Statement of Mindy Herzfeld before the House Ways & Means Committee Subcommittee on Tax at a hearing on "Biden's Global Tax Surrender Harms American Workers and Our Economy" (July 19, 2023)

Chairman Kelly, Ranking Member Thompson, and distinguished members of this subcommittee, thank you for the opportunity to testify here today on this very important topic – the international agreement brokered by the OECD on the tax challenges arising from the digitalization of the economy, also known as the two-pillar solution.

The background to my testimony is a recent analysis by the Joint Committee on Taxation showing that Pillar Two alone of this agreement will likely impose significant costs on the U.S. government, in the form of reduced revenue collections.[1] Most of my testimony will focus on the Pillar Two agreement for a global minimum tax, but I will also touch briefly on Pillar One – a timely topic, given the OECD' release last week of an Outcome Statement on Pillar One and additional guidance earlier this week.[2]

To put the two-pillar project in perspective, I will start by sketching out the international tax principles in place since enactment of an income tax in the early 20th century. I'll then summarize some of the changes the 2017 tax law – the Tax Cuts & Jobs Act – made to that system. It's also important to place these changes within the context of global tax developments and proposals to modify international tax rules made by the OECD as part of its effort to crack down on cross-border base erosion and profit shifting, known as BEPS.

Together, the BEPS project and the TCJA set the stage for the 2021 OECD 2-pillar agreement, of which the United States was one of approximately 140 signatories, and which it played a key role in negotiating. I'll explain why certain aspects of that agreement – specifically, some of the provisions introduced at a late stage in the negotiations – are predicted to have such a harmful effect on U.S. tax revenues – as quantified by the Joint Committee on Taxation. But I would then like to turn to thinking about what might be done to address those harmful effects, both in the short term and over the longer term as well.

Pre-2017 international tax law.

From its earliest days, the U.S. income tax system, as it applied to taxing U.S. persons' foreign earnings, can be characterized by 3 basic principles:

1. *Worldwide taxation.*

Unlike most other countries – which impose a territorial system, or limit their taxing rights to income earned within their own jurisdictions -- the United States imposes worldwide taxation. That is, U.S. persons are taxed on all of their income, regardless of where earned.

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[1] Jt. Comm. on Tax'n, *Possible Effects of Adopting the OECD's Pillar Two, Both Worldwide and in the United States (*Jun. 2023).

[2] OECD/G20 Base Erosion and Profit Shifting Project, Outcome Statement on the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy (Jul. 11, 2023) at https://www.oecd.org/tax/beps/outcome-statement-on-the-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2023.pdf ; OECD Secretary-General Tax Report to G20 Finance Ministers and Central Bank Governors (July 2023) at https://www.oecd.org/tax/oecd-secretary-general-tax-report-g20-finance-ministers-india-july-2023.pdf.

2. The Foreign Tax Credit.

In order to address concerns over double taxation of non-U.S. source income, the United States – in what has been described as an act of unprecedented generosity by Congress[3] – has since 1918 provided U.S. taxpayers with a dollar-for-dollar credit for foreign taxes paid (the foreign tax credit), subject to various limitations. This credit is not entirely gratuitous on Congress' part – the foreign tax credit has encouraged U.S. businesses to access and serve foreign markets, and so benefited both corporate America and the American economy as a whole.

3. Deferral.

In general, the U.S. tax law respects corporate entities as separate taxpayers, and has refrained from subjecting the earnings of foreign corporations owned by U.S. persons to taxation in the United States until repatriated. This principle of deferral stands in contrast to a system that would require full and immediate U.S. tax on U.S. shareholders on the foreign earned income of the foreign corporations in which they own shares. Together with the high U.S. corporate tax rate prior to 2017 -- as compared to other OECD countries[4] -- the principle of deferral encouraged U.S. headquartered companies to keep their earnings offshore rather than repatriating them back to the United States.[5] Deferring repatriation eventually led to approximately $1 trillion in cash held offshore by U.S. companies prior to enactment of the Tax Cuts & Jobs Act.[6]

Combined, the principles of worldwide taxation and the large differential between the U.S. corporate rate and other countries' tax rates prior to 2017 also led to the phenomenon of inversions, whereby U.S. companies had strong incentives to reincorporate overseas in order to avoid being stuck in the U.S. tax net.[7]

