



Testimony for the Hearing “How U.S. International Tax Policy Impacts American Workers, Jobs, and Investment”

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Chairman Wyden, Ranking Member Crapo, and distinguished members of the Committee, thank you for the opportunity to testify today. It is an honor to participate in this hearing.

The COVID-19 recession was a heavy blow to the incomes of low-wage workers and workers of color, and it followed decades of near-stagnant incomes and wages for low- and moderate-income households.¹ These workers and families should be a top priority when making U.S. tax policy, including reforms to the U.S. international tax regime.

To prioritize workers and families, lawmakers may soon make overdue investments in areas including infrastructure, education, securing permanent historic reductions in child poverty, and ensuring low-wage workers are not taxed *into* poverty. Doing so would help secure U.S. competitiveness and innovation in ways that benefit ordinary workers and families. For example, expanding economic security for children in low- and moderate-income families can help ensure that those who have talent for innovation and entrepreneurship have opportunities to fully realize those abilities.²

Lawmakers may decide to finance some of these investments with tax revenues, and international tax reform is one of a suite of sound tax policies that could contribute. Such reform could ensure that highly profitable multinationals contribute adequately to national investments from which they benefit.

Even aside from the substantial revenues that would be raised, sound international tax reform would help strengthen the economy by reducing current tax incentives for companies to locate profits and investments offshore or, potentially, invert. Many large multinationals use cross-border tax avoidance as a profit center. Reducing their ability to do so would help other U.S. businesses that cannot or do not want to use tax avoidance as a business strategy to compete while staying focused on customers, products, and innovation.

¹ Chad Stone, “Jobs Recovery Still Long Way Off, Especially for Low-Wage Workers and Workers of Color,” Center on Budget and Policy Priorities, February 5, 2021, <https://www.cbpp.org/blog/jobs-recovery-still-long-way-off-especially-for-low-wage-workers-and-workers-of-color>; Chuck Marr, Brandon DeBot, and Emily Horton, “How Tax Reform Can Raise Working Class Incomes,” Center on Budget and Policy Priorities, October 13, 2017, <https://www.cbpp.org/research/federal-tax/how-tax-reform-can-raise-working-class-incomes>; Jane. G. Gravelle, “Wage Inequality and the Stagnation of Earnings of Low-Wage Workers: Contributing Factors and Policy Options,” Congressional Research Service, February 5, 2020, p. 2, <https://crsreports.congress.gov/product/pdf/R/R46212>; Opportunity Insights Economic Tracker, <https://tracktherecovery.org/>.

² See Wesley Tharpe, Michael Leachman, and Matt Saenz, “Tapping More People’s Capacity to Innovate Can Help States Thrive,” Center on Budget and Policy Priorities, December 9, 2020, <https://www.cbpp.org/research/state-budget-and-tax/tapping-more-peoples-capacity-to-innovate-can-help-states-thrive>.

The 2017 tax law, including its corporate and international provisions, did not serve national priorities well. The law's large permanent corporate tax cuts did not lead to a perceptible increase in investment or wages above the trends underway under the prior tax law.³ It did not adequately curtail profit shifting: multinationals still shift hundreds of billions in profits offshore each year.⁴ But it dramatically shrank corporate tax revenues and increased after-tax inequality.⁵

My testimony offers three further points about the international tax regime and how it can be reformed:

- I. The post-2017 legal structure of the U.S. international tax regime contains defects that are opportunities and incentives for multinationals to locate profits and activities offshore.
- II. Elements of the U.S. international tax regime can be salvaged and strengthened. A more robust minimum tax and a re-tooled provision to address base erosion by foreign-resident multinationals could form part of a workable, coherent tax structure that raises revenues, while reducing the current tax tilt towards offshore profits and investment.
- III. 2021 offers timely opportunities to make these reforms. The U.S. can strengthen its tax system to benefit U.S. workers and families and improve the economy's recovery and long-run health. In doing so the U.S. can take a leadership role by seizing the once-in-a-century opportunity offered by current multilateral negotiations to build the framework for a robust, cooperative international tax system.

I. DEFECTS IN THE CURRENT LEGAL REGIME

The 2017 tax law not only cut the domestic corporate tax rate to 21 percent, but also moved the U.S. tax regime to a partial "territorial" system, including by permanently excluding certain income of U.S. multinationals from tax. Today, U.S. parent companies can enjoy a far lower rate of tax on their foreign profits – often zero percent – than the rate on U.S. profits if they meet certain conditions.

