tax credits under Pillar Two is very much a problem now. Reduced investment today will result in fewer U.S. jobs tomorrow.

Compliance Cost Burdens and the GIR

Changes in tax laws result in compliance costs. A new, global tax regime implemented by different countries in different ways results in a massive increase in costs. This includes new systems, calculating new metrics, additional tax staff and support for those resources, as well as an investment of time. One NFTC member company has spent the past two years preparing for these changes and estimates the cost is eight figures, requires an additional 15,000 hours of work, and 6-8 new full-time employees to comply. Many NFTC members are struggling to produce an accurate estimate of what the tax increase might be since there are still many open items. Companies are not the only ones to face challenges; tax authorities will also struggle to accurately and timely interpret the information provided by taxpayers due to the design complexity of Pillar Two. The rules require detailed knowledge of book accounting as well as international tax rules. Many companies and tax authorities do not possess the requisite knowledge to effectively comply with and administer the rules. Additionally, as countries each implement a slightly different variation of the rules, compliance and labor and labor costs required increase exponentially. In the long term, the complexity will challenge the stability of the Pillar Two design.

The GIR (referenced earlier) requires an inordinate amount of information to be compiled and provided to foreign governments to comply with the Pillar Two regimes. This is in addition to the implementation of public Country-by-Country reporting in Europe and elsewhere, which will now require publishing information that they already receive on a confidential basis. The consultation on the GIR at the end of 2022 provided insight into the data required which far exceeds the data requirements of a U.S. corporate tax return. NFTC member companies have estimated that the GIR as envisioned would require them to provide anywhere from 50,000 to 200,000 data points – far greater than the estimated 1,000 data points needed for public country by country reporting. The immediate impacts are an increase in compliance costs and well-founded concerns about the confidentiality and misuse of the data. That dramatic additional compliance cost must come at the expense of more productive uses of taxpayer resources.

[6] *See* OECD Forum on Harmful Tax Practices, Harmful Tax Practices – Peer Review Results (June 2023), available at https://www.oecd.org/tax/beps/harmful-tax-practices-consolidated-peer-review-results-on-preferential-regimes.pdf (noting that the United States has “committed to abolish” FDII).

Furthermore, the data required far exceeds the information necessary to compute any potential tax liability.

There are many helpful changes we have recommended. We have not yet reviewed in detail the updated GIR released on July 17, 2023, and are hopeful that some of these recommendations have been adopted. First, limit the information required to that necessary for the computation of tax, and allow requests for data relating to extraneous items such as group structure and changes in the structure. There is simply no legitimate need to require this volume of information to be provided to tax authorities around the world as a matter of course. Second, require calculations of the effective tax rate at the jurisdictional level (i.e., in each country instead of each entity). Third, as we transition to using the new reporting regime, the current temporary safe harbor that permits taxpayers to report their calculations under the country-by-country safe harbor provisions should continue. Once the safe harbor calculation is provided, no additional data or returns should be required.

Confidentiality

Even more troublesome is the lack of assurance companies have that their data will be protected. As things currently stand, it is conceivable that many of the 140+ countries involved in the Inclusive Framework (some of whom are strategic competitors of the U.S.) would receive the GIR of U.S. companies to enforce their UTPRs. Whereas if, as discussed above, the U.S. is considered to have a fully-compliant Pillar Two tax system, that global data would not be relevant to any other countries and could be provided only to the IRS. Protecting confidential data is a critical issue for NFTC member companies as other countries do not make the same effort to ensure confidentiality of taxpayer data. The IRS is required under section 6103 of the Internal Revenue Code to keep information confidential. Some countries may use the data to gain insight for local competitors or for a state-run entity or share sensitive defense industry data with their military. This is especially true when tax data is combined with other information contained in databases or otherwise publicly available. It is of utmost importance that the U.S. continue to advocate for limited sharing of sensitive taxpayer data and that countries receive the specific data needed to correctly impose tax.