<u>The BEPS Project</u>

Several trends combined to put increasing pressure on the long-standing international rules for taxing cross-border income during the early 2000s. These included distortions introduced by the increase in the differential between the U.S. corporate tax rate and that of other countries, the growth of U.S. companies' overseas profits, the rise of globalization and global supply chains, and the pressures that digital business models created for local businesses and the tax revenues generated by those local businesses. Related to these global trends were the distortions introduced by EU integration efforts – which required free movement of people and capital within EU borders – with the limitations of the EU Treaty, which left corporate tax systems

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[3] See Michael J. Graetz and Michael M O'Hear, *The 'Original Intent' of U.S. International Taxation*, 46 Duke L. J. 1020 (1997) (describing enactment of the foreign tax credit as representing "what was an extraordinarily generous measure for its time: the United States was assuming sole responsibility for the costs of reducing the double taxation of its residents and citizens."

[4] See Kari Jahnsen and Kyle Pomerleau, *Corporate Income Tax Rates Around the World, 2017*, Tax Foundation (Sept. 7, 2017), at https://taxfoundation.org/corporate-income-tax-rates-around-the-world-2017/.

[5] See Jt. Comm. on Tax'n, Background and Selected Policy Issues on International Tax Reform, JCX-45-17 (Sept. 28, 2017).

[6] See Michael Smolyansky, Gustavo Suarez & Alexandra Tabova, *U.S. Corporations' Repatriation of Offshore Profits: Evidence from 2018*, FEDS Notes (Aug. 6, 2019) at https://www.federalreserve.gov/econres/notes/feds-notes/us-corporations-repatriation-of-offshore-profits-20190806.html.

[7] See Donald Marples & Jane Gravelle, *Corporate Expatriation, Inversions, and Mergers: Tax Issues*, Cong. Rsch. Rep. No. R43568 (updated Jun. 17, 2021).

within the sole purview of EU member countries. These countervailing doctrines allowed for maximum cross-border profit shifting within the EU but also limited the tools EU countries could use to address that concern, leading them to look outside the EU for solutions.

In short, developments in the United States, the EU, and around the world prompted the G20 and the OECD to undertake a mammoth project focused on creating new rules for addressing cross-border profit shifting and the digitalization of the economy. The resulting BEPS project fell short in 2 respects:

The first is that it didn't manage to come up with concrete proposals for taxing the digitalized economy.

The second is that despite U.S. efforts to convince other countries to adopt expanded rules for taxing foreign earned income – in the form of expanded controlled foreign corporation regimes – most other countries declined to move forward with this idea.[8]

Both of these ideas and missed opportunities have been revived in the current OECD work on Pillars One and Two.

TCJA Changes

The same pressures that led to the OECD's BEPS work, together with the unique challenges posed by an outdated set of rules in the United States for taxing cross-border income, helped prompt passage of the TCJA. That law introduced a number of important changes to the U.S. international tax rules, alleviating some of the distortions described above. I'll highlight four of them below, as particularly relevant to the current OECD project.

1. *Territorial taxation*.

In theory, the TCJA introduced a territorial system by allowing for a 100 percent dividends received deduction on dividends from foreign companies to U.S. corporate shareholders.[9] (In practice, this territoriality is very limited.)

2. Taxation of Global Intangible Low-Taxed Income.

To ensure that enactment of an exemption for dividends paid out of foreign earnings wouldn't further encourage U.S. taxpayers to shift profits and assets overseas, the TCJA introduced a broad anti-abuse measure which subjects to U.S. tax on a current basis much of controlled foreign corporations' foreign earnings.[10] In enacting GILTI, the United States was essentially a first mover in adopting a global minimum tax. To minimize the distortions created by the fact that U.S. was proposing a minimum tax on the foreign earnings of U.S. headquartered companies, whereas other countries mostly retained full territorial (exemption) systems, GILTI generally taxes foreign earnings of CFCs at a lower rate than domestic earnings.

