TESTIMONY OF PROFESSOR BRET WELLS
before the
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My name is Bret Wells, and I hold the John Mixon Chair and am a Professor of Law at the University of Houston Law Center. I would like to thank Chairman Smith, Ranking Member Neal, Subcommittee Chair Kelly, Subcommittee Ranking Member Thompson, and the other members of the committee and subcommittee for inviting me to testify. I am testifying in my individual capacity, and so my testimony does not necessarily represent the views of the University of Houston Law Center or the University of Houston. I request that my full written testimony be included in the record.

In today's testimony, I am limiting my remarks to US international taxation. In that context, Congress has made several notable reforms in recent years, and this committee is to be commended for its role in making that happen. To accurately assess the impact of these important reforms and what remains to be accomplished, it is helpful to revisit the historic and ongoing policy challenges that must be confronted as these provide the framework for addressing the opportunities for further needed reform.

First Key Reform Opportunity: Inbound Earnings Stripping.

In order to preserve competitive neutrality and raise much needed revenue, Congress must ensure that business profits earned within the United States are subjected to a comparable amount of taxation regardless of whether the US-situs business is owned by a US person or a foreign person. Historically, the United States failed to restrict inbound earnings stripping opportunities of foreign-based multinational corporations, and this historic failure created a competitive advantage for foreign-based corporations in

their ownership of US-situs businesses.[1] This advantage in turn created an unlevel playing field that disadvantaged US-based multinational corporations.

How does inbound earnings stripping come about? When a US affiliate of a foreign-based multinational corporation remits a related party deductible payment to a low-taxed foreign affiliate, the overall income of the foreign-based multinational corporation has not changed. The multinational corporation has simply moved profits out of its US affiliate's pocket and into its offshore affiliate's pocket. And yet, from a tax perspective, this related party transaction can be quite lucrative because it affords the US affiliate with a US tax deduction while the payment received by the foreign affiliate often escapes US taxation entirely[2] with the consequence that the US tax base is reduced. There are five basic earnings stripping techniques that are available for stripping tax revenue out of the US: (1) related party interest stripping transactions; (2) related party royalty stripping transactions;[3] (3) related party lease stripping transactions; (4) related party supply chain transactions that route trade flows through offshore base companies; and (5) related party service stripping transactions. Multinational corporations come to every jurisdiction, including the United States, with this toolbox of earnings stripping techniques. So, to have sustainable taxation of US-situs business activities, the United

[1] Earnings stripping has been identified as a systemic challenge. See Staff of the Joint Comm. On Tax'n, *Present Law and Background Related to Possible Income Shifting and Transfer Pricing,* JCX-37-10 (2010); Bret Wells, *Territorial Taxation: Homeless Income is the Achilles Heel,* 12 HOUS. BUS. & TAX L.J. 1 (2012).

[2] Profits stripped out of the US tax base through an earnings stripping transaction often become "homeless income" in the sense that it loses its tax home in the country of source and often is not subjected to meaningful taxation in the offshore jurisdiction. See Bret Wells & Cym Lowell, *Tax Base Erosion and Homeless Income: Collection at Source is the Linchpin*, 65 TAX L. REV. 535 (2012); Bret Wells & Cym Lowell, *Income Tax Treaty Policy in the 21st Century: Residence vs. Source*, 5 COLUM. TAX J. 1 (2013).

[3] The outbound migration of foreign-use intangibles is another systemic challenge. I have previously argued that the Treasury Department should address this problem by amending its cost sharing regulations to disregard a funding party's tax ownership of an intangible above its actual functional contribution toward the intangible's creation apart from funding. See Bret Wells, *Revisiting §367(d): How Treasury Took the Bite Out of Section 367(d) and What Should Be Done About It,* 16 FLA. TAX REV. 519 (2014).

States must address each earnings stripping technique. Foreclosing one, but not all, of the earnings stripping techniques only works to motivate a multinational corporation to shift its inbound earnings stripping efforts to other unaddressed earnings stripping techniques.

Corporate inversions were a visible manifestation of the larger inbound earnings stripping cancer.[4] The corporate inversion phenomenon[5] represented an effort by a US-based multinational corporation to become a foreign-based multinational corporation exactly because US companies coveted the inbound earnings stripping opportunities available to foreign-based multinational corporations.

