Analysis

The Biden administration's international tax proposals: will they fly?

Speed read

The new Biden administration has seemingly unlocked the impasse that has plagued the OECD Inclusive Framework project on addressing the tax challenges of digitalisation. Positive words promising engagement in the multilateral process by secretary of the Treasury, Janet Yellen, were followed by 'The Made in America Tax Plan' (making changes to the US international tax regime) and, the following day, a presentation to the steering group of the Inclusive Framework (proposing a simplified pillar one and a pillar two global minimum tax set at a rate of 21%). The interventions have been widely welcomed but will the plans take off?

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During the past several weeks, the new President Biden administration has unveiled ambitious plans to upgrade America's physical and social infrastructure, including proposals to raise needed revenue by increasing taxes on corporations generally and on multinational corporations in particular. At the same time, the administration has jump-started the stalled negotiations of the OECD/G20's Inclusive Framework on the tax challenges of digitalisation by offering a new approach for pillar one's tax nexus and global profit allocation rules, and proposing a significantly higher global minimum tax rate under pillar two than had previously been contemplated.

Interestingly, the two tax proposals – one domestic and one multilateral – are linked. In trying to develop a unified global tax solution, the Inclusive Framework's process is a relatively new phenomenon. Despite the OECD's promotion of a unified approach, many countries, such as France, Italy, Spain and the UK, have unilaterally enacted tax measures such as digital services taxes, without any serious attempt to coordinate the introduction of their domestic measures with the Inclusive Framework's global deliberations. The US is breaking new ground in now attempting to tie the multi-jurisdictional process to its legislative effort at home, in the hope of achieving a global consensus.

The Made in America tax plan

On April 7, 2021 the US Treasury Department released a 19-page document, *The Made in America Tax Plan* (see bit.ly/3nAxHsq), describing proposed tax measures that would help pay for the administration's proposed infrastructure improvements, dubbed the 'American jobs plan'. The goal of the tax plan is stated at the outset: 'to make American companies and workers more competitive' by, among other things, 'eliminating incentives to offshore investment, substantially reducing profit shifting [and] countering tax competition on corporate rates'.

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The plan includes the following proposals related to international taxation:

- increase the corporate income tax rate from 21% to 28%;
- amend the rules on global low-taxed intangible income (GILTI), the global minimum tax regime for US multinational enterprises, by raising the rate to 21%, requiring country by country computations, and eliminating the exemption of 10% of 'qualified business asset investment' (QBAI), i.e. investments by controlled foreign subsidiaries in tangible business assets;
- reduce 'incentives for foreign jurisdictions to maintain ultra-low corporate tax rates by encouraging global adoption of robust minimum taxes': this refers to the US effort to reinvigorate the Inclusive Framework process and move towards a 21% global minimum rate.
- introduce an alternative 15% tax on the book income of 'large companies that report high profits, but have little taxable income';
- repeal the rules on foreign-derived intangible income (FDII), which provide for a reduced rate of tax on income from sales by US corporations to foreign customers, and enacting new tax incentives for research and development in the US; and
- replace the base erosion and anti-avoidance tax (BEAT) with a new anti-avoidance regime called 'stopping harmful inversions and ending low-tax developments' (SHIELD), which would deny

deductions for payments to offshore affiliates that are subject to a foreign tax rate of less than either 21% or whatever rate has been agreed upon by the Inclusive Framework as the global minimum rate. In addition, the existing anti-inversion rules would be amended to treat an acquiring foreign corporation as a US corporation for tax purposes if, after the acquisition of the US target company, it was managed and controlled in the US or was at least 50% owned by former shareholders of the acquired US corporation.

Following the announcement of the American jobs plan, President Biden announced, during a joint session of Congress on 28 April, another ambitious proposal for which additional funds will be needed. The president's American families plan aims to pay for an expansion of federal support for lower-income Americans with tax increases on the wealthy. The $1.8 trillion plan includes:

- a near doubling of the capital gains rate for people earning more than $1m a year;
- a top marginal income tax rate of 39.6% for individuals;
- taxing unrealised gains at death;
- eliminating the preferential tax treatment of carried interest; and
- limiting the benefit of like-kind exchanges.