3. Foreign Derived Intangible Income.

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[8] See OECD, *Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, (2015), at https://doi.org/10.1787/9789264241152-en.
[9] I.R.C. § 245A.
[10] I.R.C. § 951A.

The TCJA introduced a new deduction for foreign derived intangible income, intended to bring parity to the U.S. tax rate on foreign earnings, regardless of whether earned by a U.S. or foreign company.[11] The FDII deduction was intended to incentivize U.S. companies to repatriate their intellectual property to the United States and minimize incentives for such IP to be transferred overseas.[12]

4. The BEAT

Because GILTI arguably put U.S. companies at a competitive disadvantage relative to foreign companies with U.S. operations, TCJA also included a base erosion and anti-abuse tax, the BEAT, a complex rule that was supposed to target foreign companies' U.S. operations' base stripping activities. In practice, this rule has proved both overly broad and too circumscribed in scope.

Global Responses

The unfinished business from the BEPS project – particularly the failures to address concerns about taxation of the digitalized economy – led some countries to propose, and others to enact, gross-basis digital services taxes, widely understood to be inefficient taxes that primarily target U.S. tech companies. Partly to limit the spread of such efforts, the OECD – with the willing participation of U.S. Treasury – undertook what is sometimes referred to as BEPS 2.0, which includes two pillars. Pillar One remains focused on the efforts of taxing very large, highly profitable multinational companies (with the end result that it disproportionately impacts U.S. tech companies) and reallocates a share of those profits – in contrast to the historical rules – to market economies. There's been no formal agreement so far on the details of that proposal.

Meanwhile, the other part of BEPS 2.0 -- Pillar Two – morphed into a plan for a global minimum tax. At a high level, the agreement over global minimum tax represented other countries' efforts to copy the U.S. idea of taxing foreign earnings enacted as GILTI in 2017. But once the OECD took up the project, the idea for a global minimum tax began to grow in scope and reach.

The OECD Deal

If Pillar Two was simply a platform for other countries to mimic and modify the U.S. approach to addressing cross-border profit shifting by taxing foreign earnings on an immediate basis, we wouldn't be here today. But three changes were made between the time the broad terms of the 2021 deal were agreed to, and the details of the OECD model rules were released last year that has turned the OECD agreement for a global minimum tax into the U.S. revenue loser that the Joint Committee on Taxation has estimated that it likely will be.

1. The UPTR.

While the U.S. GILTI tax only imposes tax on the U.S. shareholders of CFCs on their share of the CFCs' earnings, Pillar 2 goes much further. Introduced as part of the model rules in 2022, the OECD version of a global minimum tax has been expanded to include a provision under which all countries in a which a multinational has a presence are entitled (and obligated) to tax the

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[11] I.R.C. § 250.

[12] There are some suggestions that this benefit could be working as intended. See Martin Sullivan, *Latest SEC Filings Show FDII Benefits Continue to Climb*, 110 Tax Notes Int'l 164 (Apr. 10, 2023).

(undertaxed) domestic earnings of parent companies. This rule – the UTPR (undertaxed profits rule) – gives other countries full rein to tax the domestic earnings of U.S. multinationals.

2. Credits.

The U.S. statutory corporate rate of 21 percent is higher than the 15 percent rate agreed to as part of the OECD deal. So one could think that granting other countries the right to tax low-taxed domestic earnings of U.S. headquartered companies shouldn't pose a problem. One has to get deep into the rules to figure out why this is so. One reason relates to how tax credits – including business credits such as the R&E tax credit – are treated under the OECD model rules.

The OECD global minimum tax – known as GLOBE – operates by first requiring companies to calculate the effective tax rate paid in each jurisdiction. To the extent that this rate is below 15 percent, a top-up tax then may be imposed. There are special rules for calculating GLOBE income for this purpose, and these rules treat some types of credits as reducing the tax rate (thereby creating additional risk of triggering a top-up tax), and other types of credits as income instead. Under these rules, many U.S. general business credits – because they are not refundable – are treated as reducing taxes paid, and so increase the risk of a top-up tax being imposed on U.S. companies' domestic income under the UTPR. (A similar principle applies to companies that benefit from the FDII deduction, described above).