The drafters of the 2017 law were aware that a much lower permanent rate on foreign profits than U.S. profits is a large, permanent incentive for multinationals to both report profits offshore, and locate real investment overseas. Recognizing the danger of this lopsided basic structure, the 2017 law included provisions aimed at limiting the damage: GILTI, BEAT, and FDII.⁶ The anti-abuse rationale of some of these provisions is sound, and the provisions contain some novel and promising elements. But their design undermines their effectiveness, and retains incentives to locate profits or investment overseas in some circumstances, and increases those incentives in others.

Treasury regulations cannot be expected to cure all the major flaws of such statutory provisions. In some cases, however, regulations have enlarged the statute's problems. Some regulations probably overstepped the scope of legal authority. Others did not take the *best* interpretation of the law within the range of regulatory

³ See Jason Furman, "Prepared Testimony for the Hearing 'The Disappearing Corporate Income Tax,'" February 11, 2020, <https://waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/Furman%20Testimony.pdf>.

⁴ Kimberly Clausing, "Profit Shifting Before and After the Tax Cuts and Jobs Act," *National Tax Journal*, Vol. 73, No. 4, 2020, p. 11, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3274827.

⁵ Jane G. Gravelle and Donald J. Marples, "The Economic Effects of the 2017 Tax Revision: Preliminary Observations," Congressional Research Service, last updated June 7, 2019, p. 7, <https://crsreports.congress.gov/product/pdf/R/R45736>; Furman, *supra* note 3.

⁶ Global Intangible Low-Taxed Income, the Base Erosion and Anti-Abuse Tax, and Foreign-Derived Intangible Income.

authority. Instead, some regulations interpreted the law to permit U.S. multinationals to use various planning techniques to reduce their taxes and avoid the potential impact of the law's anti-abuse provisions, contrary to the basic purpose of those statutory rules.

Some notable defects in the legal regime include:

1. **GILTI's promising minimum tax structure has three large flaws.** A well-designed minimum tax on foreign profits can ensure that profits that U.S. multinationals report offshore, and that are taxed not at all or very lightly in foreign countries, are subject to some tax by the U.S. A robust minimum tax would greatly reduce the incentive for multinationals to shift profits and investment offshore, because it would reduce or eliminate tax savings from doing so. It would also reduce the incentive for U.S. multinationals to report income generated in other non-U.S. source countries as having been made in tax havens.

GILTI, however, is not robust: large classes of profits are exempt from its reach, its design creates new incentives to shift profits and investment offshore, and its rate on foreign profits is too far below the U.S. corporate tax rate.⁷ Specifically:

- ***Substantial profits are entirely outside of the reach of GILTI, meaning zero U.S. tax applies to certain income from real activity or paper profits that are reported offshore.*** GILTI applies only to foreign profits that are greater than 10 percent of a company's investment in tangible assets (such as factories) in foreign countries. That means a U.S. tax rate of zero percent on swaths of U.S. multinationals' foreign income.

This is an incentive for firms to shift or locate plants, equipment, and other physical assets offshore, because the more such assets a corporation has overseas, the more of that firm's offshore income will face a U.S. tax rate of zero percent rather than the domestic corporate tax rate of 21 percent. That is true even when the firm's foreign tangible assets generate little or no profits themselves.⁸ In other words, if a U.S. multinational puts physical plants and other tangible assets offshore, it can get a tax rate of zero percent on profits from intellectual property and other intangible assets that it has also moved on paper into tax havens.⁹

Furthermore, the value of assets that is used to calculate the 10 percent exemption is the basis used for the purpose of calculating depreciation, so newer property generally gets a bigger exemption, bolstering the incentive to locate new investment offshore.

- ***GILTI's global approach creates a perverse incentive in some circumstances to favor locating profits in both countries that have lower and higher tax rates than the U.S.*** GILTI is calculated based on a multinational's global income and non-U.S. taxes, instead of its income and taxes for each country separately.¹⁰ GILTI therefore allows multinationals to aggregate income and taxes from countries where they pay little or no tax and those where they pay significant tax. The blending or

⁷ This section draws on prior work of the author in Chuck Marr, Brendan Duke, and Chye-Ching Huang, "New Tax Law is Fundamentally Flawed and Will Require Basic Restructuring," Center on Budget and Policy Priorities, August 14, 2018, <https://www.cbpp.org/research/federal-tax/new-tax-law-is-fundamentally-flawed-and-will-require-basic-restructuring>.

⁸ A ten percent rate of return is far higher than the historical rate of return on low-risk assets. The interest rate on a ten-year Treasury bond is currently below 2 percent.

⁹ Clausing, *supra* note 4, Figure 2.