Congress responded to the inbound earnings stripping phenomenon in 2017 and in 2025 in at least the following three ways:

1. The US corporate tax rate was reduced to 21 percent, thus placing the US tax rate in closer alignment to that of other developed nations.
2. Congress reformulated Section 163(j) to address interest stripping strategies.[6] In 2025, Congress made further technical corrections to Section 163(j).[7]

[4] For a more in depth discussion of my views on why the corporate inversion phenomenon is best understood as a commentary on the broader inbound earnings stripping problem, see Bret Wells, *Corporate Inversions and Whack-a-Mole Tax Policy,* 143 TAX NOTES 1429 (June 23, 2014); Bret Wells, *Cant and the Inconvenient Truth About Corporate Inversions,* 136 TAX NOTES 429 (July 23, 2012); Bret Wells, *What Corporate Inversions Teach Us About International Tax Reform,* 127 TAX NOTES 1345 (June 21, 2010).

[5] Corporate inversions have caused significant revenue losses. See Congressional Budget Office, An Analysis of Corporate Inversions (September 2017), available at https://www.cbo.gov/system/files/115th-congress-2017-2018/reports/53093-inversions.pdf.

[6] For a more detailed discussion of Section 163(j) and its base protection goals, see Joseph Isenbergh and Bret Wells, INTERNATIONAL TAXATION: U.S. TAXATION OF FOREIGN PERSONS AND FOREIGN INCOME at Chapter 39 (Wolters Kluwer 6th ed. Updated 2025).

[7] Congress appropriately amended Section 163(j)(8)(A)(vi) to exclude any inclusions arising by reason of Section 951A, Section 951, and Section 78 from providing any interest deductibility benefit under the interest expense limitation regime of Section 163(j). Simultaneous with that 2025 change, Congress appropriately added Section 904(b)(5) to no longer consider indirect expenses (like interest expense) in the foreign tax credit limitation calculation for Section 951A inclusions. Because subpart F and Section 951A inclusions are not allowed to increase the §163(j) limitation, no interest expense should be allocated for foreign tax credit limitation purposes because to do so would represent a double detriment. See Bret Wells, Revisiting the Interaction of the Interest Expense Deduction and the Foreign Tax Credit, 26 FLORIDA TAX REV. 168 (2022). Section 904(b)(5) thus achieves the right normative foreign tax credit limitation outcome for Section 951A inclusions, but the same result should also apply to subpart F inclusions. If Section 954(d) and Section 954(e) remain in the Code, then Section 904(b)(5) should be modified to extend its exclusion of any indirect expense allocation to encompass Subpart F inclusions under Section 954(d) and (e) that

3. Congress enacted Section 59A's base erosion alternative tax (or BEAT) in 2017 and made further technical corrections to it in 2025.[8]

The combination of these reforms worked to reduce the financial benefits of inbound earnings stripping and thus have better levelled the playing field. Just focusing on the second and the third reform measures listed above, the reform of Section 163(j) and the enactment of Section 59A, in combination, represent the most comprehensive Congressional effort to address inbound earnings stripping in decades, perhaps ever. These were needed reforms. When a foreign-based multinational corporation is afforded an inbound earnings stripping advantage, a perverse incentive is created that rewards profit shifting strategies and rewards the offshoring of ownership of US-situs businesses. At the end of the day, the United States should not discriminate against foreign-owned firms, but the United States should not tolerate an unlevel playing field either.

Even though Congress took important steps to address the systemic inbound earnings stripping challenges, more can and should be done. Countries that adopt "adequately compliant" Pillar 2 regimes can design their Pillar 2 regimes so as to avoid imposition of meaningful taxation. Given this reality, the United States cannot assume that profits shifted to a Pillar 2 jurisdiction will bear a minimum tax, notwithstanding the popular narrative to the contrary.[9] Moreover, even if US origin profits might be subjected to adequate taxation in an offshore jurisdiction, the US still should not cede its first taxing right over US origin business profits to other jurisdictions. In this era of systemic federal

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would otherwise be placed in the general basket because the disallowance of both a deduction benefit under Section 163(j) and an expense allocation detriment represent an unwarranted double detriment.