But refundable credits – such as the UK's R&E credits – generally are treated as income rather than a reduction to tax under the OECD model rules, and so are less likely to trigger a top-up tax. In the past, the OECD has explained that this distinction is due to the different accounting treatment of refundable v. non-refundable credits.[13]

3. The Qualified Domestic Minimum Top-up Tax, or QDMTT.

The most important reason why the OECD agreement on Pillar Two is likely going to end up costing the U.S. significant revenues is an aspect of the model rules that appeared late in the game. This is the encouragement the OECD is providing to other countries to enact their own qualified domestic minimum taxes, designed to prevent other countries' adoption of a global minimum tax from stripping away their tax base. The details here are complicated but the principle is not: when other countries increase their corporate tax rates, it costs the United States money, because the U.S. continues to provide a foreign tax credit for foreign taxes paid. An international agreement that encourages other countries to increase their tax rates will necessarily reduce the residual U.S. tax that can be collected on that income.

<u>What Can be Done?</u>

This is the landscape the U.S. government and U.S. businesses face today. I'd like now to shift to sketch out some possibilities for fixing the deal to minimize its harmful impacts on the United

[13] Administrative guidance released July 17 walks back the reliance on the accounting treatment in favor of "uniform and mandatory" treatment of tax credits, which it says "is necessary to ensure that different financial accounting rules do not advantage or disadvantage some" multinationals. OECD, *Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)*, (July 2023) at www.oecd.org/tax/beps/administrative-guidance-global-anti-base-erosionrules-pillar-two-july-2023.pdf .

States. I expand upon these possibilities in the attached article, published this week in Tax Notes International. None of them is a cure-all.

1. *Domestic law changes.*

The United States could modify its domestic rules so that they conform to Pillar Two, including by modifying its tax credits or by enacting its own qualified domestic minimum tax. This is unlikely to make up the revenue lost due to other countries' adoption of QDMTT, while modifying the U.S. regime for business credits could also end up as a revenue loser.

2. *Retaliation*

The United States could threaten other countries with retaliation in order to get them to drop or scale back implementation of Pillar Two. For a number of reasons – in particular, the fact that the EU has already adopted a Pillar Two directive – this is unlikely to have the desired effect, and could have harmful effects on cross-border trade.

3. *Modifications to GLOBE*

The United States could work with the OECD to encourage modification of some of the more arbitrary rules that have the worst effects on US businesses and revenues, such as the definition of qualifying credits. This approach may be the most promising, but may require a shift in tactics.

4. *Accounting Rule Changes*

Although Congress has handed over authority for drafting and oversight of accounting principles for financial reporting generally to the Securities and Exchange Commission, which in turn has given over its authority to the private organization the Financial Accounting Standards Board, Congress retains the ultimate authority here. Perhaps the OECD, the SEC, and FASB might be reminded of that fact in considering the extent to which the GLOBE rules harm the U.S. government.

Longer-term Solutions

Over the longer term, the OECD Pillar Two agreement – and most importantly, the details of the model rules - highlight a failure in the way Treasury interacts with Congress in pursuing international tax negotiations. Congress could and should be working more closely with Treasury to provide it with clearer direction as to what position to adopt in international tax negotiations, most importantly when the negotiations would significantly affect the United States' jurisdiction to tax or would require statutory changes. Doing so would avoid the situation we find ourselves in today, where Treasury has negotiated a deal that Congress cannot implement, a result which is not productive, nor does it enhance U.S. standing among its trading partners. I reiterate suggestions made by others to consider as a model in this regard that adopted by Congress along the lines of the Trade Promotion Authority, which guides the executive branch in pursuing and negotiating trade agreements. Doing so could have the productive result of preventing Treasury from over-promising and giving its negotiating positions greater credence among its partners.

Thank you again for inviting me to testify. I would be happy to answer any questions you may have.

Is There a Way to Fix Pillar 2?

POSTED ON JULY 17, 2023

MINDY HERZFELD

The Joint Committee on Taxation's June analysis of the U.S. revenue impacts of pillar 2 provided stark confirmation of what many had long suspected: that the OECD pillars, negotiated and agreed to by the U.S. Treasury Department, are likely to impose significant costs on the U.S. fisc. And the JCT report considers only the impact of the rules on the government's revenue collection. When the impact on U.S. businesses — and U.S. shareholders, investment, and workers — is taken into account, the negative consequences are probably even higher. Although the questions of how and why the United States participated in getting us here deserve attention, more immediately pressing is how to minimize the harm. The JCT report provides the impetus for constructive thinking about how to modify the regime to lessen the adverse results for the United States.