¹⁰ With a credit of up to 80 percent on foreign taxes they do pay. A firm paying \$100 in foreign taxes can thus reduce its U.S. minimum tax by \$80.

averaging feature of GILTI is a serious weakness. It leads to the striking outcome that the U.S. can be the *least* attractive place for a multinational to invest or place its profits, from a tax perspective.

On the one hand, if a multinational already has a lot of profits generated in high-tax countries (a so-called excess credit position), it creates an incentive for multinationals to book profits in tax havens because no U.S. tax will apply. Because the multinational can average the profits newly booked in a tax haven with the existing profits in high-tax countries, its average tax rate on foreign income may be high enough to avoid any GILTI tax. Indeed, even after the 2017 tax law, more than half of multinational corporations' foreign income is still booked in Bermuda and six other large tax havens.¹¹

On the other hand, if the multinational already has a lot of profits located in low-tax countries or tax havens and is therefore paying the GILTI tax, it can benefit by shifting U.S. profits or real activities to foreign countries with a tax rate similar to the U.S. – including to countries with rates that are somewhat higher than those in the U.S. Doing so will result in a similar amount of tax due on the shifted profits or real activities. But it will reduce the total tax on the profits located in low-tax countries by reducing or eliminating the GILTI owed, due to the ability to average across countries under the GILTI.

As tax advisor, former Treasury international tax official, and Director of the International tax Program at NYU Law David Rosenbloom has said, this feature of GILTI can mean that it:¹²

“[...] creates a great incentive to send investment outside the United States because averaging always produces an incentive to go outside the United States. If you are low, you have an incentive to average up by going outside the United States; if you are high, you have an incentive to go abroad to bring the average down.”

- ***The GILTI rate is still far below the rate on U.S. profits, leaving a large tilt towards offshore profits and activity.*** The maximum effective GILTI rate currently ranges between 10.5 and 13.125 percent.¹³ This is only roughly half the headline rate that domestic companies face on their US profits.

Having a minimum tax like GILTI is a recognition that allowing U.S. multinationals to earn tax-free profits abroad (a “pure” territorial system) is a very harmful incentive to locate profits and investments offshore. GILTI attempts to offset that tilt by somewhat closing the gulf between the rate on foreign and domestic profits, without going all the way to equalizing them. There is, however, much room for tax-motivated profit and investment shifting in the space between 10.5 percent (or sometimes zero percent) and 21 percent, and the only way to curb much of that tax avoidance activity is to narrow the tax rate gap.

¹¹ Clausing, *supra* note 4, Figure 2.

¹² Symposium, “The Future of the New International Tax Regime,” *Fordham Journal of Corporate and Financial Law*, Vol. 24, No. 2, 2019, p. 292, <https://ir.lawnet.fordham.edu/jcfl/vol24/iss2/1/>.

¹³ Income subject to GILTI is taxed with a 50 percent deduction, and only up to 80 percent of foreign tax credits are creditable. This means that the effective GILTI rate is 10.5 percent when no foreign tax credits are available, and up to 13.125% when full foreign tax credits are available. Other circumstances involving further limitations on foreign tax credits are discussed below.

- 2. BEAT aims at an important problem, but its “irrational” rules need retooling.** The BEAT is also intended to address a serious problem. Multinationals, including foreign-based multinationals, shift profits out of the U.S. and into low-tax countries by making large payments from their U.S. affiliates to their foreign affiliates. The payments can be deductible by the U.S. affiliate in the U.S. (reducing U.S. profits taxed at the U.S. domestic corporate tax rate). But even though those payments are income of the foreign affiliate, if the affiliate is in a tax haven, the payments can face little or no U.S. or foreign tax. The multinational corporate group is on both sides of the payments, so there may be opportunities to inflate the payments beyond a realistic price for the transfer of actual assets, goods, or services. Such base erosion payments are a problem encompassing all multinationals, but are particularly severe for foreign-resident multinationals because they are not subject to GILTI. This also means an incentive for U.S. multinationals to invert.

The BEAT is an add-on alternative minimum tax. Broadly speaking, the BEAT disallows some deductions that a multinational would otherwise be able to claim for payments to related foreign parties if those payments exceed a threshold. BEAT’s rules on what payments and entities are counted or excluded are complex. The rules have politely been called “curious”¹⁴ – also, “weird,” “irrational,” and “truly bizarre.”¹⁵

The BEAT catches some payments that do not appear to be a base erosion risk yet ignores other large categories of payments that are a base erosion risk.¹⁶ The implementing regulations created further exclusions to the BEAT that are not well-supported by the statute, noted below. Thus, while the BEAT has a sound objective to prevent payments that artificially shift profits out of the U.S. for tax purposes, the BEAT needs to be substantially revamped to hit its mark.