[8] For a more detailed discussion of Section 59A and its base protection goals, see Joseph Isenbergh and Bret Wells, INTERNATIONAL TAXATION: U.S. TAXATION OF FOREIGN PERSONS AND FOREIGN INCOME at Chapter 44 (Wolters Kluwer 6th ed. Updated 2025).

[9] The OECD BEPS Inclusive Framework that includes its Pillar 2 model rules, commentary, and guidance is available online at the OECD website. For a further explanation of this conclusion, see See Bret Wells, The Enigma of the United States, Base Erosion, and Global Tax Cooperation, 57 LOY. LA. L. REV. 673 (2024).

budget deficits, the United States should retain meaningful taxation over all economic participants that benefit from the US economy, and so the United States should protect against inbound earnings stripping techniques.

Given that inbound earnings stripping remains a serious continuing policy concern, I urge Congress to build on its earlier enactment of the BEAT by making the following additional reforms to Section 59A:

(i) The BEAT should be made applicable to all business entities with gross revenue of $25 million or more.[10] This expanded scope would allow Section 59A to better fulfill its base protection mission.
(ii) Congress should remove the so-called "cost of goods sold" (or "COGS") safe harbor that prevents the BEAT from addressing related party supply chain transactions. The COGS safe harbor is already denied to certain inverted companies, and Congress should simply eliminate this safe harbor entirely for all multinational enterprises.
(iii) Congress should remove the effectively connected income exception[11] that the Treasury Department inexplicably created in its regulatory guidance. The Treasury Department exceeded its delegated authority to craft such an exception, and that exception undercuts the goals of Section 59A.
(iv) Congress should expand the definition of a base erosion payment to include payments to unrelated parties if the recipient is unable to satisfy the limitation on benefits restrictions found in Article 22(4)(b) of the US model income tax treaty.
(v) Congress should allow foreign tax credit relief under Section 59A if modified taxable income includes foreign income.[12]

Bottom Line: This committee has already achieved important improvements in inbound taxation, but more can and should be done. I urge this committee to remain vigilant in its efforts to ensure that at least half of the US origin profits remain subject to US taxation and to plug the loopholes that circumvent this outcome. Doing so can raise much needed revenue and better level the playing field for all multinational corporations.

[10] This would harmonize the threshold for the application of Section 59A with what is utilized with Section 163(j) where small business are afforded an exclusion. See I.R.C. §163(j)(3); I.R.C. §448(c).
[11] See Reg. §1.59A-3(b)(e)(iii).
[12] This could be accomplished by incorporating a modified Section 904 limitation calculation and foreign tax credit relief within the computation of the BEAT tax liability. The BEAT should ensure a minimum US tax on US source income and should give appropriate foreign tax credit relief for foreign taxes paid on foreign income.

Second Key Reform Opportunity: Strengthen and Simplify Outbound Taxation.

Historically, the United States utilized the Subpart F regime to balance the goal of international competitiveness with the goal of addressing profit shifting.[13] The Subpart F regime's balancing act relied on identifying particular transactions of interest and particular types of income that are susceptible to profit shifting. If those identified transactions or types of income resulted in earnings in controlled foreign corporations, then the Subpart F regime subjected the US shareholder to immediate taxation on such earnings. Yet, the very act of describing "transactions of interest" had the collateral consequence of spawning reactive taxpayer planning that sought to recast transactions so that they might fall outside the prescriptive scope of the Subpart F regime. Thus, the Subpart F regime has always represented an imperfect policy prescription.

In 2017, Congress enacted Section 951A as a global minimum tax, and in 2025 Congress enacted further technical corrections to make it a more effective global minimum tax. Under Section 951A, a minimum tax is imposed on all low-taxed net CFC tested income, however derived.[14] Unlike the Subpart F regime, Section 951A does not attempt to describe transactions of interest. Instead, it simply imposes a minimum tax on all net CFC tested income. Therefore, it represents a much more holistic effort to impose a global minimum tax than the Subpart F regime ever was.