It would be foolhardy to think that the bad outcomes highlighted by the JCT are limited to the United States. Over the longer term, they also threaten the OECD's role in overseeing and coordinating international tax rules. Although the OECD has 38 members and the inclusive framework has over 140, the United States funds almost 20 percent of the OECD's Part I budget, an amount that nearly totals the contributions of the next three countries combined (Japan, Germany, and the United Kingdom). The OECD's tax function has expanded over the past two decades — both geographically and substantively — but an organization responsible for developing regimes that pose real harm to its leading donor doesn't have long-term viability.

Although the two-pillar project was always in part a revenue grab by other countries of the profits of U.S. tech companies, the harshness of the fallout for the United States depicted by the JCT report shows that other countries — even those nominally depicted as winners — also stand to lose. U.S. legislators have already begun to explore various means of ensuring that U.S. tax revenue lost overseas via pillar 2 is recouped — means that are not likely to strengthen cross-border trade.

The JCT Report

The JCT report depicts five possible scenarios. If the rest of the world adopts pillar 2 — with or without the United States — the United States loses significant revenue over the next 10 years: about $120 billion if it doesn't adopt pillar 2 and about $56 billion if it does. Only in the scenario in which the rest of the world doesn't adopt pillar 2, but the United States does, will the latter stand to increase its revenue collections. The JCT projects that if the United States is the only country that adopts pillar 2 (including adopting the UTPR, formerly known as the undertaxed payments rule), it will see a $236.5 billion revenue gain over 10 years.

The Assumptions

Like any economic model, the JCT conclusions rest on a series of assumptions, which may lead some to question the results.

The report notes that pillar 2 could have a range of effects on federal income tax receipts, with the upper and lower bounds of the effects based on a range of potential behavioral responses from U.S. taxpayers. In both its upper- and lower-bound scenarios, the JCT assumes that U.S. multinationals subject to pillar 2's income inclusion rules and UTPRs shift up to 75 percent of their low-taxed profits to other jurisdictions. The difference between the two — which determines whether the United States is a net revenue gainer or loser — is derived from assumptions about where those profits are shifted. In the lower bound, U.S. multinationals shift up to 75 percent of their low-taxed profits to pillar-2-compliant jurisdictions (namely, jurisdictions with a qualified domestic minimum top-up tax, or QDMTT). The upper bound assumes that those companies shift up to 75 percent of their low-taxed profits to the United States.

In other words, the JCT report is based on assumptions about future behavior of multinational companies that is hard to predict, verify, and quantify, and the validity of those assumptions is important in substantiating its conclusions.

The JCT analysis assumes that the pillar 2 rules will apply in the following order of priority: first, local corporate income taxes (including the U.S. corporate alternative minimum tax, but excluding the corporate AMT on foreign income), then QDMTTs, controlled foreign corporation rules (including the global intangible low-taxed income regime, subpart F, and the corporate AMT on foreign income), IIRs, and finally UTPRs. It follows from this ordering rule that domestic taxes are collected before CFC taxes or the new pillar 2 taxes. The JCT also assumes that Treasury will issue regulations indicating that QDMTTs are creditable and that foreign IIRs and UTPRs are not, and that U.S. state and local income taxes are included in calculating pillar 2 effective tax rates (if they aren't, the revenue costs to the United States would be higher). The JCT also ignores any effects of pillar 1 by assuming that it will not be adopted within the budget window.

While some may be inclined to question the report's assumptions and therefore its conclusions, those doubts fail to consider the weight that the JCT's analyses carry on Capitol Hill.

Who Gains?

Although the JCT report notes the likelihood that the United States will lose revenue if most countries adopt pillar 2, it does not indicate, other than in the broadest of strokes, which countries are likely to benefit.