- 3. FDII has an unclear purpose and muddled design.** FDII allows a multinational to deduct a share of its “foreign-derived intangible income.” That is, if a multinational holds intangible assets (such as patents or other IP) in the U.S., its above-normal profits from exports of products, services, and assets related to those intangibles get a tax break. This structure favors selling such products to foreign consumers rather than U.S. consumers, which makes it very likely subject to WTO challenge as an export subsidy.¹⁷ Compounding that (perhaps fatal) flaw, FDII creates incentives for certain multinationals to sell their U.S. tangible assets or locate them offshore to get more income taxed at the favorable FDII rate. This is because the FDII deduction is allowed only to the extent that profits from covered exports exceed a set rate of return on tangible assets located in the U.S., so the fewer tangible assets a company has in the U.S., all else equal, the larger its FDII tax break.¹⁸ FDII’s tax break is also on income from both old and new investments alike, meaning a large part of it is a wasteful giveaway on profits from old investments.
- 4. Regulations cannot be expected to fix the flaws of a statute, but under trying circumstances, the regulations introduced some new problems.** When a tax law’s design or drafting is flawed, Treasury

¹⁴ Clausing, *supra* note 4, p. 15.

¹⁵ Symposium, *supra* note 12, p. 287.

¹⁶ *Id.*

¹⁷ Rebecca M. Kysar, “Critiquing (and Repairing) the New International Tax Regime,” *Yale Law Journal Forum*, Vol. 128, October 25, 2018, pp. 350-51, https://www.yalelawjournal.org/pdf/Kysar_su38oca6.pdf; Congressional Research Service, “Issues In International Corporate Taxation: the 2017 Revision (P.L. 115-97),” April 23, 2020, pp. 32-33, <https://fas.org/sgp/crs/misc/R45186.pdf>.

¹⁸ Dhammika Dharmapala, “The Consequences of the Tax Cut and Jobs Act’s International Provisions: Lessons from Existing Research,” *National Tax Journal*, Vol. 71, No. 4, 2018, pp. 722-723, <https://www.ntanet.org/NTJ/71/4/ntj-v71n04p707-728-Consequences-of-the-Tax-Cut-and-Jobs-Acts-International-Provisions.html>; Clausing, *supra* note 4, p. 14.

and the IRS cannot be expected to fix those flaws fully through regulation and guidance. But when faced with a law's flaws, ideally regulation would not add to them. The circumstances of the enactment of the 2017 tax law, however, were not ideal.

After a truncated legislative process, the under-resourced agencies were required to propose and finalize a tremendous number of regulations quickly. Comments on proposed regulations came overwhelmingly from corporations and their representatives seeking an interpretation of the law that would lower (or further lower) their tax liability.¹⁹ With notable exceptions, there were very few comments from a broad public interest perspective, despite the large consequences of these technical decisions.

Several regulations exacerbated weaknesses in the law, even when the statute gave scope for better alternatives. Neither usual congressional estimation and scorekeeping processes, nor Treasury's regulatory processes provide explicit estimates of the net impact of the 2017 tax law's regulations on revenues or distribution.²⁰ There are indications, however, that the law's international tax regulations were consequential. Together with new information on corporations' financial reporting and on multinationals' tax planning around the law, CBO projected in 2020 that the international tax regulations will lower projected revenues by roughly \$110 billion over ten years relative to earlier estimates.²¹

International tax regulations implementing the 2017 tax law that are highly questionable in terms of both authority and policy include:

- ***The foreign bank exception to BEAT***, that, according to the New York Times is estimated to reduce the BEAT's revenues by up to \$50 billion.²²
- ***The GILTI high-tax exception election***. Regulations allow multinationals facing usual limitations on their foreign tax credits (intended to serve an anti-abuse purpose) to elect out of

¹⁹ For discussion of regulatory processes see Rebecca Kysar, "TCJA's Business Provisions: Design Flaws and Undemocratic Implementation," Testimony before the U.S. House of Representatives Ways and Means Committee, February 11, 2020, <https://waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/Kysar%20Testimony.pdf>. For an example of the one-sided nature of comments on regulations generally, see Shu-Yi Oei and Leigh Osofsky, "Legislation and Comment: The Making of the § 199A Regulations," *Emory Law Journal*, Vol. 69, No. 2, January 2019, <https://lawdigitalcommons.bc.edu/cgi/viewcontent.cgi?article=2273&context=lsfp>. Oei and Osofsky found that comments on the regulations implementing the lower rate for pass-through businesses were overwhelmingly from taxpayers, industries or other private interests. Only 1 out of out of 51 communications during the pre-notice period were submitted by public interest oriented individuals or groups, and only 5 out of 388 comments during the notice and comment period.