[13] For a more detailed discussion of the Subpart F regime, see Joseph Isenbergh and Bret Wells, INTERNATIONAL TAXATION: U.S. TAXATION OF FOREIGN PERSONS AND FOREIGN INCOME at Chapters 71 through 75 (Wolters Kluwer 6th ed. Updated 2025).

[14] If a foreign minimum tax of at least 14 percent were imposed on those net CFC tested income, then sufficient foreign tax credits would be available to offset the potential U.S. income inclusion arising by reason of section 951A. For a more detailed discussion of Section 951A, see Joseph Isenbergh and Bret Wells, INTERNATIONAL TAXATION: U.S. TAXATION OF FOREIGN PERSONS AND FOREIGN INCOME at Chapter 76 (Wolters Kluwer 6th ed. Updated 2025).

Given that other nations are moving forward with adopting the OECD's Pillar 2 framework, a few comments about the relative merits of the global minimum tax imposed under Section 951A over the minimum tax imposed under an IIR regime modelled after the OECD's Pillar 2 framework are in order. In my view, Section 951A is a more rigorous and more robust global minimum tax than is an IIR regime for several reasons. First, because the Pillar 2 framework allows countries to craft "substance based carve-out exclusions," an IIR regime modelled under the Pillar 2 framework fails to ensure that a true global minimum tax is assessed in all events. In contrast, Section 951A does not provide for substance-based carve-out exclusions.

Second, the Treasury Department issued foreign tax credit regulations in 2022 that largely deny foreign tax credit relief for taxes that are returned to taxpayers as refundable tax credits.[15] In contrast, the OECD Pillar 2 guidance allows countries to treat refundable tax credits as not a refund of the minimum tax but as additional gross income. Thus, countries that adopt the OECD's Pillar 2 framework can infuse into their tax regimes significant tax competition elements that subvert the imposition of a global minimum tax if either the QDMTT regime or the IIR regime decide to do so. As a result, the Pillar 2 framework has significant tax loopholes that make it a less effective global minimum tax.

Third, the Subpart F regime segregates passive income and subjects it to full US taxation under Section 951 so that this passive income cannot get blended into the global minimum tax computation of Section 951A whereas the OECD Pillar 2 framework

[15] See Reg. §1.901-2(e)(2) and (3); T.D. 9959, 87 FED. REG. 276, 301-302 (Jan. 4, 2022); Notice of Proposed Rulemaking, REG-101657-20, 85 FED. REG. 72,078, 72,093 (Nov. 12, 2020). The Treasury Department provided temporary relief for changes in creditability standards made in changes to Reg. §1.901-2(a) and (b) but did not extend temporary relief to the changes to refundable credits made in Reg. §1.901-2(e). See Notice 2023-55, Sec. 3, 2023-32 I.R.B. 427; Notice 2023-80, Sec. 5.03, 2023-52, I.R.B. 1583.

allows blending of passive income into the country-by-country calculations for purposes of the Pillar 2 framework.

Some would argue that the more granular country-by-country calculation envisioned under the OECD Pillar 2 rules makes those rules more rigorous than the global blending approach utilized under Section 951A, but I believe this misstates reality by under-appreciating at least four observations about the flaws in country reporting: (i) country reporting relies on flexible stand-alone management financial reporting statements, (ii) country reporting for a QDMTT regime turns the IIR regime into a de facto territorial regime by eliminating any opportunity for residency-based taxation even if substance-based carve-out exclusions and refundable credit exclusions are grafted into the QDMTT regime, (iii) country reporting affords blending of passive income into the calculation, and (iv) country reporting utilizes deferred tax accounting so that a minimum tax is recorded even if no current taxes are paid. In contrast, the approach taken under Section 951A is to apply more rigorous US tax reporting concepts that must be consistently applied across all CFCs, retains residency taxation if actual minimum taxes are not paid, eliminates passive income blending, and does not allow for any deferred tax liability adjustments in its global minimum tax calculation.[16] Thus, Section 951A more closely aligns its global minimum tax to actual taxes paid in the current year whereas the Pillar 2 framework does not. In the end, Section 951A provides a more administrable and more rigorous minimum tax regime when compared to the OECD's Pillar 2 framework.[17]

[16] The OECD's Pillar 2 framework in fact fosters ongoing tax competition and a race to the bottom because it sanctions refundable credit tax subsidies and substance based carve-outs. See Bret Wells, The Enigma of the United States, Base Erosion, and Global Tax Cooperation, 57 LOY. LA. L. REV. 673 (2024).
[17] The leakiness of the Pillar 2 regime has already been widely reported in the press. See Natalio Olivo, Pillar 2 at 4: High Compliance Costs, Low Tax Liabilities, Law360 (Sept. 19, 2025).