It is worth recapping at this point that the US corporate tax rules were changed dramatically in 2018 due to the passage of the Tax Cuts and Jobs Act (TCJA) at the end of 2017, Donald Trump's first year in office. The TCJA:

- reduced the corporate tax rate from 35% to 21%;
- ended tax deferral for undistributed earnings of foreign subsidiaries of US multinationals (with a transition tax on the deemed repatriation of such earnings);
- introduced a participation exemption for foreign dividend income; and
- created the GILTI, FDII and BEAT rules for the purpose of levelling the tax playing field for US multinationals with respect to investing in the US versus investing abroad.

The TCJA also adopted certain recommendations of the BEPS project, namely anti-hybrid rules and a tighter limitation on the deductibility of interest expense. The Treasury Department has produced a flood of regulations during the past three years interpreting the new rules, while taxpayers have had to invest substantial resources to comply with them.

The TCJA was passed by Republicans in Congress using a Senate parliamentarian procedure known as 'budget reconciliation' that allows the majority party to pass a bill with a bare majority of votes, rather than the normal supermajority of more than 60 votes needed to pass a bill in the US Senate. Now the shoe is on the other foot, as, after the elections in November 2020, the Democrats have a slim majority in the House of Representatives and the ability to break a tie in the evenly divided Senate using the vote of Vice President Kamala Harris. The Biden administration has characterised the TCJA as a massive giveaway to multinational corporations that needs to be reversed through the proposals in the Made in America tax plan.

The US proposal to the Inclusive Framework

Immediately after the publication of the Made in America tax plan, the US Treasury delegate to the steering group of the Inclusive Framework presented new proposals to that group, on 8 April, regarding both pillar one and pillar two.

The presentation, which was leaked to the press and has been widely viewed, indicates that the US is proposing the following:

- Regarding pillar one, the scope of the amount A rules regarding nexus and reallocation of global profit should be limited to no more than 100 very large multinational enterprises whose total annual revenue and operating profit margin exceed yet to be determined levels.
- Regarding pillar two, a 21% global minimum tax rate to 'level the playing field' and end the alleged 'race to the bottom' in corporate taxation.
- Elimination of to be specified (but undoubtedly including DSTs) relevant unilateral measures, defined as measures that apply regardless of tax treaties, are discriminatory against a particular country in law or in fact, and/or create a new nexus standard.

Curiously, the US presentation refers to 'maintaining the [pillar one] blueprint's level of re-allocable profits' despite the large reduction in the number of taxpayers subject to the amount A rules. This is a surprise because the pillar one blueprint did not state any particular amount of profits that would be reallocated. Rather, it said that reallocation would occur according to a formula consisting of certain elements that would be decided through future political negotiations among the Inclusive Framework member countries.

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The US proposal abandons the blueprint's two categories of automated digital services and consumer facing businesses in favour of a shortlist approach that would not exclude any business sector, subject to the possibility of industry-specific exclusions based on 'fundamental policy mismatches or irresolvable administrative constraints'. This provides hope to the extractive and financial services sectors, to the extent they might include companies with sufficiently high profit margins.

The US presentation also alluded to the need for agreement on a 'binding, non-optional dispute prevention and resolution process'. This has been a sticking point in the multilateral negotiations thus far, with many developing countries rejecting the idea of losing control of dispute resolution in a case that would otherwise be within the jurisdiction of their courts. The US proposals, therefore, are unlikely to resolve this particular issue.

Notably, the US presentation made no mention of amount B, the fixed return on baseline marketing and distribution activities in a market jurisdiction. The pillar one blueprint left a number of issues concerning amount B open for future determination, including its scope and the possibility of a safe-harbour mechanism that would prevent any amount A reallocation if amount B was at a certain level. At this point, it is unclear whether or not amount B continues to be part of the pillar one package under discussion.

Prospects of success for these initiatives

The Made in America tax plan is, as students of US legislative procedure will know, merely an opening offer from the Biden administration to Congress. Given the Democrats' slim majority in the House of Representatives and the 50/50 split between the parties in the Senate, the administration cannot be sure that any part of its plan that is not supported by all Congressional Democrats will survive. Stated otherwise, all Democrats in the Senate – including extremes of the party like progressive Senator Bernie Sanders (I-VT) and moderate Senator Joe Manchin (D-WV) – would need to stick together on a reconciliation bill.