²⁰ Either compared to the regulatory settings that were assumed when the revenue impact of the law as enacted was first estimated, or compared to a scenario where no regulations were issued. For an explanation of how OIRA review of tax regulations has failed to produce informative revenue or distribution analysis of tax regulations, see Greg Leiserson, "Cost-Benefit Analysis of U.S. Tax Regulations has Failed: What Should Come Next?" Washington Center for Equitable Growth, September 30, 2020, <https://equitablegrowth.org/research-paper/cost-benefit-analysis-of-u-s-tax-regulations-has-failed-what-should-come-next/>.

²¹ Samantha Jacoby, "Corporation-Friendly Treasury Regulations Reducing Federal Revenues," Center on Budget and Policy Priorities, last updated February 13, 2020, <https://www.cbpp.org/research/federal-tax/corporation-friendly-treasury-regulations-reducing-federal-revenues>. That loss is likely be mechanically lower now in dollar terms due to the recession.

²² Jesse Drucker and Jim Tankersley, "How Big Companies Won New Tax Breaks From the Trump Administration," New York Times, December 30, 2019, <https://www.nytimes.com/2019/12/30/business/trump-tax-cuts-beat-gilti.html>. For further analysis of the statutory authority issue, see Kysar, *supra* note 19.

GILTI when the tax credit limits cause them to face an effective foreign tax rate above 18.9 percent.²³

- ***The failure to allocate R&D to GILTI***, meaning that a multinational's R&D expenses are not adequately matched to their foreign income, increasing their ability to maneuver foreign tax credits to reduce U.S. tax liability under GILTI.²⁴
- ***A weakened statutory interest expense limit on the 10 percent return exempt from GILTI*** with a highly permissible rule for calculating the amount of interest allocated under this rule.²⁵

This is not to say all the regulations were maximally generous to multinationals. As tax law expert Samantha Jacoby noted, “Companies and lobbyists didn’t get everything they asked for,” but “[in] some very important areas, they got a lot of what they asked for.”²⁶

The lopsided process of corporations seeking more favorable tax treatment from the law and regulations has not yet finished. Strained statutory interpretations taken by some regulations open a door for taxpayers to push for similarly stretched interpretations of *other* parts of the tax code – but only when it would lower their taxes.²⁷ Multinationals wishing to make the international tax regulations even more favorable to them can also challenge them in court. This is a one-sided ratchet, because it is not clear who can challenge legally-flawed regulations that are overly generous.²⁸

Furthermore, if adequate funding is not restored to a deeply under-resourced IRS – which since 2010 has lost more than a third of its revenue agents who are expert enough to deal with the most complex tax audits – even the laws and regulations that are on the books will not be adequately enforced.²⁹

²³ Stephen E. Shay, “A GILTI High-Tax Exclusion Election Would Erode the U.S. Tax Base,” Tax Notes, November 18, 2019, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3490053. The strained interpretation may also carry risks for other parts of the code. See Jasper Cummings, “Not GILTI ‘by Reason of’ the High-Tax Exclusion,” Tax Notes, October 5, 2020, <https://www.taxnotes.com/tax-notes-federal/global-intangible-low-taxed-income-gilti/not-gilti-reason-high-tax-exclusion/2020/10/05/2czwq>.

²⁴ Stephen E. Shay, Reuven S. Avi-Yonah, Patrick Driessen, J. Clifton Fleming, and Robert J. Peroni, “Why R&D Should be Allocated to Subpart F and GILTI,” Tax Notes, June 22 2020, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3633962.

²⁵ See Kysar, *supra* note 19; Symposium, *supra* note 12, pp. 290-91.

²⁶ Richard Rubin, “Trump-Era Tax Rule Benefiting Some Multinationals May Get Revised Under Biden,” Wall Street Journal, 7 December 2020, <https://www.wsj.com/articles/trump-era-tax-rule-benefiting-some-multinationals-may-get-revised-under-biden-11607337001>.

²⁷ Cummings, *supra* note 23.

²⁸ See Shay et al., *supra* note 23, section VI. For discussion of who may challenge overly generous tax regulations, see Daniel J. Hemel and David Kamin, “The False Promise of Presidential Taxation,” *Yale Journal on Regulation*, Vol. 36, No. 2, 2019, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3184051.