One can deduce which countries might be expected to gain from the U.S. loss in revenue from the JCT's depiction of behavioral responses to the adoption of pillar 2. In the lower bound of those responses, U.S. companies are assumed to shift their low-taxed profits to QDMTT jurisdictions — meaning that low-tax jurisdictions that enact QDMTTs should expect revenue gains. But the report also says that pillar 2's implementation is expected to produce high heterogeneity in responses.

It's useful to look at how other countries expect pillar 2 will affect their domestic revenue. The Tax Foundation has a helpful roundup that suggests that the United States' largest trading partners are expected to gain from the adoption of pillar 2. Within the EU, France could gain at least €1 billion ($1.1 billion) annually, and Germany could gain between €5.1 billion and €6.7 billion annually ($5.8 billion to $7.6 billion). Belgium projects annual revenue increases of about €330 million ($360 million), Denmark expects similar gains, and the Netherlands slightly higher ones. Switzerland, meanwhile, is looking at an annual increase in revenue in the range of CHF 1 billion to CHF 2.5 billion ($1 billion to $2.6 billion), and the United Kingdom is eyeing an increase of £2.3 billion a year by 2027 and 2028 ($2.7 billion). Outside Europe, Canada projects even larger increases — about C $5.1 billion ($3.8 billion) in fiscal 2025 and 2026, C

$2.8 billion ($2 billion) in fiscal 2027, and C $2.4 billion ($1.8 billion) in fiscal 2028. Australia's latest budget projected revenue gains of AUD 370 million ($250 million) over the next five years. Add up all those revenue gains for other countries, and they look like the flip side of the losses the JCT has projected for the United States.

There is a long history of the United States picking up the tab for European infrastructure costs, and pillar 2 may simply be the latest iteration of that trend.

A Tax Code Aid Program?

Perhaps the projected U.S. revenue loss from pillar 2 would be more palatable if the agreement were viewed as an aid program delivered via the tax rules. But while delivering aid through the tax code would also raise questions, that's not what's going on here. Developing countries are expected to gain little, if any, revenue from pillar 2. (Prior coverage: *Tax Notes Int'l*, July 10, 2023, p. 206.) The country projecting the largest revenue gains, after Germany, is Canada, which has also declined to sign on to the multilateral agreement that would commit it to roll back its digital services taxes. (Related coverage: p. 319.)

Costs Beyond U.S. Revenue

The JCT report attempts to quantify only the costs of lost federal government revenue from pillar 2 implementation. For knock-on costs, the assumptions embedded in the report regarding behavioral responses become relevant — namely, that U.S. companies will pay an overall higher tax burden because of pillar 2. The IMF estimates that pillar 2 would raise global corporate income tax revenues by 5.7 percent before any behavioral responses by firms (IMF, "International Corporate Tax Reform," Policy Paper No. 2023/001 (Feb. 26, 2023)). According to an OECD analysis from earlier this year, the proposed global minimum tax is expected to result in annual global revenue gains of about $220 billion, or 9 percent of global corporate income tax revenues.

The OECD economic impact assessment — revised upward from a previous estimate of $150 billion — shows that the average global marginal ETR is projected to increase by about 1.85 percent. The IMF says that corporate ETRs can be expected to rise because of the direct effect of the global anti-base-erosion (GLOBE) rules, tax increases from reduced competitive pressure, and reduced scope for profit shifting. As a result, it says that in the aggregate, investment by multinationals is predicted to decline modestly in the face of higher tax burdens. Other estimates, such as the U.N. Conference on Trade and Development's "2022 World Investment Report," are that the potential drop in global foreign direct investment from the new rules is about 2 percent. (Prior coverage: *Tax Notes Int'l*, June 13, 2022, p. 1452.)

None of these estimates pinpoints which companies would be ponying up those funds, but presumably — given how many U.S. companies make up the group of large companies that are within scope of pillar 2 — many would be headquartered in the United States. That translates into lower investment by U.S. companies. Although economists debate whether capital or labor bears more of the burden of a rise in corporate tax rates, in either case the U.S. economy may be on the losing end of a global tax increase that is disproportionately borne by U.S. companies.