Although President Biden so far has indicated an openness to work with Republicans on passing a bipartisan bill, Republicans have strenuously signalled opposition to any tax increases and generally want to limit the size and scope of these infrastructure packages. Most observers believe it is safe to assume that all Republicans will oppose the administration's plan, even if it is watered down to some degree. In addition, a few Democrats have expressed concerns with raising taxes in order to pay for the proposed federal spending increases. In fact, key Senate Democrats, including Sen. Manchin (D-WV), Bob Menendez (D-NJ), and Mark Warner (D-VA), appear sceptical about raising tax rates on capital gains. As a result, there is additional speculation that the proposed 28% corporate tax rate may need to be reduced somewhat, perhaps to 25% (a level matching the UK's recently announced (future) rate from 2023), in order to secure support from Sen. Manchin and others.

> Both the Made in America tax plan and the US proposal to the Inclusive Framework have a significant amount of (possibly rather bumpy) runway ahead

An additional complication arose (also in early April) when a competing international corporate tax reform 'framework' document was released by three Democrats in the Senate: Senator Ron Wyden of Oregon, Senator Sherrod Brown of Ohio, and Senator Mark Warner of Virginia. All three sit on the Senate Finance Committee, which is responsible for tax legislation (along with the House Ways and Means Committee), with Senator Wyden being the current chair of the committee. Their proposed framework contemplates a higher corporate tax rate and a higher GILTI rate, but does not specify the rates and does not propose to repeal either the FDII or BEAT regimes. Therefore, further work is inevitable before the administration and Senate Democrats are in complete agreement on a final set of proposed international corporate tax changes in the US.

Congress will also play a crucial role in determining whether the US Treasury proposal to the Inclusive Framework will fly, assuming that a multilateral agreement on that basis is ultimately reached by a critical mass of countries. It is generally believed that any commitment by the US to amount A reallocation rules under pillar one, as well as the pillar two global minimum tax regime, would require legislation and possibly also ratification of a new multilateral tax treaty. If the revenue effect of the overall deal is not favourable to the US, it is doubtful that Congress will be willing to pass the necessary legislation.

This puts a great deal of pressure on the question of which companies are on the proposed shortlist of 100 or fewer. The US Treasury presentation to the Inclusive Framework said, in bold font, that 'the United States cannot accept any result that is discriminatory towards US firms'. It is difficult to imagine, however, any list of very large and profitable multinational enterprises does not contain a disproportionate number of US-based companies. Even if a list was created that did achieve a proportionate balance of non-US and US companies, the revenue effect of reallocation under the amount A rules might still be negative for the US. No doubt other jurisdictions will be carrying out similar calculations for the potential impact of the new proposals on their own tax revenue.

The Biden administration would likely hope to make up any revenue leakage from amount A reallocation through revenue gains from tougher GILTI rules and the new SHIELD regime. If low-tax countries (say, for example, Hong Kong and Singapore) were to keep their current low rates despite a multilateral agreement on pillar two among a critical mass of higher-tax countries, the SHIELD rules would deny tax deductions in the US for outbound payments to affiliates in those low-tax jurisdictions. If, on the other hand, the entire Inclusive Framework were to commit to a minimum rate of 21% or thereabouts, the US would not necessarily be prevented by its foreign tax credit from extracting some revenue from foreign income of US groups. The technicalities of the US foreign tax credit rules, combined with the fact that the GILTI rules limit the credit to 80% of relevant foreign taxes paid, could in many cases result in US tax liability, net of the foreign tax credit, on foreign income that has been taxed abroad at a 21% rate.

It is far from certain, however, that the Inclusive Framework will be able to agree on a 21% minimum rate. Some European officials have already expressed doubt as to the appropriateness or feasibility of that rate, given that EU member states, such as Ireland and Hungary, have significantly lower rates. In fact, Hungary recently announced that agreeing to a minimum tax rate would undermine its economic development, strongly indicating it is not inclined to agree to any such proposal. This is significant because, as things currently stand, agreement by all EU member states will be required for any of them to commit to a deal. Comments made by Benjamin Angel, the European Commission's director of direct taxation, at a seminar on 15 April 2021 reinforced that position.

Thus, it seems that both the Made in America tax plan and the US proposal to the Inclusive Framework have a significant amount of (possibly rather bumpy) runway ahead of them. We will not know whether the proposals will gain enough momentum to take off for at least another few months and possibly much longer than that. ■

With acknowledgement of the contribution by Robert O'Hare, senior tax policy adviser based in the London office of Squire Patton Boggs.

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