Pillar Two and Dispute Resolution

Another likely impact of widely sharing tax data is increased audits for U.S. companies. One goal of the Pillar Two work was to provide tax certainty and reduce the number of disputes, audits, and litigation for companies and tax authorities. The opposite is more likely to occur when countries receive more data than they need (or can effectively parse) to assess audit risk. The impact is compounded by the fact there is currently no mechanism to address dispute resolution. Even under the current regime, foreign governments can be overly aggressive in audits – especially when targeting U.S. companies. The implementation of Pillar Two without a workable dispute resolution framework would only make this worse. Existing bilateral tax treaties provide dispute resolution mechanisms such as competent authority. Even with those protections, punitive additions to corporate tax or the imposition of criminal penalties on the officers of these companies are occasionally threatened if companies avail themselves of competent authority. Thus, U.S. companies sometimes pay the increased foreign tax instead. The NFTC and other U.S. business groups have asked repeatedly for dispute resolution mechanisms to address Pillar Two, yet these requests have not yet been answered.

Allowing both MNCs and tax authorities to request dispute resolution and then notifying other relevant parties to the transaction and allowing them to participate in the process would help streamline the dispute resolution process. Ideally, Pillar Two requires a broadly agreed multilateral treaty. Absent such an agreement, the approach to achieving advance certainty for Pillar Two calculations and for resolving conflicts should have a clearly defined scope, process, and timeline. Having one central process per transaction flow or tax year could help mitigate double taxation and redundant audits or litigation. Without dispute resolution and a limit on the scope of foreign audits, U.S. companies will be subject to double (or even multiple) taxation on the same income with limited options for a remedy.

United Nations

Recently, Latin American and other developing countries have expressed dismay with the OECD Inclusive Framework. Major concerns include the restriction of withholding taxes that are simply proxies for DSTs, and the accounting for withholding taxes in the Amount A calculation to prevent two bites of the same apple. Using a withholding tax on gross income may be a simple mechanism to collect revenue without complexity, but it is the wrong solution. Further, withholding taxes creates tax liabilities without regard to whether the transaction is profitable at all. Many of these countries expected revenue windfalls that are not materializing and are confounded by the complexity of the Pillar One and Two rules. While the OECD process is imperfect, the technical expertise is unrivaled. If the U.S. completely withdraws from the negotiations, the result may be a new process at the UN saddled by international process and politics and based on majority votes. The U.S. should continue its engagement at the UN, pushing back on the notion that a new process is needed and will yield better results. The UN could add value by providing technical guidance and model treaties for developing nations and facilitating regional alignment. However, employing two competing processes or layering the UN regime over the OECD Pillars would be a disastrous result.

Conclusion

At this juncture, it appears that U.S. companies and the U.S. fisc will be losers whether or not the U.S. adopts a conforming Pillar Two regime. Unfortunately, U.S. companies will have little choice but to comply with the new regime when implemented by other countries. However, the OECD has shown flexibility in interpreting and clarifying its rules. They have also provided numerous temporary safe harbors to account for U.S. rules and the looming 2025 fiscal cliff. And they have recently provided a temporary reprieve from the imposition of UTPRs on the U.S. income of U.S. companies. The attention of the Congress to this process has been helpful in obtaining this temporary relief.

This is not the first time that an Administration has negotiated a “deal” without aligning or consulting with Congress, and U.S. companies are told that it is simply too late to scale back or reconsider. Just a few years ago, the United States-Mexico-Canada Agreement (“USMCA”) was a done deal – then suddenly, it was reopened, renegotiated and resulted in better terms. The Congressional leadership and members of this committee asserted their legislative prerogatives to adjust the agreement to reflect their views on how the agreement could better serve American interests. We urge Congress to continue working with the OECD, Department of the Treasury negotiators, and foreign counterparts to create a regime that works with the U.S. tax code, protects U.S. companies and workers from an unlevel playing field, and encourages investment and economic growth in the U.S.