Potential Responses

What can be done to minimize the harmful effects on the U.S. fisc and U.S. businesses? Potential fixes fall into three categories: changes the United States could make to domestic law to minimize the harmful impact of pillar 2; retaliatory measures; and modifications to the OECD rules. (Prior analysis: *Tax Notes Int'l*, Apr. 3, 2023, p. 7.)

Conformity and Domestic Law Changes

Biden administration officials have generally argued that U.S. adoption of pillar 2 is necessary to eliminate any harmful impact (and ex-officials continue to make these claims). But U.S. adoption of the OECD rules is no panacea, even though the JCT report depicts it as potentially leading to a revenue increase for the United States. There are revenue, efficiency, philosophical, and practical reasons to reject that argument.

On the revenue side, under the JCT's midrange assumptions of behavioral responses, the country still loses revenue from pillar 2 even if Congress fully adopts it (assuming other countries do as well). In terms of efficiency, the Congressional Research Service notes that if GLOBE is widely adopted, changes in U.S. taxes might shift receipt of revenue to the United States, but it also raises concerns about the effects on domestic investment (Jane G. Gravelle and Mark P. Keightley, "The Pillar 2 Global Minimum Tax: Implications for U.S. Tax Policy," Congressional Research Service, R47174, July 6, 2023).

There are other concerns regarding the administration's use of international agreements to pressure Congress into action. In a recent op-ed in *The Wall Street Journal*, David Schizer, former dean of Columbia Law School, makes the case against congressional adoption of pillar 2 for reasons of sovereignty and democracy, urging readers to consider whether "it's really a good idea to establish a precedent for the executive branch to pressure and circumvent Congress through such a deal with an international organization" (David M. Schizer, "Biden and the OECD's Taxation Without Representation," *The Wall Street Journal*, July 2, 2023). (Prior analysis: *Tax Notes Int'l*, Dec. 7, 2020, p. 1264.)

Country-by-Country

Although modifying the foreign income inclusion so that it's calculated on a jurisdictional rather than blended basis is generally highlighted as the primary change needed to bring GILTI into conformity with pillar 2, that likely wouldn't change the results noted in the JCT report. To the extent that the U.S. revenue costs result from other countries' application of the UTPR to U.S.-source profits, amending GILTI wouldn't affect the results. And to the extent the revenue impacts result from other countries' adoption of QDMTTs, modifying GILTI also would make no difference.

Rate

While GLOBE imposes a 15 percent minimum tax, GILTI is imposed at a 10.5 percent rate. Could increasing the rate on GILTI change the conclusions in the JCT report? The U.S. rate is scheduled to rise to 13.125 percent in 2026 (a detail presumably factored into the JCT report), and the expense allocation rules mean that the rate on GILTI is often higher than 10.5 percent. The ordering rule — in which QDMTTs take priority over GILTI — also means that a GILTI rate increase might not make a difference.

Credits

As the CRS report summarizes, the major U.S. business tax credits are not refundable and so could trigger a top-up tax under pillar 2 (and reduce investment in the activities that generate the credits). The CRS notes that one option to preserve these credits' incentives, even under pillar 2, would be to make them refundable. But estimates are that making all general business credits refundable would cost $193 billion from fiscal 2023 to fiscal 2032. (Prior analysis: *Tax Notes Int'l*, Mar. 20, 2023, p. 1627.) It may be worth exploring other alternatives that could allow these credits to receive the necessary accounting treatment without costing the United States too much.

For example, a change in the accounting rules could alter the result under pillar 2 without modifying the substance of the credit. Congress has the power to change the accounting treatment of business tax credits, as does the SEC.

Modifying the Corporate AMT

Congress could also consider modifying the new corporate AMT so that it qualifies as a good QDMTT. That would involve significantly expanding the scope of the law — which now applies to only a few companies — and its base. Whether Congress really wants to do so is unclear — the corporate AMT was narrowed considerably during political negotiations to reduce its impact.

Retaliation

House Ways and Means Committee Chair Jason Smith, R-Mo., in May introduced the Defending American Jobs and Investment Act (H.R. 3665), which would require Treasury to identify extraterritorial and discriminatory taxes that other countries levy on U.S. companies. The bill would increase U.S. tax rates on the U.S. income of investors and corporations in those countries by 5 percentage points annually for four years (up to a maximum of 20 percent). (Prior coverage: *Tax Notes Int'l*, May 29, 2023, p. 1177.)