²⁹ Chye-Ching Huang, “Depletion of IRS Enforcement Is Undermining the Tax Code,” Testimony before the House Ways and Means committee, February 11, 2020, <https://www.cbpp.org/research/federal-tax/depletion-of-irs-enforcement-is-undermining-the-tax-code/>.

II. SALVAGING AND STRENGTHENING ELEMENTS OF THE INTERNATIONAL TAX REGIME

Reform to U.S. international tax law that focuses on workers, jobs, and investment would address the law's flaws while strengthening its promising elements. A robust minimum tax on U.S. multinationals and a re-tooled provision to address base erosion, especially by foreign multinationals, could be part of a workable, durable structure that raises revenues while reducing the current tilt towards offshore profits and investment. Broad directions for reform include:

1. **Crafting a robust minimum tax out of GILTI.** Professor Susan Morse has observed that “GILTI will perhaps end up saving the corporate tax.”³⁰ GILTI would be a robust minimum tax on U.S. multinationals if it were reformed to:
 - **Exclude less foreign income from its reach.** This means eliminating the 10 percent return on tangible assets that is currently exempt and eliminating the high-tax exception election.
 - **Eliminate or reduce various opportunities to blend and shelter income, expenses, and credits from different sources to avoid GILTI.** Calculating GILTI on a country-by-country basis is one key way to achieve this objective. It would mean that every dollar earned in a tax haven would be subject to GILTI tax. It would also eliminate the incentive for multinationals to shift profits and activities to foreign countries with similar tax rates as the U.S. in order to reduce or eliminate the minimum tax that would be otherwise due on profits booked in tax havens. Reforms should also address the calculation of the interest expense allocation, and the failure to allocate R&D to GILTI.
 - **Set a minimum rate far closer to, and certainly no less than, 75 percent of the U.S. domestic rate.** This is the most straightforward way to limit incentives to locate profits and investment offshore.

Another attraction of a strong GILTI with these features is that it could allow the U.S. to more strongly advocate for a robust global minimum tax in multilateral negotiations, as discussed below.

2. **Re-working BEAT.** The BEAT diagnoses a serious problem – payments that shift profits into tax haven countries – but little about the BEAT rules make sense. A substantially reworked BEAT could more precisely and effectively target payments that are in fact more likely to be base erosion, while exempting those that are not. It could apply to payments only to countries where the payments are not subject to a reasonable tax rate, so that it does not capture payments that are not likely to be “base-erosion.” On the other hand, BEAT should be reformed to catch other payments that may be base erosion (such as its exclusions for costs of goods sold, and the treatment of the portion of certain payments that do not represent mark-up).³¹ As with a robust GILTI, a re-worked BEAT could also support the development of a cooperative multilateral approach, as discussed below.
3. **Leaving FDII behind.** I am skeptical that FDII can be salvaged given its muddled rationale and WTO problems. Some commentators have suggested making FDII into a “patent/innovation box” that gives a discounted tax rate on profits for IP located in the U.S., regardless of the location of the end consumer. Patent boxes are not a good solution to any well-defined problem: they deliver windfall tax cuts to already-profitable investments of the sort that already enjoy substantial tax subsidies, and patent boxes

³⁰ Symposium, *supra* note 12, p. 259. Morse's comments also related to the potential role of GILTI in multilateral negotiations; this is discussed further below.

³¹ Ksyar, *supra* note 17, p. 357.

are a magnet for tax avoidance. Public resources intended to support innovation would be better directed towards public investment in science, basic research, broadband infrastructure, education, and ensuring all children can thrive.³²

4. **Seizing missed opportunities in areas like check-the-box and transfer pricing.** While providing some promising new structures that can be the basis of further reform, the 2017 tax law largely failed to address several other weaknesses of the prior regime. These could also be revisited. For example, it would be timely to consider the “check-the-box” rules that allow U.S. multinationals to avoid paying taxes on their foreign subsidiaries’ passive earnings (such as interests and royalties) by checking a box on an IRS form that has the effect of making those offshore subsidiaries and their passive income invisible for U.S. tax purposes. Check-the-box has spawned complex regulatory attempts to limit its abuses, and it can now be used to reduce GILTI.³³ Various transfer pricing rules also deserve further scrutiny. There may be both regulatory and legislative opportunities to address such issues.
5. **Creating more coherent, less gameable rules.** The scaffolding of a reformed international tax regime will need detailed and robust rules layered on top of it. Some rules of thumb for crafting them are:

- ***Eliminate blending/averaging in some cases or reduce its extent in others.*** The late Edward Kleinbard, former tax practitioner, Joint Committee on Taxation staff director, and then University of Southern California professor, described international rules that permit averaging of income, deductions, and credits across high and low-taxed sources as being a “tax distillery.” In this distillery, “tax master blenders” at each company perfect the mix of income, deductions, and credits reported in each entity, country, and other relevant categories to lower the ultimate rate on foreign profits.³⁴

An example of the tax minimization benefits of averaging include where high-taxed profits can be used to shield low-tax profits, such as in the global approach of GILTI. A similar structure is when different categories of income or expenses can be averaged before allocating them to different sets of entities or countries, such as in the interest computation rules for calculating exempt income under GILTI. Permissive averaging structures can protect incentives to book profits in tax havens, and can create other perverse incentives. Such structures should generally be avoided (such as moving to country-by-country for GILTI). Any other averaging (or blending, cross-crediting, etc.) that is permitted should occur only within boundaries drawn as tightly as possible.

- ***Minimize electivity.*** Letting multinationals choose how to be taxed under various regimes – as is the case with the GILTI high-tax exception election – simply means most multinationals will claim a tax cut for having competent tax advisors. If the election is annual, as for the high-tax exception, it can mean switching in and out of different regimes from year to year.

International tax rules will never be especially simple. But elective rules create the type of unnecessary complexity that benefits only multinationals and their advisors. When large tax benefits

³² Alex Bell, Raj Chetty, Xavier Jaravel, Neviana Petkova, and John van Reenen, “Who Becomes an Inventor in America? The Importance of Exposure to Innovation,” Opportunity Insights, November 2018, <https://opportunityinsights.org/paper/losteinsteins/>; Tharpe et al., *supra* note 2.

³³ Moshe Spinowitz and Robert Stevenson, “To Check or Not to Check? The TCJA’s Impact on Entity Classification Decisions,” *International Tax Journal*, March - April 2019, <https://www.skadden.com/insights/publications/2019/04/to-check-or-not-to-check>.

³⁴ Edward D. Kleinbard, “Stateless Income,” *Florida Tax Review*, Vol. 11, 2011, p. 727, https://gould.usc.edu/centers/class/class-workshops/usc-legal-studies-working-papers/documents/C11_1_paper.pdf.

are at stake, it can seem that multinationals' calls for simplicity and certainty can grow quieter, while their calls for (complex and variable) electivity that lowers taxes grow louder.

- ***Align different regimes.*** Different parts of the international tax code serve different purposes, but where rules misalign for no good reason, they can create opportunities to plan into and out of whichever regime results in less tax. Limiting electivity is one way to minimize such gaming; aligning rules (such as expense allocation rules for GILTI that are more like other foreign tax credit allocation rules, or the various aspects of FDII and GILTI that are misaligned³⁵) is another.

III. THE UNIQUE OPPORTUNITY TO MAKE NEEDED REFORMS IN 2021

Sound reforms of the U.S. international tax system will deliver benefits to U.S. workers and the economy, as discussed above. Lawmakers can also ensure that such reforms are consistent with the U.S. taking a constructive and leading role in the current effort to ensure the global international tax system moves toward a strong, cooperative framework. Doing so could also profoundly benefit U.S. workers and the economy by potentially eliminating the current race-to-the-bottom amongst countries, where each seeks to undercut the others' corporate tax systems in order to attract corporate residence, profits, or investments. This race-to-the-bottom depletes revenues that are critical to making the investments with widely-shared benefits that would strengthen the living standards of workers and families while improving the strength of the economy.

The global international tax system is at a once-in-a-century crossroads.³⁶ Its current framework was constructed in the 1920s and focused on preventing double taxation, so that income would not be taxed twice (or more) by different countries. It was not designed to prevent double *non*-taxation, where multinationals report income in neither their home country nor where they made the income, but instead in tax havens where they are taxed at zero or very low rates. Multilateral attempts to address double non-taxation were sporadic until recently, and often focused on trying to discipline low-tax countries and tax havens. These efforts were ineffective, in part because they paid insufficient attention to the role of high-income countries' tax rules in allowing resident multinationals to enjoy large tax benefits when those companies shift their profits to tax havens. But the Great Recession, long-run fiscal challenges, and growing inequality increased countries' focus on holes in the international tax system.³⁷

OECD/G20 multilateral efforts are now seeking to build a new international framework to address "base erosion and profit-shifting" and curtail the race-to-the-bottom on corporate tax rates and international tax rules, while still preventing double taxation. These efforts have faced challenges. For instance, the prior Administration's efforts in multilateral forums were not as constructive as they might have been.³⁸ The COVID-19 recession created new fiscal pressures, and many countries have started to consider, propose, and

³⁵ For discussion of misalignments between GILTI and FDII, see Jonathan S. Brenner and Josiah P. Child, "The Nitty-Gritty of FDII," Tax Notes, September 17, 2018, http://www.capdale.com/files/24250_the_nitty-gritty_of_fdii.pdf.