As a result, the United States was right to reject Pillar 2, and this Congress was right to strengthen the Section 951A regime in 2025.

However, now that the global minimum tax of Section 951A is in place, this is an opportune moment to address CFC inbound tax planning[18] and to simplify the United States outbound international tax regime through the following further reform measures:

1. The foreign base company sales income rules of §954(d) should be reformed so that they apply only to the sale of goods (whether related or unrelated party sales) from a CFC that are destined for use or consumption in the United States.

2. The foreign base company service income rules of §954(e) should be reformed so that they apply only to services income (including services from cloud transactions) derived by a CFC with respect to either related or unrelated US-based customers.

3. The foreign personal holding company income rules of §954(c) should be retained without change.

4. Limit the application of Section 959 (previously tax earnings and profits or "PTEP") to only individual taxpayers. For corporate shareholders, the interaction of Section 959's PTEP regime and Section 245A is overly complex and redundant given that the 100 percent foreign dividends received deduction is afforded to domestic corporate US shareholders. Technical corrections should be made so that Section 245A would apply to any earnings of specified foreign corporations, and Section 964(e) and Section 1248 should be amended to recast gain on the sale of stock of all specified foreign corporations is treated as a deemed dividend eligible Section 245A treatment. Once Section 245A were reformed in this manner, the need to track the separate PTEP categories in the context of a domestic corporate US shareholder would no longer exist.

5. Eliminate the foreign branch basket of Section 904(d)(1)(B) and Section 904(d)(2)(J). The recent Treasury regulations that attempt to distinguish between branch income and general basket income are overly complex.[19] The reduction in the number of foreign tax credit baskets would achieve significant simplification.

6. Repeal the foreign tax credit limitation adjustment aspects of Section 904(b)(4) while retaining the deductibility of expenses allocable to foreign dividends eligible for Section 245A treatment.

[18] CFC inbound tax planning refers to the provisions of goods and services into the US economy from a controlled foreign corporation instead of through a US domestic entity in order to access a lower minimum tax rate than what could be achieved by conducting those same activities in a US domestic corporation.
[19] See Reg. §1.904-4(f).

7. Statutorily address the extraordinary reduction concerns that the Treasury Department has sought to correct through regulations[20] by doing the following:
   (i) Amend Section 951(c)(2)(B) so that only dividends ineligible for the dividends received deduction are entitled to reduce subpart F inclusions.
   (ii) Amend Section 245A so that foreign earnings that are part of an extraordinary reduction are not eligible for the dividends received deduction unless a closing book election is made.

8. Limit Section 956 to apply only when unrepatriated earnings and profits would not be eligible for the foreign dividends received deduction under Section 245A.[21]

Bottom Line: Now that §951A applies a global minimum tax on active foreign business income, the foreign base company sales income provisions and the foreign base company services income should be reformulated so that they solely address CFC inbound tax planning transactions.[22] Further, now that Section 951A has been grafted into the United States outbound international tax regime, there is a very real opportunity to achieve further significant simplification as outlined above.

Conclusion

Let me conclude my testimony by stating that this committee is to be commended for the work it has already done. Even so, more can and should be done. I urge this committee to enact further inbound tax reform measures to better level the playing field. In the outbound context, I urge this committee to address CFC inbound tax planning transactions and enact further simplification reforms that are now made possible by reason of the enactment of Section 951A. Thank you for allowing me to speak at today's hearing. I would be happy to answer any of your questions.

[20] See Reg. §1.245A-5(e) and (f).
[21] This codifies the Treasury Department's regulatory guidance. See Reg. §1.956-1(a)(2)(i).
[22] Having those provisions apply to active business income earned in foreign-to-foreign situations or with respect of the export of US goods is redundant.