Increasing the tax rate on foreign businesses with U.S. income in retaliation for pillar 2 taxes is a heavy penalty, one with numerous ripple effects.

Exchange of Information

The GLOBE rules rely on companies to prepare extensive information returns. The rules contemplate that the return could be filed with the jurisdiction of the company's headquarters and then be exchanged with other relevant countries.

Congress could attempt to block the functioning of GLOBE by precluding the IRS from collecting or exchanging the information included in the GLOBE information return. But some countries have already introduced legislation that would require companies to file the return directly with their own tax administrations.

Denial of Credits

The JCT report is based on the assumption that QDMTTs will be considered creditable taxes, while IIRs and UTPRs would not. But it's not at all clear that QDMTTs — which may operate by denying some deductions that U.S. tax law allows — would be considered creditable taxes under reg. section 1.901-2. Congress could modify section 901 so that QDMTTs (and IIRs and UTPRs) are non-creditable taxes.

This would have the effect of reducing the negative revenue impacts on the United States, but at the same time increasing the costs for U.S. businesses operating overseas.

Treaties

OECD and Treasury officials have regularly claimed that pillar 2 can be implemented without a treaty, and that the UTPR is consistent with existing treaties. Those claims are backed up by leading academics. (Prior analysis: *Tax Notes Int'l*, Jan. 23, 2023, p. 445.) Still, much uncertainty remains, with prominent European academics concluding that "the UTPR in its current form likely violates tax treaties." (Prior analysis: *Tax Notes Int'l*, May 15, 2023, p. 857.)

If Treasury or Congress were to set out reasoned arguments why application of the UTPR violates tax treaties and clarify that U.S. rights would be asserted under those treaties if other countries sought to apply the UTPR to the profits of U.S. multinationals, that could have the effect of reducing adoption of the UTPR.

Changes to GLOBE

OECD and Treasury officials have said that the GLOBE rules that have been published can't be revisited. But rules and agreements are always subject to modification. And given the high stakes involved, creative thinking and a more assertive position on the part of the United States could ameliorate the harsh impact of the rules on U.S. revenues.

Credits

The definition of good tax credits in the OECD model rules (and subsequent guidance) is arbitrary, tied to accounting principles that make little sense here. The rules have already been tweaked to clarify that credits delivered via U.S. equity partnerships (the historical means of delivering energy and low-income housing credits) would meet the definition of good credits — showing that with enough at stake, there's room for revising definitions.

There's no reason why more tweaks to the model rules couldn't be made so that U.S. research and development and research and experimentation credits would qualify as good credits.

Priority

The United States loses revenue under GLOBE in large part because under current law, GILTI imposes a residual tax on low-taxed foreign earned income, but countries that adopt QDMTTs — as they are encouraged to do under GLOBE — would soak up that difference.

Can the priority of the ordering rule be tweaked? Perhaps giving greater weight to GILTI could have that result, even without changing the formal ordering rule.

Safe Harbors

The model rules may not be open for revision, but there's another means by which the OECD retains great flexibility to modify them even without explicitly changing the agreement. That's through the adoption of safe harbors that effectively revise the results of the rules without changing them. Examples could be qualifying the corporate AMT as a QDMTT, providing that R&D and R&E credits that meet certain standards qualify as good refundable credits, or granting CFC rules priority over QDMTTs in certain instances.

Deferred Effective Dates

Harmful results could be delayed — perhaps even indefinitely — by deferring the effective dates of some provisions. This may already be happening with the UTPR.

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DOCUMENT ATTRIBUTES

JURISDICTIONS	UNITED STATES
SUBJECT AREAS / TAX TOPICS	OECD PILLAR 2 (GLOBAL MINIMUM TAX)
MAGAZINE CITATION	TAX NOTES INT'L, JULY 17, 2023, P. 255 111 TAX NOTES INT'L 255 (JULY 17, 2023) TAX NOTES FEDERAL, JULY 17, 2023, P. 351 180 TAX NOTES FEDERAL 351 (JULY 17, 2023)
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