³⁶ For some discussion of the development of the global international tax system and recent developments, see the discussion in the Symposium proceedings at *supra* note 12; Ruth Mason, "The Transformation of International Tax," *The American Journal of International Law*, Vol. 114, No. 3, July 2020, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3576520; Steven A Dean, "FACTCA, the U.S. Congressional Black Caucus, and the OECD Blacklist," Tax Notes, July 7, 2020, <https://www.taxnotes.com/tax-notes-today-international/competition-and-state-aid/fatca-us-congressional-black-caucus-and-oecd-blacklist/2020/07/07/2cns4>.

³⁷ See Mason, *supra* note 38.

³⁸ Alan Rappeport, Ana Swanson, Jim Tankersley, and Liz Alderman, "U.S. Withdraws From Global Digital Tax Talks," New York Times, June 17, 2020, <https://www.nytimes.com/2020/06/17/us/politics/us-digital-tax-talks.html>.

implement Digital Services Taxes (“DSTs”) on sales of intangible digital services to customers in those countries. These destination countries argue they have a claim to some tax on corporate profits and note that that profits deriving from intangible assets often go entirely untaxed. However, some features of some DSTs have given rise to claims that they target U.S. companies, and uncoordinated responses could create an incoherent patchwork of taxation and raise the specter of some double tax. But there is still a chance to achieve a cooperative framework to prevent double non-taxation and the race-to-the bottom, while avoiding a proliferation of uncoordinated unilateral measures.

Building a strong global framework will require the U.S. to use its intellectual and economic gravity. Secretary Yellen has stated that the Biden Administration will engage “robustly” in the OECD/G20 multilateral process, and withdrew an unconstructive demand made by the prior Administration.³⁹

Given the opportunity presented by the OECD/G20 negotiations, reforms to GILTI of the types outlined above could have dual benefits. First, they would deliver significant benefits to the U.S. in their own right. Second, such reforms could support a cooperative effort. For instance, lawmakers can ensure that GILTI reforms are drafted consistently with potential commitments in “Pillar Two” of the OECD/G20 Inclusive Framework. Pillar Two seeks to ensure that all companies pay a minimum level of tax, including through the adoption of Income Inclusion Rules (“IIR”s) which could have the features of a reformed GILTI. The adoption of strong IIRs would help reduce multinationals’ gains from profit shifting to tax havens (as those profits would still face minimum taxes in multinationals’ countries of residence) and help to curtail the “race to the bottom” by reducing the incentive for countries to set their corporate tax rates below the minimum rate (as doing so would have less impact on the worldwide tax liability of multinationals).

Assuming GILTI were strengthened, and the BEAT reformed so that it more adequately captures base-erosion by foreign-headquartered multinationals, U.S.-headquartered multinationals could be exempt from the BEAT, because base erosion payments by U.S. multinationals would be more adequately addressed by the reformed GILTI. This would help rationalize the BEAT so it is more targeted and effective, and make it more consistent with the structures being considered under Pillar Two. (The OECD Blueprint for Pillar Two notes that the Inclusive Framework “strongly encourages” the U.S. to turn off BEAT when entities are resident in countries that have an IIR.)

The fact that a minimum tax along the lines of GILTI is now a focus of multilateral negotiations shows the U.S.’s intellectual and economic gravity in international tax. The Obama Administration was reportedly “laughed out of the room” when it first floated minimum taxes as the basis of a multilateral approach.⁴⁰ Today, however, the enactment of GILTI in 2017 has helped change the conversation such that a reformed GILTI could now be a model for a cooperative international regime. Even if a multilateral agreement among countries that represent a major slice of the global economy takes time to finalize, therefore, lawmakers should not hesitate to reform GILTI, BEAT, and FDII in ways that would deliver significant benefits to the United States.

³⁹ James Polti, Aime Williams, Chris Giles, Sam Fleming, and Miles Johnson, “US Removes Stumbling Block to Global Deal on Digital Tax,” *Financial Times*, February 26, 2021, <https://www.ft.com/content/c2a6808e-ec6d-41d5-85e9-3a27c2b2c1bc>.

⁴⁰ Symposium, *supra* note 12, p. 294.